TWENTY-SIXTH ANNUAL TAX SYMPOSIUM

Controlled and Affiliated Service Groups

Chapter 7

Affordable Care Act: What You and Your Family Need to Know

PUBLICATION 5187

TAX YEAR 2016

27334 Federal Register / V

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

RIN 1545–BN77

[REG–136118–15]

Centralized Partnership Audit Re

AGENCY: Internal Revenue Service Treasury.

ACTION: Notice of proposed rulema notice of public hearing, and withdrawal of notice of proposed rulemaking.

Form 8938

Financial Assets

2016

Report of Foreign Bank an

FinCEN Form 114 OMB No. 1506-0009

The new annual due date for filing Reports of financial accounts is April 18.

…IFIED DISPOSITIONS IN TRUST

Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL

Senate Bill 597 (as enacted)
House Bill 5504 (as enacted)
Sponsor: Senator Tonya Schuitmaker (S.B. 597)
Representative Klint Kesto (H.B. 5504)
Senate Committee: Judiciary
House Committee: Judiciary

Date Completed: 12-27-16

maddin hauser

Maddin Hauser Roth & Heller PC
attorneys and counselors

THE HOW AND WHY OF NON-CHARITABLE PURPOSE TRUSTS

By: Robert D. Kaplow, Esq.

I. TYPES OF TRUSTS

A. Private

B. Charitable

C. Non-Charitable Purpose

II. PRIVATE TRUST

A. Examples

1. Revocable Living Trust

2. Irrevocable Life Insurance Trust

3. Dynasty Trust

4. Intentionally Defective Grantor Trust

B. Elements

1. Grantor (settlor, trustor)

2. Trustee

3. Beneficiary

4. Trust Corpus (principal)

5. Trust protector

III. CHARITABLE TRUST

A. Purposes

1. Relief of poverty

2. Advancement of education or religion

3. Promotion of health, governmental or municipal purposes

4. Promotion of other purposes that are beneficial to the community [501(c)(3)]

5. Must benefit the public or a significant segment of the public

B. Elements

1. Grantor

2. Trustee

3. No identifiable beneficiary – state attorney general enforces proper use of trust funds

IV. NON-CHARITABLE PURPOSE TRUST

A. Intended to meet a particular non-charitable purpose instead of specific beneficiaries

B. Examples

1. Trust for maintenance of graves or monuments

2. Trust for saying of masses and other religious services

3. Trust for animals

4. Gun trusts

C. Also known as "Honorary Trusts"

D. Legal issues.

1. Non-charitable purpose trusts have no beneficiary – who is going to monitor the trust to make sure the trust funds are being used properly?

2. Generally violates the rule against perpetuities because the trust never vested in a particular person

E. Current law

1. Uniform Probate Code allows for Honorary Trust

2. Michigan statutes (MCL §700.2722) specifically allows Honorary Trust and trust for pets

a. Pet trusts can continue until no living animal is covered by the trust (cat, dog, turtle)

b. Any other Honorary Trust can continue only for 21 years, whether or not the terms of the trust contemplate a longer duration

c. Except as expressly provided in the terms of the trust, no portion of the principal or income may be converted to the use of the trustee or for a use other than the trust's purpose

d. No annual filing, reporting or accountings required unless ordered by a court or required by the terms of the trust

e. Court can order the trust assets transferred to another trustee if necessary to insure that the intended use is met

f. Trust is not subject to the rule against perpetuities

V. PET TRUST

A. Statute

1. Allowed by Michigan statute (MCL §700.2722) for the care of a designated domestic or pet animal.

2. Trust terminates when no living animal is covered by the trust

3. Statute provides that the trust shall be liberally construed to carry out the general intent of the transferor

B. Why? – Trust can answer these questions:

1. Who will take care of the pet?

2. Where will funds come from to pay for the care of the pet?

3. What care will be provided to the pet?

C. Typical Provisions

1. Naming trustee and successor

2. Naming caregiver for the pet

3. Have adequate duration of trust – how long will the pet live (a dog versus a parrot.)

4. Have adequate funding

   a. Leona Helmsley

   b. Provide for disposition of remaining trust assets upon death of pet

5. Provide for pets to be kept together if appropriate

6. Have a trust protector to supervise actions of the trustee/caregiver

7. Don't incentivize the death of the pet – remaining assets should not pass to the trustee or caregiver

8. Provide instructions for standard of living and care of the pet, including end of life decisions

9. Carry wallet card to notify emergency personnel that there is a pet at home and also include name of a contact person. Have a similar notice visible in your home

10. Provide for compensation to trustee and caregiver

11. Identify animal specifically in order to prevent fraud by caregiver

11. See sample provisions of a pet trust attached

VI <u>GUN TRUST</u>

A. Separate trust which becomes the owner of the firearms

B. Facilitates passing of firearms to heirs

C. Can avoid paperwork required for additional transfers

D. Can own general firearms or NFA firearms

E. NFA firearms

1. Certain guns are regulated by the National Firearms Act (NFA)

2. Possession (direct or constructive) of a NFA firearm can be subject to prosecution if not properly registered

3. NFA firearms include the following:

a. Short barrel shotgun

b. Short barrel rifle

c. Machine gun

d. Any other weapon – such as a pen gun, umbrella gun, or camera gun

e. Any silencer

f. A destructive device – hand grenade, bomb, large caliber weapons

F. Trust provisions

1. State the purpose of the trust, i.e. to own NFA firearms for my benefit in compliance with applicable local, state and federal law

2. Trust name – must identify the trust as a gun trust and indicate the name of the grantor of the trust

3. Provide for trustee and qualifications of the trustee. The trustee must meet all local, state and federal rules applicable to gun ownership

4. Should be a stand-alone trust, not a part of another trust

5. Provide for continued ownership of the firearms for the benefit of grantor’s family.

6. Trust needs to be drafted carefully as laws and regulations regarding firearms are continually changing.

Sample Pet Trust Provisions

E.4. Pet Trust

My dog, Fido ("Pet"), has provided me with great enjoyment and unconditional love. For that reason, I, MARLON PERKINS, as Grantor, establish this Pet Trust ("Pet Trust") to provide for him after my death or disability. The Trustee shall hold and administer the Pet Trust as follows:

a. **Transfer of Pet at My Death or Disability**. At my death or disability, Trustee shall deliver Fido to Grantor's son, SVEN PERKINS, or if SVEN is not then living, to my son, FRANKLIN PERKINS ("Caregiver"). If Caregiver is not able to keep Fido, Trustee shall find a loving home for Fido. If no loving home is found for Fido, Trustee shall attempt to place Fido in an appropriate breed rescue program or, if none is available, Trustee shall have Fido euthanized by Fido's veterinarian.

b. **Distributions.** My Trustee shall distribute to the Caregiver such sums from the Pet Trust as my Trustee shall determine are necessary for Fido's health, support and maintenance. Such distributions would be for food, treats, toys, regular veterinary care, dental care, Veterinary Pet Insurance (VPI), grooming, reasonable recreation, license as required by the City or State, and other essentials. The Trustee shall require the Caregiver to provide receipts for expenses relating to Fido to be reimbursed from the Pet Trust. Alternatively, the Trustee may make payment directly to third parties (upon receipt of bills from the third party) for services or expenses related to the care of Fido.

c. **Extraordinary Veterinary Care**. Distributions for extraordinary veterinary treatment shall be in my Trustee's discretion, as guided by the provisions of Section E.4.d. of this Pet Trust, as guided by Fido's Caregiver. If the treatment would qualify under the guidelines of Section E.4.d. of this Pet Trust, my Trustee shall make such distribution

regardless of the cost if the Caregiver and Trustee feel that such treatment is in Fido's best interest.

The current veterinarian for Fido is the Happy Valley Ranch Animal Hospital.

d. **Distribution Guidelines**. Having dealt with extra-ordinary health issues with Fido, the following guidelines are provided to guide my Trustee in making distribution for the health care of Fido.

i. **Diagnosis**.

If Fido has symptoms that require diagnosis, the veterinarian shall be called and consulted on the potential seriousness of the situation. If the veterinarian suggests that Fido should be looked at immediately, that advice should be followed. Animals often do not show signs of illness until they are in the advanced stages, so minutes can make a difference.

ii. **Routine Treatment**.

All treatments that are fairly routine and not highly uncomfortable for Fido will be performed.

iii. **Short Term Discomfort**.

If a treatment is likely to cause significant short term discomfort, an analysis of the benefits should be made, as should a determination of whether those benefits outweigh the discomfort and other drawbacks. If a treatment is given, all reasonable pain relief measures should be followed.

iv. **Long Term Discomfort**.

If a treatment or Fido's follow-up care after such treatment is likely to cause long term discomfort for Fido, it should not be done. I believe strongly in quality of life for Fido. Nothing should be done that would reduce Fido's joy and comfort on an ongoing basis. A specific example of a treatment that would be excluded due to quality of life impacts is organ transplantation.

v. **Experimental Treatment**.

If a treatment is experimental, but not likely to cause Fido grave harm or pain, and is not extremely expensive, then it should be done.

vi. **Exceptionally Expensive Treatment**.

If a treatment is exceptionally expensive, then my Trustee, following the above guidelines, shall decide whether to make such a distribution.

vii. **Euthanasia**.

In the event that Fido is in ongoing pain or discomfort, and no reasonable treatment is available to alleviate the discomfort and provide a quality life, then I ask that Fido be given a wonderful last day, then euthanized, surrounded by his family and preferably in the comfort of his home.

e. **Standard of Care**. Fido is an indoor pet that is used to regular interaction with members of the family. He is used to regular veterinary care, regular walks, professional grooming every four (4) weeks, and play time for games such as fetch. Caregiver shall not keep Fido as an outside pet. Because Fido is unaccustomed to commercial kennels, Trustee may distribute additional funds to provide for temporary in-home pet sitter

service while Caregiver is on vacation or otherwise out of town. My intent is that Caregiver, who is familiar with my lifestyle, will provide Fido with a loving home where he will enjoy the same human care and interaction as he had in my home. Current details regarding the care of Fido is attached as Exhibit A to this Trust.

It is further my expectation and requirement that SVEN PERKINS take full responsibility for Fido's daily care and well-being until Fido's death. If SVEN PERKINS does not take full responsibility, then his right to receive remaining assets of this Pet Trust upon Fido's death shall promptly terminate as provided in Section E.4.h. of this Pet Trust. Trustee shall, from time to time, observe Fido and his living conditions to ensure Caregiver is providing care consistent with the terms set forth in this Pet Trust. This Pet Trust shall pay all expenses for Trustee, Big National Bank, to periodically travel to personally observe Fido and the care that he is receiving, to ensure Caregiver is providing care consistent with the terms set forth in this Pet Trust. Trustee shall bring any concerns about Fido's care to Caregiver, but if Caregiver consistently fails to meet the standard of care set forth in this Pet Trust, Trustee may remove Caregiver and substitute the named successor or, if there is no named successor Caregiver, Trustee may select one who, in Trustee's opinion, is well-suited to meet Fido's needs.

f. **Final Disposition**. After Fido has died, Trustee shall pay for his burial, and Caregiver shall arrange for the burial nearby where SVEN PERKINS resides.

g. **Right to Enforce the Trust**. If Trustee fails to carry out the terms of this Pet Trust, Caregiver shall have the right and authority to enforce the terms of the Trust.

h. **Distribution of Remaining Assets in Trust**. After Fido has died and his final disposition has occurred, Trustee shall distribute all remaining assets of this Pet Trust to the Trust created in the Trust

Agreement for SVEN PERKINS, if surviving. If SVEN PERKINS is not surviving, the remaining Pet Trust assets shall be distributed to his living issue, by right of representation. If SVEN PERKINS has no living issue, then the assets shall be distributed to FRANKLIN PERKINS or to his living issue by right of representation if he is not surviving at the time of distribution.

Notwithstanding the above provisions of this Section E.4.h., if SVEN PERKINS has not taken full responsibility for Fido's care and well-being, then he and his issue shall be deemed to no longer be surviving and any remaining assets in this Pet Trust shall pass to FRANKLIN PERKINS, or his issue if he is not surviving.

THE NEW CENTRALIZED PARTNERSHIP AUDIT REGIME: AN OVERVIEW

I. WHERE ARE WE NOW? THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982 ("TEFRA")

A. Prior to TEFRA, partnership audits were conducted by the IRS examination division at the partner level because a partnership, as a flow-through entity, is not subject to payment of federal income tax.

1. Pre-TEFRA, IRS had to audit each individual partner separately.

2. This led to inconsistent reporting and tax results for partners in the same partnership.

B. TEFRA shifted the audit of "partnership items" from each individual partner to the partnership level by mandating that the tax treatment of any partnership item must be determined at the partnership level.

C. What are "partnership items"? They are those tax items required to be taken into account for the partnership's taxable year, including:

1. A partner's distributive share of the partnership's income, gain, loss, deduction, or credit;

2. Partnership liabilities; and

3. Guaranteed payments.

D. While audits and adjustments of "partnership items" happen at the partnership level, any resulting assessment and collection of tax is pursued at the partner level.

E. Audits of "non-partnership items" and corresponding adjustments to individual partners' tax liability are made at the partner level.

F. Generally, TEFRA applies to all partnerships unless an exception applies. For example, “small partnerships” of ten or fewer partners are exempt from the TEFRA rules; however, such small partnerships may “opt-in” to TEFRA.

G. Under TEFRA, the “Tax Matters Partner” (“TMP”) is the partnership’s designated point-person during partnership audits.

1. Must be a partner with authority to bind the partnership. As such, the following persons can be a TMP:

    a. In a General Partnership → Any member;

    b. In a Limited Partnership → A general partner; and

    c. In a Limited Liability Company → A member-manager or, if there is no member-manager, any member.

    d. NOTE: Non-members in LLC or limited partners in limited partnership are <u>not</u> eligible to serve as TMP.

2. The TMP has the duty/authority to:

    a. Be the partnership’s liaison to the IRS during audits and the partnership’s single representative in litigation.

    b. Keep other partners informed of the audit and other administrative tax proceedings.

    c. File a lawsuit or a refund claim on behalf of the partnership.

    d. Extend the statute of limitations on behalf of the partnership.

3. Despite having a designated TMP, all individuals or each partner generally have the right to notice of the audit of the partnership, as well as the right to participate in partnership audit proceedings.

II. THE CENTRALIZED PARTNERSHIP AUDIT REGIME ("CPA")

A. Introduced as part of the Bipartisan Budget Act of 2015.

B. In January 2016, IRS issued proposed regulations that provided guidance with respect to CPA. Those proposed regulations were withdrawn, then re-proposed in June 2017 with minor changes.

C. What are the big differences between TEFRA and CPA?

1. The IRS may now assess an "imputed underpayment" directly against a partnership.

   a. If, during an audit of the partnership, the IRS makes adjustments that result in an increase of the partnership's tax liability, the IRS will issue a "Notice of Proposed Partnership Adjustment" ("NOPPA") setting forth such adjustment and treating such additional tax liability as an "imputed underpayment" that is assessed directly against, and must be paid by, the partnership itself.

   b. Generally, the imputed underpayment will be equal to the net of all audit adjustments multiplied by the highest then applicable tax rate.

   c. Assessment of imputed underpayment will generally be applied against the "adjustment year" (the year in which the audit occurs), not the "reviewed year" (the tax year being audited), meaning that the adjustment year partners, rather than the reviewed year partners, will indirectly bear the burden of paying such imputed underpayment.

2. The "Partnership Representative" replaces the "Tax Matters Partner".

a. Who can be a Partnership Representative ("PR")?

   i. A person with "substantial presence" in the United States, meaning someone who is available to meet with the IRS in the United States, who has a United States street address and telephone number, and has a United States taxpayer ID number.

   ii. Does not need to be a partner. Can be a non-member manager.

   iii. Partnership can appoint an entity as PR; however, if the partnership appoints an entity as PR, it must also appoint a "designated individual" to be the sole individual through whom the partnership representative will act. If the partnership fails to name a designated individual, the IRS may simply disregard the PR designation.

   iv. If the partnership fails to appoint a PR, the Secretary of the Treasury may select one.

b. Differences between PR and TMP?

   i. PR can bind the partnership and its partners to an adjustment or settlement in an IRS audit or in a related court proceeding. No other partner may participate without the consent of the IRS.

   ii. PR must be designated each year on the partnership's tax return.

   iii. PR generally has no duty to notify the partners of a partnership adjustment.

iv. IRS will not recognize limits to PR's authority set forth in the partnership agreement, meaning that the PR can exceed the authority granted to it and bind the partnership.

D. PR may request to have an imputed underpayment "modified" within 270 days of the IRS's mailing of a NOPPA. Code Section 6225(c)(7); Proposed Reg. Section 301.6225-2(c)(3)(i).

1. The purpose of a modification is to reflect the tax due as closely as possible to the tax due if the partnership and the partners had correctly reported and paid (i.e., not at the highest rate).

2. Different types of modification include:

a. Amended Returns – one or more reviewed year partners file amended returns and calculate and pay the tax attributable to the adjustment allocable to that partner.

b. Tax-Exempt Partners – upon proof that one or more partners is tax-exempt, the IRS may modify the imputed underpayment disregarding the portion of the partnership adjustment allocable to the tax-exempt partner(s).

c. Rate Modification – the partnership may provide proof that some items treated as ordinary income should have been treated as capital gains.

E. Partnership may elect to "push out" any assessed adjustment to the "reviewed year" partners. Section 6226(a)(1); Proposed Reg. Section 301.6226-1(a).

1. This mechanism helps to avoid issue of "new partners" paying tax liability of partners who have since left the partnership.

2. Election must be made by PR within 45 days after the partnership receives a Notice of Final Partnership Adjustment ("FPA").

3. If a "push out" election is made, the partnership is no longer liable for the imputed underpayment, and the reviewed year partners are liable for tax, penalties, additions to tax, and additional amounts, as well as interest on such amounts. Each reviewed year partner will have to calculate the additional tax related to the adjustment for the reviewed year and all intervening years. Any additional taxes must be paid on the partner's current year income tax return.

4. If push out election is made, a reviewed year partner will have no ability to challenge the assessment or any related interest or penalties.

5. NOTE: "push out" is mandatory if the partnership has ceased to exist or cannot otherwise pay the adjustment.

F. CPA will be effective for tax years beginning after December 31, 2017 unless an eligible partnership "opts-out". REG-136118-15, Section 2(B). Partnerships can elect to "opt-in" to CPA before January 1, 2018.

1. What partnerships are eligible to opt-out? A partnership with 100 or fewer "eligible partners" at all times during the subject tax year.

2. Per Proposed Reg. Section 301.6221(b)–1(b)(3)(i) "Eligible Partners" are:

a. Individuals;

b. C corporations (including regulated investment companies, real estate investment trusts, and tax-exempt entities other than trusts);

c. S corporations;

d. Estates of deceased partners; and

e. Foreign entities treated as corporations.

3. Per Proposed Reg. Section 301.6221(b)–1(b)(3)(ii), "Ineligible Partners" are:

a. Partnerships;

b. Trusts;

c. Disregarded entities; and

d. Estates that are not estates of a deceased partner.

4. The partnership must notify its partners of the election to opt-out within 30 days of the date the election is made.

5. Even if the partnership elects to opt-out of CPA, the partnership should still designate a PR in the event that the IRS determines the election is defective or untimely filed.

6. The effect of opting out is that the partnership will be subject to pre-TEFRA audit procedures.

G. Some states are beginning to implement similar provisions in their state taxation statutes.

1. Arizona law now requires partnerships that receive an imputed underpayment under CPA to file a state return for the reviewed year that shows the adjustments to income or the gain, loss or deduction upon which the federal imputed adjustment was based. If the adjustment results in a net increase in Arizona taxable income, the partnership would be required to file a return and pay the tax on the adjustment within 90 days at the highest Arizona individual rate. If the adjustment results in a net reduction in

Arizona taxable income, the partnership is not authorized to claim a refund for amounts not actually paid by the partnership. Instead, the partnership must notify the partners of the adjustment within 90 days and each partner must file an amended return to claim a refund.

2. Multistate Tax Commission and other groups are working on model provisions for use at state level.

III. RECOMMENDATIONS FOR OUR CLIENTS WHO ARE PARTNERSHIPS

A. Partnership agreements should be reviewed and amended to address CPA.

B. Items to be addressed in an amendment to the partnership agreement:

1. Designation and removal of PR.

2. Requirement to opt-out of CPA.

3. Requirement for PR and partners to obtain and provide information that may reduce partnership's liability for imputed underpayment.

4. Restrictions on number of partners and on transfers of partnership interests to entities that are ineligible partners (this is especially important for partnerships that wish to opt-out of CPA).

5. Obligation for PR to seek to lower partnership's tax rate.

6. Indemnification provisions for current and former partners and PR, perhaps even a clawback provision.

7. Voting rights for partners on tax matters. For example:

a. Should partnership make a push out election?

b. Should PR elect to extend statute of limitations?

c. Should partnership petition for readjustment?

C. Until regulations are final and full extent of CPA's impact are known, partnerships should:

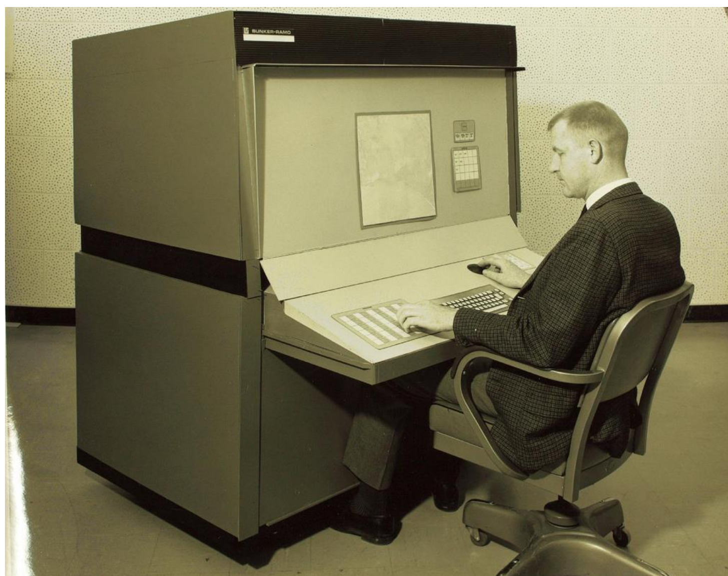
1. Elect to opt-out of CPA. Partnerships that make such an election will remain subject to pre-TEFRA regulations.

2. If the partnership is ineligible or otherwise decides not to opt-out of CPA, the partnership should elect to "push out" any adjustments to the "reviewed year" partners.

THE ACCOUNTANT'S ROLE IN THE DUE DILIGENCE PROCESS

PURCHASE OF A BUSINESS

By: Stuart M. Bordman, Esq.



M E M O R A N D U M

TO: ALAN, THE ACCOUNTANT

FROM: STUART M. BORDMAN

RE: DUE DILIGENCE WITH RESPECT TO PURCHASE OF PRODUCE BUSINESS

DATE: NOVEMBER 11, 2017

One of my long term clients has been in the wholesale produce business for many years. He has an opportunity to purchase a competitor. His accountant is good at counting oranges and bananas, but is not up to the task of due diligence with respect to a business purchase. Accordingly, he has requested me to retain an accountant on his behalf to perform due diligence with respect to the target and based upon our years of working together. I thought of you.

BACKGROUND ON THE TARGET

The target has been in business for many years and has grown organically. Annual sales are in excess of $10 Million. The target is a corporation with one shareholder. The shareholder started the company as a proprietorship many years ago and about ten years ago incorporated the business. The shareholder is no longer competent. The shareholder transferred his stock to a revocable living trust for estate planning purposes and appointed his accountant as successor trustee. The successor trustee elected a long term employee as the president of the company and gave him broad discretionary powers. The president is overworked. He handles purchasing, marketing, distribution, warehousing, equipment repairs, equipment purchase, building maintenance, pays the bills, etc.

The accountant for the target was a sole practitioner who passed away unexpectedly. He operated out of his home without an assistant.

The Probate Court appointed a bank to be successor trustee after the accountant. The Bank wants to sell and my client, now our mutual client wants to buy.

THE TRANSACTION

The problem is that our client knows very little about the target other than its annual sales. The decision to purchase stock or assets is open.

Your task is to:

A. Perform due diligence regarding accounting and tax matters;
B. Learn about the target;
C. Identify problems; and
D. Analyze the target.

DUE DILIGENCE STEPS

1. Obtain and review income tax returns and financial statements. Determine if the income tax returns, in all material respects, reflect the income and financial condition of the target;
2. Determine if all state and local returns have been filed.
3. Analyze internal controls, i.e., can the books and records which lead to preparation of the 1120 and any financial statement be relied upon;
4. Identify tax issues.
5. Identify areas for potential undisclosed liabilities.
6. Find out if there are any related entities that are essential for business operations, i.e., real estate leased to the business by a related party. (Are payments to related parties at arm's length?)
7. Spend some time at the target's warehouse so you can meet the office and accounting personnel. Determine their competency. Should they be replaced upon closing of the acquisition?
8. Is the computer hardware and software adequate for the business or should it be replaced upon closing the transaction?
9. Can the information on the target's computer system be transferred to other computer systems, if necessary?

10. Prepare a proforma financial statement, adding back shareholder compensation, dividends and any expenses such as travel, entertainment and auto that are really not business expenses.
11. Assuming a purchase price of $2 Million Dollars, how would you allocate under Section 1060 of the IRC so if assets are acquired, we can complete the form 8594.

Please send an engagement letter as soon as possible. I have a stand-still agreement pursuant to which the trustee will not sell the stock or assets or invite other offers or negotiate with others until December 31, 2017. Accordingly, I need a report by December 15, 2017 so our client can decide if he wants to make an offer and the terms and conditions upon which he will make an offer to acquire the target.

DUE DILIGENCE CHECKLIST*
(Tasks to be Divided Between Attorney and Accountant)

- ☐ Limited liability company
  - ☐ Certified copy of articles of organization
  - ☐ Annual statement
  - ☐ Operating agreement
  - ☐ List of current members and their addresses
  - ☐ List of managers, if any, and other key employees and their titles
- ☐ Corporation
  - ☐ Certified copy of articles of incorporation
  - ☐ Bylaws
  - ☐ Profit corporation annual reports for last three years
  - ☐ List of all subsidiaries and affiliates
  - ☐ List of current directors and officers and other key employees and their titles

Financial Condition

- ☐ Most recent financial statements, with comparable statements for prior year
- ☐ Description of material continent liabilities
- ☐ Revenue recognition policy
- ☐ Accounts receivable reports (aging, quality and special problems)
- ☐ Inventory valuation, turnover and obsolescence

Tax Matters

- ☐ Federal income tax returns for last three years
- ☐ State and local income and/or gross receipts tax returns for last three years
- ☐ Audit and revenue agents' reports (federal, state and local) for last three years

- ☐ Correspondence regarding any audit or investigation inquires
- ☐ Settlement documents and correspondence for last three years
- ☐ Sales and use tax returns for last three years
- ☐ Evidence that all payroll, withholding and real and personal property taxes are paid
- ☐ All tax elections filed (and related correspondence) for last three years (including Subchapter S, if applicable)
- ☐ Unemployment tax rate, payment status (UIA Form 1027)

Assets

- ☐ Real Property
  - ☐ Address and legal description for each owned or leased real property that the Company owns or as which it conducts operations
  - ☐ Mortgages
  - ☐ Leases and subleases
  - ☐ Surveys
  - ☐ Most recent title insurance polices
- ☐ Personal Property
  - ☐ Fixed-asset list indicating which assets are subject to capital or operating leases
  - ☐ Confirmation all assets are at the facility
  - ☐ Most recent personal property appraisal
  - ☐ Maintenance contracts
  - ☐ Service records
  - ☐ Documents of title
  - ☐ Copyrights
  - ☐ Patents
  - ☐ Trademarks/registration/application

- ☐ Trade names and trade dress
- ☐ Trade secrets (nature of trade secrets; procedures for protecting; third-party claims)

Contracts and Commitments

- ☐ Credit, loan and security agreements
  - ☐ Credit or loan agreements
  - ☐ Promissory notes
  - ☐ Security agreements
  - ☐ Guarantees
  - ☐ Indemnification agreements
  - ☐ Balance due and interest rates
  - ☐ Any financing agreements with or for suppliers/customers
- ☐ List of bank accounts
- ☐ Contracts involving expenditures above $______________________________
- ☐ Contracts outside ordinary course of business
- ☐ Summary of all material oral contracts
- ☐ Equipment leases
- ☐ Insurance
  - ☐ Comprehensive public general liability coverage
  - ☐ Comprehensive public general liability coverage
  - ☐ Unemployment compensation
  - ☐ Commercial fire and extended coverage
  - ☐ Business interruption insurance
  - ☐ Comprehensive motor vehicle coverage
  - ☐ Product liability coverage and information regarding claims over past five years
  - ☐ Workers’ compensation coverage and loss runs past three years

- ☐ Key-person insurance and present-value calculation
- ☐ Directors’ and officers’ coverage

Employees

- ☐ List of current employees, including name, department, date of hire, position, hour rate/salary, Fair Labor Standards Act exempt status
- ☐ Union matters
  - ☐ Collective bargaining agreement and local agreements and work rules
  - ☐ Pending and recent arbitration awards under contract
  - ☐ Unfair labor practices (pending and potential charges)
- ☐ Employee size, turnover (including any work force reductions during preceding 90 days) absentee history and distribution
- ☐ Agreements
  - ☐ Employment contracts
  - ☐ Noncompetition agreements/confidentiality agreements
- ☐ Employee handbook/personnel policies/posters
- ☐ List of fringe benefits, perquisites, holidays, vacation

Employee Benefit Plans

- ☐ Tax-qualified pension and profit-sharing plans maintained or contributed to by the business or any member of the controlled group, including terminated and frozen plans
- ☐ Welfare plans maintained or contributed to by any member of the controlled group to medical, medical reimbursements, disability, accident, dental, vision, life insurance, financial assistance, substance abuse, counseling, prepaid legal services and formal or informal severance arrangements) for active or retired employees

*This list is abbreviated and is for illustration only

SERVING AS A RETAINED EXPERT WITNESS
THE SUCCESSFUL EXPERT EXPERIENCE: PRACTICAL TIPS FOR SERVING WELL AND GETTING PAID

By: Michelle C. Harrell, Esq.

"Lawyers will always want an expert CPA witness who possesses the wisdom of Alan Greenspan, the litigation skills of Clarence Darrow, the charisma of John F. Kennedy, and the technical skills of Bill Gates." – Thomas French, Esq.

I. THE EXPERT ROLE

A.. Testimonial v. Non-Testimonial

1. Testimonial Experts are exactly that what they sound like: They are expected to testify at deposition and in court when required. As a threshold matter when they testify in court, they are first required to be an expert in the field(s) in which they are called to testify qualify when examined through questions by opposing counsel and the court. The process by which the court determines if a purported expert is qualified as an expert for testimonial purposes as to particular subject matter(s) through in-depth questioning of the proposed expert witness is called "*voir dire*." Generally, the work and opinions of testimonial experts are discoverable through interrogatories (written questions) and depositions (verbal questioning under oath) by the opposing side. The names and other information regarding these experts must be listed on the witness list or expert witness disclosure or the court may bar them from testifying.

2. Non-Testimonial Experts are retained and utilized by attorneys to investigate claims and theories, provide review of documents, facts or issues to the attorney for purposes of the case development and strategy formulation and provide opinions on particular issues.

These experts serve the role of litigation support, are not expected to testify and are not listed on the case witness list. Generally, the work and opinions of non-testimonial experts retained by one side are not discoverable by the opposing side unless the opposing side can establish very specific criteria.

B. Fact Witness v. "True" Expert Witness**:** When testifying, witnesses are generally expected to testify only based upon their personal knowledge, and are not allowed to give their mere opinions. Qualified expert witnesses are an exception to this general rule because they are allowed to provide their opinions on the meaning, import and impact of proffered facts. Many attorneys believe that a witness cannot be both a "fact" witness (one who is testifying based upon personal, firsthand knowledge of the facts) and a "true" expert witness (one who is providing opinions based upon facts that were provided to the expert but which he did not witness personally). It can be difficult to qualify a fact witness as having sufficient expertise to be authorized to provide his or her opinions. There are exceptions to many general rules. For example, an orthopedic surgeon who personally witnessed an accident that resulted in an injury should be able to testify and give his opinion about the cause, severity and resulting injury. Many attorneys will retain independent experts instead of relying upon persons who otherwise have sufficient expertise to serve as an expert because the jury may consider him biased or less credible than an independent expert.

II. TIPS FOR HAVING A SUCCESSFUL EXPERT ENGAGEMENT AND GETTING PAID FOR YOUR EXPERT SERVICES

A. Don't sprint before the starting gun fires. Some experts are most concerned about getting the work in the door than performing a proper intake process. Many problems that arise during an expert engagement (including having a client that does not want to pay you) can be avoided with sufficient attention to certain matters at the outset of the engagement.

B. Have a well drafted, signed retainer agreement before commencing work. Many expert witnesses begin an assignment without a signed, well-drafted retainer

agreement because the attorney will often call at the last minute with extreme urgency. Have a form retainer agreement ready that you can complete quickly and forward to the attorney to expedite the commencement of your work.

C. Define the scope of your work with specifics and ascertain the client's expectations from you. The biggest rifts are caused when expectations do not match reality. The expert believes that he is preparing a damage calculation for lost rent while the client (and maybe the attorney) believes that the expert is preparing an expert report for lost rent, damage to business reputation, attorney fees due from the other side, lack of marketability and other damages that the expert may have never heard of from the attorney. Know what you are to deliver before you start.

D. Never inflate your credentials. As an expert, your credentials will be subject to verification and investigation by an opposing team. If you inflate your credentials, it is very likely that your "puffing" will be exposed and likely at the most inopportune time (at deposition, in court). You should have recent and substantive experience in the area for which you are serving as an expert. Once your credibility is destroyed, then your entire worth as an expert is usually destroyed as well.

E. Determine what information you need for your analysis and do not rely solely upon what the attorney tells you. Some attorneys will attempt to limit what the expert sees in hopes that the expert will more easily issue a favorable opinion at a lesser cost. Other times, information will be inadvertently withheld. Don't fall into this trap. As an expert, you should have a list in mind (or better, on paper) of the specific materials that you need to receive and review before rendering your opinion. Look for gaps or obvious omissions in the materials provided. This approach protects you as the expert so that your opinion is not thrashed at a deposition or at trial. You will also be protecting the attorney and the client as a byproduct of your diligence because a case adrift without a credible expert if often lost.

F. Remember that you are an advocate for your opinion and methodology but not the case itself. You are retained to develop your analysis and opinion and not advocate for the client. Advocacy for the client is the attorney's job. You should tell the

truth directly and simply and try to avoid coloring the facts to fit the attorney's theory of the case. The case of *Daubert v Merrell Dow*, a landmark United States Supreme Court case regarding expert testimony, caused courts to focus less upon the expert's mere credentials and more upon the methodology applied by the expert. In other words, the court's inquiry is not focused as much upon whether the expert has enough experience or education, but rather upon how the expert applied that expertise to the facts of this case when rendering an opinion. This new focus more often exposes an expert's biases or attempts at advocacy. The court serves as a "gatekeeper" for expert testimony because it can be very powerful and case-determinative. The court will not allow expert testimony unless the expert is sufficiently qualified with education and experience and the expert developed his opinion through a proper application of his specialized knowledge to a given set of facts or assumptions in a manner that is scientifically reliable and would be sustained by peer review. Later cases have extended *Daubert* to non-scientific experts, such as accountants. The jury is the trier of the expert's credibility and can often "sniff out" if an expert is biased. An objective expert views the underlying data and applies his expertise unemotionally and without regard to how the attorney or client wishes him to do so.

G. Don't put too much in writing too soon (or maybe ever). If it's in writing, it can be had. Experts are human beings and like the rest of us. If an expert sees a weakness or error, or has a question, it is human nature to send off an email or a memo to the attorney or the client. If a report is not required, don't draft one. Only the court, by direct order or by inserting a requirement in a case scheduling order, can require an expert to prepare a written report (unless the case is pending in federal court where there are definitive expert report requirements). The opposing side can inquire about your analysis, investigation and opinion at deposition or by written questions to the client and attorney. However, as soon as you put any of your thoughts in writing, they may as well be carved into Mt. Rushmore. Pick up the phone and talk with the attorney instead of emailing. Although there are court rules about how much the other side can see of the expert's work, a rule of thumb is that if you write it, the other side can see it, because there are ways around most court rules.

H. Include a sufficient retainer in your retainer agreement and do not commence work before the retainer is paid. You should estimate the amount of work that it will take to get started on the engagement and collect at least that retainer to begin. For example, ask the attorney to estimate the amount of materials that you will be required to review initially (such as four banker boxes, etc.), and then estimate the amount of time that you will need to review those materials and multiply that time by your hourly rate. If there are four banker boxes and it will take you two hours each to review their contents at $300 per hour, plus two hours of analysis and communication with the attorney, your service will cost at least $3,000 at the outset. Do not skip this step and start the work without a retainer, or you may end up without being paid.

I. Consider an "evergreen" retainer or a "holding" retainer. There are different types of retainers that experts often use to protect their fee. An evergreen retainer is a retainer that the expert can bill against while the engagement is ongoing, but the client agrees to replenish the retainer to an agreed-upon level each month so that the retainer remains at that level. A holding retainer is a retainer that is held without deduction until the expert submits his final invoice. The holding retainer is then applied to the final invoice with any surplus refunded to the client. Both of these types of retainers will prevent the client from falling far behind in payment or jeopardizing the expert's fee.

J. Beware of certain expert witness referral service companies. There are many referral service companies that provide expert witness referrals to attorneys based upon subject matter areas. The referral companies contract with the expert witness to place the expert's credentials on their approved roster, and then recommend them to attorneys who seek an expert witness. There are many credible referral services but some are questionable. Some of these referral services require that the expert agree in their contract that the expert will only be paid when the referral service is paid by the attorney, and prohibit the expert from contacting the retaining attorney. An example is if the expert is retained through the referral service, and performs $10,000 worth of work and invoices the referral service. The referral service than informs the expert that the attorney will only pay $5,000 for the work as performed. The expert

becomes very dissatisfied and the referral service then underlines that the expert is limited to the payment received by the service and the expert cannot contact the attorney. The open question of course is whether the service was actually paid the $10,000 but then only pays the expert a percentage of $5,000, not $10,000. There is no method for the expert to verify the payments.

K. Avoid overly price sensitive retaining attorneys. Expert witnesses often end up beging stiffed on their bill or a large part of it when they are retained by attorneys who are overly "price sensitive." An attorney (just like any other client) is price sensitive if he complains about the retainer, needs time to pay the retainer (even a small one), restricts the work that the expert can do (micromanage) to hold the fees down, or the attorney says the case is small so the expert should hold down the bill. These are all bad signs for the expert. The attorney then will continue with limiting behaviors that can be very harmful. For example, the attorney may provide only very limited documents, such as excerpts of depositions. The expert's opinion is then questioned at a deposition and he is ripped to shreds because of materials that were not provided. The expert's reputation is damaged and often the attorney will then refuse to pay the expert by claiming that the expert's work was useless.

L. Avoid "rush" engagements. Many attorneys wait until after the last minute to retain necessary experts and are in a rush. This is dangerous territory for the expert because often the formalities of the engagement (retainer letter, retainer, scope of work, etc.) are overlooked due to time limitations and the rush. Only limited case documents are provided to the expert that diminishes the expert's knowledge of the case background. This situation exposes the expert to non-payment and other problems, such as having his opinion destroyed upon examination. Rush assignments should increase the retainer due, not diminish it. Experts should also bill much more often (weekly instead of monthly) on a matter that is nearing trial or conclusion.

If you follow these tips, you should have an improved and more effective experience as an expert witness, and find that you are paid in full more often.

OVERSEAS ACCOUNTS AND TRUSTS: WHAT TO DO IF MY CLIENT HAS OFFSHORE ASSETS?

By: Evan H. Kaploe

I. BITCOIN (CONVERTIBLE VIRTUAL CURRENCY "CVC")

A. The Big Picture on CVC

1. CVC is considered "property" for tax purposes, unlike cash, so the general principals of property transactions apply.

2. Two potential transactions involved in using CVC

   a. Spending the dollar-equivalent amount

   b. Disposing of the CVC

3. Individuals compensated for services with CVC are treated as receiving income.

4. Business transactions in CVC are subject to all the normal rules for sales, use, withholding and information reporting.

5. CVC does not have legal tender status in any jurisdiction.

B. Useful Rules and Definitions for CVC

1. "Virtual currency" is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store value.

2. Virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as CVC.

   a. Bitcoin is one example of a CVC.

b. Bitcoin can be digitally traded between users and can be purchased for, or exchanged into, U.S. dollars, Euros, and other real or virtual currencies.

i. As of November 8, 2017, the exchange rate was 1.00XBT = 7,481.62XBT

3. Taxpayers are required to determine the fair market value of virtual currency in U.S. dollars as of the date of payment or receipt.

4. If a CVC is listed on an exchange and the exchange rate is established by market supply and demand, the fair market value of the CVC is determined by converting the CVC into U.S. dollars at the exchange rate that is consistently applied.

C. CVC as Property and the tax Implications

1. Rule of Thumb: Every CVC transaction is taxable!

a. Users will have to calculate their gain or loss every time they purchase goods or services with CVC.

b. The recipient of the CVC also has either gain/loss or compensation (if for services)

2. Tax on Dispositions of Property

a. Income is realized for any gains on the property

b. Gain is measured by the change in the dollar value between the cost basis (purchase price) and the gross proceeds received from the disposition or amount realized (selling price).

c. Determine the character of the gain or loss using normal holding period rules.

D. Reporting CVC Transactions to the IRS and Recordkeeping

1. A disposition of CVC is reported on the tax return using Form 1040, Schedule D and Form 8949 or Form 4797

2. Gain from a disposition is also subject to the 3.8% NIIT

3. Recordkeeping software exists to track basis, exchange rates and gains.

E. Tax Tips for Merchants and Businesses

1. Identify an exchange rate to use consistently for valuing the CVC.

2. Charge sales tax when a customer purchases anything using CVC, if that is required in their line of business.

3. When paying an independent contractor more than $600 during the year, request a Form W-9 and issue Form 1099-MISC, even if you pay them in CVC.

4. Track the amount paid to contractors throughout the year to measure the threshold and determine if backup- withholding applies.

5. If paying employees in CVC, first withhold all applicable payroll taxes in U.S. dollars, and net pay can be in CVC, as appropriate.

   a. Taxes are paid in dollars, not CVC.

6. Consider converting CVC to dollars on a regular schedule so you have enough dollars to remit any income, withholding, or sales tax.

7. Include CVC transactions when determine estimated tax payments.

8. Expenses are also recorded in dollars.

9. Gain or loss on holding CVC is recorded as trading gains (Form 4797 or Schedule D, as appropriate).

II. FILING AND REPORTING REQUIREMENTS UNDER BSA AND FACTA

A. Statutory and Regulatory Compliance and Definitions.

1. A U.S. person that has a financial interest or signature authority over a foreign financial account or trust may be subject to additional reporting to the Department of Treasury (IRS and FinCen).

   a. 31 USC § 5316 – Bank Secrecy Act of 1970 ("BSA" or otherwise known as Currency and Foreign Transactions Reporting Act).

   b. 26 USC § 6038D – Foreign Account Tax Compliance Act ("FATCA")

2. If the U.S. person's interest in the foreign account exceeds $10,000 at any time during the calendar year, she must file a Report of Foreign Bank and Financial Accounts ("FBAR") with FinCen.

3. Important BSA Definitions to Remember for FBAR Filing

   a. Foreign financial account – a financial account located outside the United States, which includes an account held with a U.S. bank in a foreign branch (but not a foreign bank's branch physically located in the U.S.)

   b. U.S. person means –

      i. A U.S. citizen (including a child)

      ii. An individual who is a resident alien pursuant to IRC § 7701(b) of the U.S., D.C., the "Indian lands", and Territories and Possessions of the U.S.

iii. An entity, including a corporation, partnership, trust or limited liability company organized or formed under the laws of those identified in (ii), above, or the laws of any State.

c. Financial interest – 31 CFR § 1010.350(b)

i. The U.S. person is the owner of record or holder of legal title, regardless of whether the account is maintained for the benefit of the U.S. person or for another;

ii. The owner of record or holder of legal title is one of certain listed entities, which include:

(a) An agent, nominee, attorney, or person acting in some other capacity on behalf of the U.S. person with respect to the account, or

(b) Any of certain entities controlled by the U.S. person – 26 USC § 6030D(f); 26 USC § 7701(a)(30)(E); Treas. Reg. § 1.6030D-1(a)(1)

(i) Domestic trusts - formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets if and only if the trust has one or more specified persons as a current beneficiary. A current beneficiary for the tax year is any person who at any time during that tax year is entitled to, or at the discretion of any person may receive, a distribution from the principal

or income of the trust (determined without regard to any power of appointment to the extent that the power remains unexercised at the end of the tax year). A current beneficiary also includes any holder of a general power of appointment, whether or not exercised, that was exercisable at any time during the tax year, but does not include any holder of a general power of appointment that is exercisable only on the death of the holder.

(ii) Domestic corporations and partnerships – Treas. Reg. § 1.6038D-6(b)(1): if and only if the corporation or partnership is closely held, and at least 50% of the corporation's or partnership's gross income for the tax year is passive income or at least 50% of the assets held by the corporation or partnership for the tax year are assets that produce or are held for the production of passive income.

d. Signature authority – 31 CFR 1010.350(f)(1)

i. the authority of an individual to control the disposition of money, funds or other assets held in a financial account by direct communication to the person with whom the financial account is maintained.

e. Reportable account – 31 CFR 1010.350(c)

i. Bank accounts

ii. Securities accounts

iii. An account with a person in the business of accepting deposits as a financial agency

iv. An account that is an insurance or annuity policy with a cash value

v. An account with a broker or dealer for futures or options transactions in a commodity on, or subject to rules of, a commodity exchange or association

vi. An account with a mutual fund or similar pooled fund which issues shares available to the general public that have a regular net asset value determination and regular redemptions

4. Reporting Under FACTA and 26 USC § 6038D

a. The reporting rules under 26 USC § 6038D were enacted as part of FATCA. In some cases, the FATCA reporting can require the reporting of more information than is required on FBAR or taxpayers who don't have to file FBAR may have to report their foreign financial assets under 26 USC § 6038D. However, most taxpayers who are subject to FATCA reporting also will need to file FBAR.

b. The Treasury Department's FBAR requirements, which are imposed under the Bank Secrecy Act, should not be confused with the FACTA reporting requirements, which are imposed under the Internal Revenue Code. The two

reporting regimes are separate and there are many differences, but they overlap and some taxpayers have to report under both regimes. The FATCA requirements cover a broader class of foreign assets than the accounts covered by the FBAR requirements.

c. Any individual who, during the tax year, holds any interest in a "specified foreign financial asset" must attach to his income tax return for that tax year the information for each specified foreign financial asset if the aggregate value of all the individual's specified foreign financial assets exceeds the statutory dollar thresholds.

   i. If the taxpayer meets the applicable reporting threshold, she must report all of her specified foreign financial assets, including the specified foreign financial assets that have a *de minimis* maximum value during the tax year.

   ii. a specified person (including a specified individual, and a specified domestic entity defined under Treas. Reg § 1.6038D-6) that has any interest in a specified foreign financial asset (as defined in Treas. Reg. § 1.6038D-3) during the tax year must attach Form 8938, Statement of Specified Foreign Financial Assets, if the aggregate value of all the assets exceeds the following (Treas. Reg. § 1.6038D-2(a)(1)(i) and (ii)):

      (a) $50,000 ($100,000 if married) on the last day of the tax year; or

(b) $75,000 ($150,000 if married) at any time during the tax year.

d. If the individual resides outside of the United States, the IRS allows a higher dollar amount before reporting is necessary:

I $200,000 ($400,000 if married) on the last day of the tax year; or

ii. $300,000 ($600,000 if married) at any time during the tax year.

e. FACTA reporting for domestic entities – Treas. Reg. 1.6038D-6(b)

i. a specified person is not treated as having an interest in any specified foreign financial assets held by a corporation, partnership, trust, or estate solely as a result of the specified person's status as a shareholder, partner, or beneficiary of that entity.

(a) Two exceptions – Treas. Reg. § 1.6038D-2(b)(4)

(i) Owners of a grantor trust; and

(ii) Owners of a disregarded entity

5. Non-FACTA reporting for foreign trusts – 26 USC § 6048 and Notice 97-34.

a. Form 3520: Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts

b. Form 3520-A: Annual Information Return of Foreign Trust With a U.S. Owner

B. Civil Penalties for Failure to Comply

1. Statute of Limitations – 31 USC § 5321(b)

a. The IRS may assess a civil penalty at any time before the end of the 6-year period beginning on the date of the transaction with respect to which the proposed penalty is being assessed.

2. Penalties under BSA for failure to file FBAR (FinCen Report 114)

a. Non-willful failures

i. Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.

(a) A reasonable cause exception exists for non-willful violations. Under 31 USC § 5314, no penalty shall be imposed" if "such violation was due to reasonable cause"

(b) There is no reason to think that Congress intended the meaning of "reasonable cause" in the BSA to differ from the meaning ascribed to it in tax statutes. As with the tax statutes, Congress entrusted enforcement of the BSA to the Treasury Department. If it intended Treasury to interpret "reasonable cause" differently in the newer statute, it left no clues to which any party has pointed. A person has

"reasonable cause" for an FBAR violation when he committed that violation despite an exercise of ordinary business care and prudence. Moore v. United States, 115 AFTR 2d 2015-1375 (W.D. Wash., April 1, 2015).

ii. $10,000 per violation adjusted for inflation ($12,459 currently).

iii. Multiple years

(a) Examiners will recommend one penalty for each open year, regardless of the number of unreported foreign accounts

(b) Penalty will be determined based on the aggregate balance of all unreported foreign financial accounts but subject to the limitation

b. Willful failures

i. Landmark case applied to BSA – United States v. Ratzlaf, 510 US 135 (1994)

ii. Case law has defined willfulness as an intentional violation of a known legal duty to report or where an person exhibits a reckless disregard of a statutory duty. United States v. Pomerantz, 119 AFTR 2d 2017-2113, Case No. 16-0689 (W.D. Wash., June 8, 2017); United States v. Bussell, 117 AFTR 2d 2016-439, (C.D. Calif., December 8, 2015).

iii. greater of 50% of the amount in the account at the time of the violation or $100,000, adjusted for inflation ($124,588 currently)

iv. Multiple years

(a) Examiners will recommend a penalty for each year for which the FBAR violation was willful.

(b) Usually the penalty will be limited to 50% of the highest aggregate balance of all unreported foreign financial accounts during the years under examination

(c) The penalty is determined by allocating the total penalty amount to all years for which the FBAR violations were willful based upon the ratio of the highest aggregate balance for each year to the total of the highest aggregate balances for all years combined, subject to the maximum penalty.

3. Criminal penalties – 31 USC § 5322

a. the criminal penalty for willful violations (or filing a false FBAR) is a fine of not more than $250,000, or imprisonment for not more than five years, or both.

b. Willfully violating the FBAR reporting requirements while violating another US law or as a part of a pattern of any illegal activity involving more than $100,000 in a 12-month period, is penalized with a fine limited to $500,000, imprisonment of not more than 10-years, or both. 31 USC 5322(b)

i. The IRS may impose both civil and criminal penalties.

c. Criminal willfulness

i. Cheek v. United States, 498 US 192, 200 (1991) – the test for statutory willfulness, in a criminal tax context, is a "voluntary, intentional violation of a known legal duty" and willfulness "may be proven through inference from conduct meant to conceal or mislead sources of income or other financial information.

ii. United States v. Sturman, 951 F.2d 1446 (6th Cir. 1991).

(a) Defendant took multiple steps to conceal overseas assets from the Government aside from the failure to file his FBAR.

(b) Concealed signature authority, his interest in various transactions, and his interest in various corporations that were transferring money to the foreign accounts.

(c) Admitted to knowledge of failure to answer question on Schedule B, Question 7(a).

(d) Court upheld willful blindness theory – conscious efforts to avoid learning about reporting requirements.

4. Penalties under FACTA for failure to file Form 8398

a. The civil penalty for the first failure to report is up to $10,000

b. If any failure continues for more than 90 days after the day on which the Secretary mails notice of such failure to the

individual, such individual shall pay a penalty (in addition to the first failure penalty) of $10,000 for each 30-day period (or fraction thereof) during which such failure continues after the expiration of such 90-day period. The penalty imposed under this paragraph with respect to any failure shall not exceed $50,000.

III. OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

A. Delinquent FBAR Submission Procedures

1. Taxpayers who do not need to use either the OVDP or Streamlined procedures to file delinquent or amended tax returns to report and pay additional tax due but:

    a. Have not filed a required FBAR;

    b. Are not under civil examination or criminal investigation by the IRS; and

    c. Have not already been contacted by the IRS about the delinquent FBARs

2. These taxpayers should file the delinquent FBARs according to the FBAR instructions and include a statement explaining why the FBARs are filed late.

3. The IRS will not impose a penalty if the taxpayer properly reported on his US tax returns, and paid all tax on, the income from the financial accounts reported on the delinquent FBARs, and has not been contacted regarding an examination or a request for delinquent returns for the FBAR years.

B. 2014 Offshore Voluntary Disclosure Program (OVDP)

1. In 2014, the IRS continued the 2012 OVDP, but modified it to provide new options to help both taxpayers residing overseas and those residing in the U.S. to come into compliance with their U.S. tax obligations. The 2014 OVDP is open for an indefinite period until otherwise announced.

   a. Unlike the 2009 OVDP and the 2011 OVDI, the 2014 OVDP has no set deadline for taxpayers to apply.

2. Why participate in the OVDP

   a. Taxpayers holding undisclosed foreign accounts and assets, including those held through undisclosed foreign entities, should make a voluntary disclosure because it enables them to become compliant, avoid substantial civil penalties, and generally eliminate the risk of criminal prosecution for all issues relating to tax noncompliance and failing to file FBARs;

   b. provides the opportunity to calculate, with a reasonable degree of certainty, the total cost of resolving all offshore tax issues;

   c. taxpayers simply filing amended returns or filing through the streamlined filing compliance procedures do not eliminate the risk of criminal prosecution; and

   d. taxpayers who do not submit a voluntary disclosure run the risk of detection by IRS and the imposition of substantial penalties, including the fraud penalty and foreign information return penalties, and an increased risk of criminal prosecution.

3. In order to participate in the 2014 OVDP, the taxpayer must:

   a. Provide all the required documents;

   b. Cooperate in the voluntary disclosure process, including providing information on foreign accounts and assets, institutions and facilitators, and signing agreements to extend the period of time for assessing Title 26 liabilities and FBAR penalties

   c. Pay 20% accuracy-related penalties under 26 USC § 6662 on the full amount of offshore-related underpayments of tax for all years;

   d. Pay failure to file penalties under 26 USC § 6651(a)(1), if applicable (failure to file);

   e. Pay failure to pay penalties under 26 USC § 6651(a)(2), if applicable (failure to pay);

   f. Pay a miscellaneous Title 26 offshore penalty equal to 27.5% (or 50% in certain circumstances) of the highest aggregate value of OVDP assets during the period covered by the voluntary disclosure;

   g. Submit full payment of any Title 26 tax liabilities for years included in the offshore disclosure period, applicable interest, an offshore penalty, accuracy-related penalties for offshore-related underpayments, and, if applicable, the failure to file and failure to pay penalties or, if the taxpayer is unable to make full payment, make good faith arrangements with IRS to pay in full. (Note: the suspension of interest provisions of 26 USC § 6404(g) do not apply to interest due in this program);

h. Execute a Closing Agreement on Final Determination Covering Specific Matters, Form 906; and

i. Agree to cooperate with IRS and Department of Justice offshore enforcement efforts, if requested, by providing information about financial institutions and other facilitators who helped the taxpayer establish or maintain an offshore arrangement

4. Pre-submission period and preclearance

a. For purposes of the 2014 OVDP, a taxpayer's representative may talk to IRS without revealing the taxpayer's identity

b. For the 2014 OVDP, to obtain preclearance a taxpayers or representative must send a fax to IRS – Criminal Investigation Lead Development Center (LDC) containing the following information:

i. Applicant identifying information including complete names, dates of birth (if applicable), tax identification numbers, addresses, and telephone numbers;

ii. Identifying information of all financial institutions at which undisclosed OVDP assets were held. Identifying information for financial institutions includes complete names (including all DBAs and pseudonyms), addresses, and telephone numbers;

iii. Identifying information of all foreign and domestic entities (e.g., corporations, partnerships, limited liability companies, trusts, foundations) through which the undisclosed OVDP assets were held by the taxpayer seeking to participate in the OVDP; this does

not include any entities traded on a public stock exchange. Information must be provided for both current and dissolved entities. Identifying information for entities includes complete names (including all d/b/a names and pseudonyms), employer identification numbers (if applicable), addresses, and the jurisdiction in which the entities were organized; and

iv. Executed power of attorney forms (if represented).

5. Submission process

a. Taxpayers or their representatives should mail their Offshore Voluntary Disclosure Letter and attachments. Criminal Investigation will review the Offshore Voluntary Disclosure Letter and notify taxpayers or representatives by mail or facsimile whether their offshore voluntary disclosures have been preliminarily accepted as timely or declined. Criminal Investigation intends to complete its work within 45 days of receipt of a complete Offshore Voluntary Disclosure Letter

b. Internal Revenue Service Voluntary Disclosure Coordinator, 1-D04-100, 2970 Market Street, Philadelphia, PA 19104

c. Once a taxpayer's disclosure has been preliminarily accepted by CI as timely, the taxpayer must complete the submission and cooperate with the civil examiner in the resolution of the civil liability before the disclosure is considered complete

d. The letter from CI will instruct the taxpayer or his representative to submit the full voluntary disclosure submission to the Austin Campus within 90 days of the date

of the timeliness determination. The voluntary disclosure submission must be sent in two separate parts:

i. Payment to the Department of Treasury. Payment includes the amount of tax, interest, offshore penalty, accuracy-related penalty, and, if applicable, the failure-to-file and failure-to-pay penalties, for the voluntary disclosure period. Send payment with information identifying the taxpayer name, taxpayer identification number, and years to which the payments relate. To ensure payments are properly posted to the taxpayer's account, separate checks should be made for each tax year which would include all applicable tax, interest, accuracy-related penalties, and failure to file and failure to pay penalties. The offshore penalty should be paid by a separate check. These payments are advance payments; consequently, any credit or refund of the payments is subject to the limitations (Internal Revenue Service, 3651 S. I H 35, Stop 1919 AUSC, Austin, TX 78741, ATTN: Offshore Voluntary Disclosure Program);

ii All other required documents (Internal Revenue Service, 3651 S. I H 35, Stop 4301 AUSC Austin, TX 78741, ATTN: Offshore Voluntary Disclosure Program):

(a) copies of previously filed original (and, if applicable, previously filed amended) federal income tax returns for tax years covered by the voluntary disclosure;

(b) complete and accurate amended federal income tax returns (if delinquent) for all tax years covered by the voluntary disclosure, with applicable schedules, copies of previously filed returns for any compliant years in the offshore disclosure period (if submitting a copy of a previously filed return, “COPY” must be written on the top of the first page of the return);

(c) copy of the completed and signed Offshore Voluntary Disclosure Letter (including enclosures and attachments) submitted to Criminal Investigation;

(d) a completed Foreign Account or Asset Statement for each previously undisclosed OVDP asset during the voluntary disclosure period;

(e) a completed and signed Taxpayer Account Summary With Penalty Calculation;

(f) properly completed and signed agreements to extend the period of time to assess tax (including tax penalties) and to assess FBAR penalties (failure to extend the period of time to assess tax and assess FBAR penalties according to the instructions will render the OVDP submission incomplete);

(g) copies of statements for all financial accounts reflecting all account activity for each of the tax years covered by their voluntary disclosure.

6. Post-submission process

   a. After a taxpayer sends in his full and complete submission, his case will be assigned to a civil examiner to complete the certification of his tax returns for accuracy, and completeness

   b. Normally, no examination will be conducted with respect to an offshore voluntary disclosure made under the OVDP, although IRS reserves the right to conduct an examination

   c. the examiner has the right to ask any relevant questions, request any relevant documents, and even make third party contacts, if necessary, to certify the accuracy of the amended returns, without converting the certification to an examination

7. Applicable penalty rates

   a. The otherwise applicable OVDP penalty rate of 27.5% may be increased to 50% under certain circumstances

   b. Beginning on Aug. 4, 2014, any taxpayer who has an undisclosed foreign financial account will be subject to a 50% miscellaneous offshore penalty if, at the time of submitting the preclearance letter to IRS Criminal Investigation an event has already occurred that constitutes a public disclosure that either:

      i. The foreign financial institution where the account is held, or another facilitator who assisted in establishing or maintaining the taxpayer's offshore arrangement, is or has been under investigation by IRS or the

Department of Justice in connection with accounts that are beneficially owned by a U.S. person;

ii. The foreign financial institution or other facilitator is cooperating with IRS or the Department of Justice in connection with accounts that are beneficially owned by a U.S. person; or

iii. The foreign financial institution or other facilitator has been identified in a court-approved issuance of a summons seeking information about U.S. taxpayers who may hold financial accounts (a "John Doe summons") at the foreign financial institution or have accounts established or maintained by the facilitator

C. Streamlined Offshore Procedures

1. The streamlined filing compliance procedures are available to taxpayers certifying that their failure to report foreign financial assets and pay all tax due in respect of those assets did not result from willful conduct on their part

a. The streamlined procedures are designed to provide to taxpayers in these situations (1) a streamlined procedure for filing amended or delinquent returns and (2) terms for resolving their tax and penalty obligations

b. These procedures will be available for an indefinite period until otherwise announced

2. Domestic offshore procedures for US taxpayers residing in US

a. Eligibility for the streamlined program

i. Fail to meet the applicable non-residency requirement (for joint return filers, one or both of the spouses must fail to meet the applicable non-residency requirement);

ii. previously filed a U.S. tax return (if required) for each of the most recent 3 years for which the U.S. tax return due date (or properly applied for extended due date) has passed;

iii. failed to report gross income from a foreign financial asset and pay tax as required by U.S. law, and may have failed to file an FBAR (FinCEN Form 114, previously Form TD F 90-22.1) and/or one or more international information returns (e.g., Forms 3520, 3520-A, 5471, 5472, 8938, 926, and 8621) with respect to the foreign financial asset, and

iv. these failures resulted from non-willful conduct.

b. Procedure for filing under streamlined program

i. For each of the most recent 3 years for which the U.S. tax return due date (or properly applied for extended due date) has passed, file amended tax returns, together with all required information returns (e.g., Forms 3520, 3520-A, 5471, 5472, 8938, 926, and 8621);

ii. for each of the most recent 6 years for which the FBAR due date has passed period, file any delinquent FBARs (FinCEN Form 114), and

iii. pay a Title 26 miscellaneous offshore penalty

(a) 5% of the highest aggregate balance or value of the taxpayer's foreign financial assets that are subject to the miscellaneous penalty during the years in the covered return period.

(b) Aggregate the year-end account balances and year-end asset values of all the financial value of all financial assets subject to the penalty for each year and selecting the highest aggregate balance/value from among those years.

(c) Foreign financial asset is also subject to the miscellaneous penalty in a given year in the covered tax return period if the asset was properly reported for that year, but gross income in respect of the asset was not reported in that year.

(d) Taxpayer enters the value and files on the Form 14654, Certification by US Person Residing in the United States for Streamlined Domestic Offshore Procedures.

iv. For each of the most recent 3 years for which the U.S. tax return due date (or properly applied for extended due date) has passed, a complete and accurate amended tax return using Form 1040X (Amended U.S. Individual Income Tax Return) together with any required information returns even if these information returns would normally not be submitted with the Form 1040 had the taxpayer filed a complete and accurate original return.

(a) At the top of the first page of each amended tax return "Streamlined Domestic Offshore" must be written in red to indicate that the returns are being submitted under these procedures. This is critical to ensure that the taxpayer's returns are processed through these special procedures.

(b) A completed and signed statement on the Certification by U.S. Person Residing in the U.S. (Form 14654) certifying (1) that the taxpayer is eligible for the Streamlined Domestic Offshore Procedures; (2) that all required FBARs have now been filed; (3) that the failure to report all income, pay all tax, and submit all required information returns, including FBARs, resulted from non-willful conduct; and (4) that the miscellaneous offshore penalty amount is accurate.

v. Payment of all tax due as reflected on the tax returns and all applicable statutory interest with respect to each of the late payment amounts. The taxpayer's taxpayer identification number must be included on his check.

vii. must be sent in paper form (electronic submissions will not be accepted) to Internal Revenue Service, 3651 South I-H 35Stop 6063 AUSC, Attn: Streamlined Domestic Offshore, Austin, TX 78741. This address may only be used for returns filed under these procedures

viii. For each of the most recent 6 years for which the FBAR due date has passed, the taxpayer must file delinquent FBARs according to the FBAR instructions and include a statement explaining that the FBARs are being filed as part of the streamlined filing compliance procedures. The taxpayer is required to file these delinquent FBARs electronically at FinCen.

d. The narrative statement of facts portion of the Form 14654 must contain the following information: specific reasons for the taxpayer's failure to report all income, pay all tax, and submit all required information returns, including FBARs:

i. The whole story should be included, including favorable and unfavorable facts

ii. Specific reasons, whether favorable or unfavorable to the taxpayer, should include his personal background, financial background, and anything else he believes is relevant to his failure to report all income, pay all tax, and submit all required information returns, including FBARs; and

iii. an explanation of the source of funds in all of his foreign financial accounts/assets should be included. For example, the taxpayer should explain whether he inherited the account/asset, whether he opened it while residing in a foreign country, or whether he had a business reason to open or use it, his contacts with the account/asset including withdrawals, deposits, and investment/management decisions. The taxpayer must provide a complete story about his foreign financial account/asset

e. Avoidance of penalty under 26 USC § 6662, information return penalties and FBAR penalties

3. Foreign offshore procedures for US taxpayers residing outside US

a. Eligibility for streamlined foreign offshore procedure

i. meet the applicable non-residency requirement described below (for joint return filers, both spouses must meet the applicable non-residency requirement,) and

(a) For Individual U.S. citizens or lawful permanent residents, or estates of U.S. citizens or lawful permanent residents, any one or more of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed, the individual did not have a U.S. abode and the individual was physically outside the U.S. for at least 330 full days.

(b) Individuals who are not U.S. citizens or lawful permanent residents, or estates of individuals who were not U.S. citizens or lawful permanent residents, meet the applicable non-residency requirement if, in any one or more of the last three years for which the U.S. tax return due date (or properly applied for extended due date) has passed, the individual did not meet the substantial presence test of

ii. have failed to report the income from a foreign financial asset and pay tax as required by U.S. law,

and may have failed to file an FBAR (FinCEN Form 114)with respect to a foreign financial account, and the failures resulted from non-willful conduct.

b. Everything else is the same as the streamlined program for taxpayers residing in the US, except that there is no miscellaneous penalty. Rather, the taxpayer must simply pay the tax and interest due.

ROUNDUP OF RECENT TAX DEVELOPMENTS

By: William E. Sigler, Esq.

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I. FEDERAL

A. 2017 Tax Inflation Adjustments.

1. Limits, Deductions and Exemptions.

	2016	2017
Tax Limits, Deductions and Exemptions		
Tax Rate *(39.6%)* **Minimum Income:**		
Single	$415,050	$418,400
Married Filing Jointly	$466,950	$470,700
Heads of Household	$441,000	$444,550
Standard Deduction:		
Single	$6,300	$6,350
Married Filing Separately	$6,300	$6,350
Married Filing Jointly	$12,600	$12,700
Heads of Household	$9,300	$9,350
Limitation for Itemized Deductions:		
Single	$259,400	$261,500
Married Filing Jointly	$311,300	$313,800
Personal Exemption	$4,050	$4,050
Personal Exemption Phase-out Begins At: *(Adjusted Gross Income)*		
Single	$259,400	$261,500
Married Filing Jointly	$311,300	$313,800
Personal Exemption Completely Phased-out At: *(Adjusted Gross Income)*		
Single	$381,900	$384,000
Married Filing Jointly	$433,800	$436,300
Alternative Minimum Tax Exemption:		
Single	$53,900	$54,300
Married Filing Jointly	$83,800	$84,500
Maximum Earned Income Tax Credit for Taxpayers Filing Jointly with 3+ Qualifying Children	$6,269	$6,318
Qualified Transportation Fringes Limits		
Qualified Parking Benefits/Month	$255	$255
Combined Transit and Carpooling	$130	$130

2. Withholding Rates.

	2016	2017
Tax Withholding Rates		
Taxable Wage Base	$118,500	$127,200
Total FICA Tax for Employers/Employees	7.65%/7.65%	7.65%/7.65%
Social Security Tax for Employees/Employees	6.2%/6.2%	6.2%/6.2%
Medicare Tax for Employers/Employees	1.45%	1.45%

B. Expiring Tax Provisions.

1. Provisions Expired in 2016

Provision (Code section)	Expiration Date
1. Credit for certain nonbusiness energy property (sec. 25C(g))	12/31/16
2. Credit for residential energy property (sec. 25D)[2]	12/31/16
3. Credit for qualified fuel cell motor vehicles (sec. 30B(k)(1))	12/31/16
4. Credit for alternative fuel vehicle refueling property (sec. 30C(g))	12/31/16
5. Credit for two-wheeled plug-in electric vehicles (sec. 30D(g)(3)(E)(ii))	12/31/16
6. Second generation biofuel producer credit (sec. 40(b)(6)(J))	12/31/16
7. Incentives for biodiesel and renewable diesel:	
a. Income tax credits for biodiesel fuel, biodiesel used to produce a qualified mixture, and small agri-biodiesel producers (sec. 40A)	12/31/16
b. Income tax credits for renewable diesel fuel and renewable diesel used to produce a qualified mixture (sec. 40A)	12/31/16
c. Excise tax credits and outlay payments for biodiesel fuel mixtures (secs. 6426(c)(6) and 6427(e)(6)(B))	12/31/16

d. Excise tax credits and outlay payments for renewable diesel fuel mixtures (secs. 6426(c)(6) and 6427(e)(6)(B))	12/31/16
8. Beginning-of-construction date for non-wind renewable power facilities eligible to claim the electricity production credit or investment credit in lieu of the production credit[3] (secs. 45(d) and 48(a)(5))	12/31/16
9. Credit for production of Indian coal (sec. 45(e)(10)(A))	12/31/16
10. Indian employment credit (sec. 45A(f))	12/31/16
11. Railroad track maintenance credit (sec. 45G(f))	12/31/16
12. Credit for construction of new energy efficient homes (sec. 45L(g))	12/31/16
13. Mine rescue team training credit (sec. 45N)	12/31/16
14. Credit for hybrid solar lighting system property (sec. 48(a)(3)(A)(ii))	12/31/16
15. Credit for geothermal heat pump property, small wind property, and combined heat and power property (secs. 48(a)(3)(A)(vii), 48(c)(4), and 48(c)(3)(A)(iv))	12/31/16
16. Credit for qualified fuel cell and stationary microturbine power plant property (secs. 48(c)(1)(D) and (c)(2)(D))	12/31/16
17. Qualified zone academy bonds: allocation of bond limitation (sec. 54E(c)(1))	12/31/16
18. Discharge of indebtedness on principal residence excluded from gross income of individuals (sec. 108(a)(1)(E))	12/31/16
19. Premiums for mortgage insurance deductible as interest that is qualified residence interest (sec. 163(h)(3))	12/31/16
20. Three-year depreciation for race horses two years old or younger (sec. 168(e)(3)(A))	12/31/16
21. Five-year cost recovery for certain energy property (secs. 168(e)(3)(B)(vi)(I) and 48(a)(3)(A))	12/31/16
22. Seven-year recovery period for motorsports entertainment complexes (secs. 168(i)(15) and	12/31/16

168(e)(3)(C)(ii))

23. Accelerated depreciation for business property on an Indian reservation (sec. 168(j))	12/31/16
24. Special depreciation allowance for second generation biofuel plant property (sec. 168(l))	12/31/16
25. Energy efficient commercial buildings deduction (sec. 179D(h))	12/31/16
26. Election to expense advanced mine safety equipment (sec. 179E(g))	12/31/16
27. Special expensing rules for certain film, television, and live theatrical productions (sec. 181)	12/31/16
28. Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sec. 199(d)(8))	12/31/16
29. Medical expense deduction: adjusted gross income (AGI) floor for individuals age 65 and older (and their spouses) remains at 7.5 percent (sec. 213(f))	12/31/16
30. Deduction for qualified tuition and related expenses (sec. 222(e))	12/31/16
31. Special rule for sales or dispositions to implement Federal Energy Regulatory Commission ("FERC") or State electric restructuring policy (sec. 451(i))	12/31/16
32. Special rate for qualified timber gains (sec. 1201(b))	12/31/16
33. Empowerment zone tax incentives:[4]	
a. Designation of an empowerment zone and of additional empowerment zones (secs. 1391(d)(1)(A)(i) and (h)(2))	12/31/16
b. Empowerment zone tax-exempt bonds (secs. 1394 and 1391(d)(1)(A)(i))	12/31/16
c. Empowerment zone employment credit (secs. 1396 and 1391(d)(1)(A)(i))	12/31/16
d. Increased expensing under sec. 179 (secs. 1397A and 1391(d)(1)(A)(i))	12/31/16
e. Nonrecognition of gain on rollover of empowerment zone investments (secs. 1397B and	12/31/16

1391(d)(1)(A)(i))

Provision (Code section)	Expiration Date
34. Incentives for alternative fuel and alternative fuel mixtures:	
a. Excise tax credits and outlay payments for alternative fuel (secs. 6426(d)(5) and 6427(e)(6)(C))	12/31/16
b. Excise tax credits for alternative fuel mixtures (sec. 6426(e)(3))	12/31/16
35. Temporary increase in limit on cover over of rum excise tax revenues (from $10.50 to $13.25 per proof gallon) to Puerto Rico and the Virgin Islands (sec. 7652(f))	12/31/16
36. American Samoa economic development credit (sec. 119 of Pub. L. No. 109-432 as amended by sec. 756 of Pub. L. No. 111-312)	12/31/16

2. Provisions Expiring in 2017

Provision (Code section)	Expiration Date
1. Airport and Airway Trust Fund excise taxes:	
a. All but 4.3 cents-per-gallon of taxes on noncommercial aviation kerosene and noncommercial aviation gasoline (secs. 4081(d)(2)(B) and 4083(b))	9/30/17[5]
b. Domestic and international air passenger ticket taxes and ticket tax exemption for aircraft in fractional ownership aircraft programs (secs. 4261(k) and 4261(j))	9/30/17
c. Air cargo tax (sec. 4271(d))	9/30/17
2. Oil Spill Liability Trust Fund financing rate (sec. 4611(f)(2))	12/31/17

3. Provisions Expiring in 2018

Provision (Code section)	Expiration Date
1. Black Lung Disability Trust Fund: increase in amount of excise tax on coal (sec. 4121(e)(2))	12/31/18[6]

4. Provisions Expiring in 2019

Provision (Code section)	Expiration Date
1. Specified health insurance policy fee (sec. 4375(e))	9/30/19
2. Self-insured health plan fee (sec. 4376(e))	9/30/19
3. Credit for health insurance costs of eligible individuals (sec. 35(b))	12/31/19
4. New markets tax credit (sec. 45D(f))	12/31/19
5. Work opportunity credit (sec. 51(c)(4))	12/31/19
6. Additional first-year depreciation with respect to qualified property (secs. 168(k)(1) and 460(c)(6)(B))	12/31/19[7]
7. Election to accelerate AMT credits in lieu of additional first-year depreciation (sec. 168(k)(4))	12/31/19[8]
8. Election of additional depreciation for certain plants bearing fruits and nuts (sec. 168(k)(5))	12/31/19[9]
9. Beginning-of-construction date for wind renewable power facilities eligible to claim the electricity production credit or investment credit in lieu of the production credit (secs. 45(d) and 48(a)(5))	12/31/19[10]
10. Look-through treatment of payments between related controlled foreign corporations under the foreign personal holding company rules (sec. 954(c)(6))	12/31/19

E. Provisions Expiring in 2020

Provision (Code section)	Expiration Date
1. Placed-in-service date for eligibility for the credit for production from certified advanced nuclear power facilities (sec. 45J(d)(1)(B))	12/31/20

F. Provisions Expiring in 2021

Provision (Code section)	Expiration Date

Provision (Code section)	Expiration Date
1. Surtax on fuel used in aircraft in a fractional ownership program (sec. 4043)	9/30/21
2. Credit for individuals for residential solar property (sec. 25D(g))[11]	12/31/21
3. Beginning-of-construction date for increased credit for business solar energy property (sec. 48(a)(2)(A)(i)(II))[12]	12/31/21
4. Transportation costs of independent refiners (sec. 199(c)(3)(C))	12/31/21

G. Provisions Expiring in 2022

Provision (Code section)	Expiration Date
1. Highway Trust Fund excise tax rates:[13]	
a. All but 4.3 cents-per-gallon of the taxes on highway gasoline, diesel fuel, kerosene, and alternative fuels (secs. 4041(a) and 4081(d)(1))	9/30/22[14]
b. Reduced rate of tax on partially exempt methanol or ethanol fuel (sec. 4041(m))	9/30/22[15]
c. Tax on retail sale of heavy highway vehicles (sec. 4051(c))	9/30/22
d. Tax on heavy truck tires (sec. 4071(d))	9/30/22
2. Leaking Underground Storage Tank Trust Fund financing rate (secs. 4041(d)(4), 4042(b)(4), and 4081(d)(3))	9/30/22

H. Provisions Expiring in 2023

Provision (Code section)	Expiration Date
1. Highway Trust Fund excise tax rates:[16]	
a. Annual use tax on heavy highway vehicles (sec. 4481(f))	9/30/23

I. Provisions Expiring in 2025

Provision (Code section)	Expiration Date

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1. Transfer of excess pension assets to retiree        12/31/25
health and life insurance accounts (sec. 420(b)(4))
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[1] Joint Committee on Taxation, *List of Expiring Federal Tax Provisions 2016-2026* (JCX-1-17), January 4, 2017.
[2] December 31, 2021, for qualifying solar energy property.
[3] December 31, 2019, for wind.
[4] The empowerment zone tax incentives may have expired earlier than December 31, 2016, if a State or local government provided for an expiration date in the nomination of an empowerment zone, or the appropriate Secretary revoked an empowerment zone's designation. The State or local government may, however, amend the nomination to provide for a new termination date.
[5] The 4.3-cents-per-gallon rate is permanent.
[6] The increased amount of the excise tax on coal terminates the earlier of this date or the first December 31 as of which there is no balance of repayable advances made to the Black Lung Disability Trust Fund and no unpaid interest on such advances.
[7] Subject to a phasedown. December 31, 2020, for certain longer-lived and transportation property.
[8] December 31, 2020, for certain longer-lived and transportation property.
[9] Subject to a phasedown.
[10] Subject to a phasedown. December 31, 2021, for individual residential solar credit and enhanced business solar investment credit, and December 31, 2016, for other renewable power and alternative energy credits.
[11] Subject to a phasedown. December 31, 2016, for other residential energy property.
[12] Subject to a phasedown. December 31, 2019, for wind, and December 31, 2016, for other renewable power and alternative energy credits.
[13] The Highway Trust Fund excise tax rates relating to the annual use tax on heavy highway vehicles (sec. 4481(f)) expire September 30, 2023.
[14] The 4.3-cents-per-gallon rate is permanent.
[15] After September 30, 2022, in the case of fuel none of the alcohol in which consists of ethanol, the rate is 2.15 cents-per-gallon. In any other case, the rate is 4.3 cents-per-gallon.
[16] Other Highway Trust Fund excise tax rates expire September 30, 2022.

C. Mortgage Debt Discharge Exclusion. The IRS has issued guidance (Notice 2016-72) on the application of the qualified principal residence indebtedness exclusion under Section 108(a)(1)(E)(ii) to the Federal Housing Finance Agency's (FHFA's) principal reduction modification program (PRMP) and the Home Affordable Modification Program (HAMP). Congress extended the qualified principal residence indebtedness exclusion under Section 108(a)(1)(E) to arrangements entered into and evidenced in writing before January 1, 2017, in the Protecting Americans from Tax Hikes Act of 2015. That provision was added to protect a borrower-homeowner who is in the process of obtaining a permanent modification of a mortgage loan during 2016 that wouldn't result in discharge of indebtedness until after 2016. The maximum amount of discharged indebtedness that a borrower may exclude from gross income under the qualified principal residence indebtedness exclusion is $2 million. The guidance provides that qualified principal residence indebtedness is discharged "subject to an arrangement that is entered into and evidenced in writing before January 1, 2017," within the meaning of Section 108(a)(1)(E)(ii) if: (i) before that date, a mortgage servicer sends a borrower-homeowner under the FHFA's PRMP a notice in conjunction with a written TPP or, for a borrower-homeowner in an active TPP, a separate notice in a written opt-out letter outlining the terms and conditions of the permanent mortgage loan modification following completion of the active TPP; (ii) the borrower-homeowner satisfies all of the trial period and PRMP conditions; and (iii) the borrower-homeowner and servicer enter into a permanent modification of the mortgage loan on or after January 1, 2017. A similar conclusion applies to a TPP under HAMP.

D. Individual Improperly Attributed Income to S Corporation. In *Ryan M. Fleischer v. Commissioner*, T.C. Memo. 2016-238, No. 8685-14, the Tax Court upheld an IRS notice of deficiency against an individual, finding that he earned income through agreements to sell insurance products, that he treated the income as earned by an S corporation he established, and that he should have reported the income individually because the S corporation did not control the services he provided.

E. Surgeon's Interest in Medical Facility Is Passive Activity. A recent Tax Court ruling concluded that an ambulatory surgery center investor, who has no direct management responsibilities, can exempt his surgical center distributions from self-employment tax. The investor, Dr. Stephen P. Hardy, a pediatric reconstructive plastic surgeon in Montana, challenged the IRS' treatment of his distributions from the LLC which owns and operates the surgery center. His position was that he was entitled to treat it as passive income due to his non-involvement in any management or operational support. He argued his primary income came from his private practice and he is only a minor investor (12.5%) in the surgery center. He indicated he is not involved in the surgery center's day-to-day management responsibilities, even though he does have input with respect to the procedures he performs in the facility, and he does not make management decisions. Decision-making is done by a management team. He also confirmed his role has not changed since he started performing procedures at the surgery center. Dr. Hardy further indicated that he has no obligation to perform surgical procedures at the surgery center and that the number of cases he brings to the facility have no bearing on his distributions. Therefore, his investment should be considered passive. The Tax Court agreed with Dr. Hardy that his surgery center distributions are not subject to self-employment tax. This tax ruling is significant for surgery center partners who are self-employed. Surgery center investors are potentially subject to a 13.85% self-employment tax on their surgery center distributions. *Stephen P. Hardy and Angela M. Hardy v. Commissioner of Internal Revenue*, T.C. Memo. 2017-16.

E. Temporary Regulations on Transfers to Foreign Partners. On January 18, 2017, the IRS issued final, temporary (T.D. 9814), and proposed regulations (REG-127203-15) under Sections 721, 704, 197, and 6038B pursuant to the regulatory authority provided by Section 721(c) (the Section 721(c) regulations). The intent to issue these regulations previously was announced by the IRS in Notice 2015-54 (the "Notice"). The regulations override the general nonrecognition rule for contributions of property to a partnership under Section 721(a) if a U.S. person contributes property to a partnership that is controlled by the U.S. transferor and a related foreign partner, unless the partnership adopts the remedial method for making allocations under Section 704(c) and certain other requirements are met (e.g., the gain deferral method). The preamble to the regulations states that the regulations are intended to address the IRS's concern that taxpayers are using partnerships to shift income or gain from U.S. persons to related foreign partners that are not subject to U.S. tax. The Section 721(c) regulations generally apply to contributions occurring on or after August 6, 2015, the date of the Notice, and to contributions occurring before August 6, 2015, that result from an entity classification election filed on or after that date. New rules not described in the Notice, including any substantive changes to the rules as described in the Notice, generally are effective January 18, 2017. The regulations provide that taxpayers may elect to apply the rules of the Section 721(c) regulations to transactions prior to January 18, 2017.

F. Partnership Audit Rules.

1. The Bipartisan Budget Act of 2015 ("BBA") created a new audit regime to replace the procedures under the 1982 Tax Equity and Fiscal Responsibility

Act. Lawmakers introduced the Tax Technical Corrections Act of 2016 (H.R. 6439 and S. 3506) to make clarifications to the BBA, but the bill did not pass in the last Congress and has yet to be reintroduced in the new one.

2. The IRS published partnership audit regulations (REG-136118-15) on January 18, 2017, which were then withdrawn by the IRS in response to a January 20, 2017, White House memorandum ordering a freeze of all regulations. The proposed regulations were released again on June 13, 2017. The new version of the proposed regulations contains only a handful of changes from the version released in January. Those changes include a parenthetical early in the preamble clarifying that the new partnership audit regime will apply to both foreign and domestic partnerships, further clarification of the reservation and request for comments on multi-tier push-outs under Section 6226, a reference to Executive Order 13789, and the removal of Example 3 in Reg. Section 301.6225-1(f).

3. The preamble and proposed regulations look unfavorably on the option for certain partnerships to opt out of the centralized audit regime. They do not provide any leeway beyond what the statute provides for opting out: (i) the issuance of 100 or fewer K-1 Schedules and (ii) the requirement that each of the partners be an individual, a C corporation, any foreign entity that would be treated as a C corporation were it domestic, an S corporation or an estate of a deceased partner.

4. The proposed regulations give partnerships great freedom in selecting a partnership representative. The representative can be an individual partner or an entity with a substantial presence in the US. The partnership representative does not need to be a partner.

5. The proposed regulations include strong rules requiring partners to file consistently with their partnership returns unless they disclose the inconsistency. The IRS can treat undisclosed inconsistencies as mathematical errors and make adjustments without the ordinary due process that applies to other types of adjustments. The consistency rules plus the rules for administrative adjustment requests put a high premium on getting the original partnership return correct. A partnership will not be able to simply file an amended return and provide amended Schedules K-1 to correct an error.

6. Under Section 6226, a partnership can elect to push out all adjustments to partners who were partners in the reviewed year. The proposed regulations are “reserved” on the ability of a passthrough partner to further push out adjustments to its partners/shareholders/beneficiaries. However, the preamble sets forth the IRS’s position that a second-level push-out should not be allowed. The proposed regulations reserve on the issue because a technical corrections bill would have allowed a pass-through partner to push through adjustments to its partners. If the IRS position is followed, the pass-through partner would pay full tax on amounts that, if reported correctly on original returns, would have passed through to tax-exempt or foreign partners (or partners with NOLs or NOL carryovers) who otherwise would have paid little or no tax on the additional income.

7. The procedures for obtaining a modification to an imputed underpayment based on special tax positions of direct and indirect partners are complex. A partnership representative seeking a modification may have to furnish the IRS a detailed description of the structure, allocations, ownership, ownership changes of the partnership, its partners and, if relevant, indirect partners for each taxable year relevant to a request.

8. The proposed regulations include a voluntary safe harbor provision under Section 6226, if a partnership elects, to push out adjustments to reviewed year partners. It allows a reviewed year partner to pay an amount of additional tax and interest stated in a notice from the partnership in lieu of recomputing its tax liability for the reviewed year and other affected years. The safe harbor amount is calculated in the same manner as the tax on imputed underpayments, which appears to be an amount computed using the highest marginal tax rates for the portion of the understatements allocated to the partner.

9. The proposed regulations reserve on rules that would apply when statements that a partnership provides as part of a push-out election are provided to foreign partners and certain domestic partners that may be subject to withholding at the source. In the preamble, the IRS states that income to such a partner that was not accounted for in the reviewed year should be subject to withholding in the adjustment year.

10. The proposed regulations provide extensive guidance on partnerships that "cease to exist." Under the proposed regulations, a partnership would "cease to exist" if the partnership terminates within the meaning of Section 708(b)(1)(A) or does not have the ability to pay in full any amount the partnership owes under the new audit regime. The rules give the IRS discretion in determining whether and when a partnership ceases to exist. The proposed regulations say that the IRS will not treat a partnership as ceasing to exist solely by reason of a technical termination (a 50% change in ownership in a 12-month period). As a general rule, if a partnership is treated as ceasing to exist, the partnership's adjustment year partners are the partners at the time the partnership ceases to exist. The tax, interest and penalty liability determined at the partnership level then gets taken into account by the adjustment year partners.

11. The proposed regulations clarify that taxes, penalties and interest paid under the new audit rules are not deductible. When paid by a partnership, they are to be treated as Section 705(a)(2)(B) payments, i.e., amounts that reduce capital accounts and basis of the partners.

12. The IRS Large Business and International and Small Business/Self-Employed divisions have issued interim guidance (LB&I-04-0617-003) on initial contact with taxpayers in partnership examinations and elections into the Bipartisan Budget Act's centralized partnership audit regime for tax periods between November 2, 2015, and January 1, 2018.

G. IRS Clarifies 6-Month Extension Period for Calendar-Year C Corporations. The IRS has confirmed on its website that it is allowing calendar-year C

corporations a six-month filing extension, instead of the five-month extension specified in the Code. The instructions to Form 7004, Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns, raised questions among practitioners when they were posted on February 2, 2017, because, on page 2, they refer to "an automatic 6-month extension for a calendar year C corporation …" However, Section 6081(b), as amended by the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, P.L. 114-41, provides for five-month extensions for calendar-year C corporations (until 2026). The IRS explains on its website that this is not a mistake and "correctly reflects that calendar year C corporations are eligible for an automatic 6-month extension." The IRS cites the power granted to it in Section 6081(a)—"The Secretary may grant a reasonable extension of time for filing any return"—as authority for the longer extension period. The Surface Transportation and Veterans Health Care Choice Improvement Act set the due date for Form 1120, U.S. Corporation Income Tax Return, as the 15th day of the fourth month following the close of the corporation's year. For calendar-year corporations, Form 1120 is thus generally due April 15 (April 18 in 2017), and the six-month extended due date is Oct. 15 (Oct. 16 in 2017). Non-calendar-year C corporations already had a six-month extension available to them under Section 6081(b), except for C corporations with a June 30 year end, which are allowed a seven-month extension (until 2026).

H. Sample IRS Notice Outlines Private Tax Debt Collection Process. Congress mandated that the IRS reconstitute its private tax debt collection program under the Fixing America's Surface Transportation (FAST) Act, which former President Barack Obama signed in December 2015. The IRS has outlined the basic process for taxpayers dealing with private tax debt collection agencies, including verification procedures and information about resources such as the Taxpayer Advocate Service, in a sample notice letter and related informational pamphlet. The sample CP40 refers taxpayers to Publication 4518, "What You Can Expect When the IRS Assigns Your Account to a Private Collection Agency," which will be enclosed with the CP40 notice. In that pamphlet, taxpayers are told that they will also receive a letter from the private agency assigned to collect their tax debt before that agency contacts them about it. To ensure taxpayers' information security and privacy, the private collection agency will ask them to provide their name and address of record before offering assistance, the letter says. As part of "two-party verification," the IRS says the private agency will also request the first five digits of a taxpayer authentication number at the top of the CP40 notice, after which the agency will provide the next five digits. The unique authentication number is distinct from a Social Security or individual taxpayer identification number and, according to the pamphlet, also appears at the top of the letter taxpayers will receive from the private agency assigned to collect their tax debt, permitting further verification.

I. Fast-Track Settlement Program for Small Businesses Established. The IRS has issued Rev. Proc. 2017-25 establishing the Small Business/Self Employed fast-track settlement (FTS) program to provide an expedited format for resolving disputes with SB/SE taxpayers. In 2003, the IRS issued Rev. Proc. 2003-40 implementing an FTS program for large and midsize business taxpayers. In 2006, the IRS issued Announcement 2006-61 implementing a pilot FTS program for SB/SE taxpayers, which was extended by Announcement 2011-5, and then made available to

taxpayers nationwide. Under the FTS program, SB/SE taxpayers that have unresolved factual or legal issues in at least one open year under examination can work with SB/SE and the Appeals Office to resolve these issues while the case is still within SB/SE's jurisdiction. Rev. Proc. 2017-25 outlines significant changes to Announcement 2011-5, including case eligibility criteria and the criteria for cases excluded from the program. Consistent with Rev. Proc. 2014-63, Rev. Proc. 2017-25 also provides that SB/SE FTS program participants can't use post-appeals mediation for any issue considered during the FTS process if the parties fail to resolve the issue or if either party withdraws after the start of the FTS session. Rev. Proc. 2017-25 provides guidance on the application and settlement processes. Effective March 20, 2017, Rev. Proc. 2017-25 modifies and supersedes Announcement 2011-5.

J. IRS Won't Acquiesce in Stine on Accelerated Depreciation Allowance. In an action on decision (AOD 2017-02, 2017-15 IRB 1072), the IRS has announced it won't acquiesce in a district court's holding in *Stine LLC v. United States*, No. 13– 03224, 2015 WL 403146 (W.D. La. Jan. 27, 2015), that buildings built to operate as retail stores are placed in service for depreciation purposes when substantially completed to house and secure racks, shelving, and merchandise.

K. IRS Won't Acquiesce in Shea Homes Holding on Completed Contracts Method. In an action on decision (AOD 2017-03, 2017-15 IRB 1072), the IRS has announced it won't acquiesce in the Ninth Circuit's holding in *Shea Homes Inc. v. Commissioner*, 834 F.3d 1061 (9th Cir. 2016), aff'g 142 T.C. 60 (2014), that, under the completed contract method of accounting, a taxpayer completed a home construction contract when it incurred 95 percent of the estimated cost of constructing an entire development.

L. Court Strikes Down IRS PTIN Fees. In *Steele v. United States*, No. 1:14-cv-01523 (D.D.C. 2017), a U.S. District court held on June 1, 2017, that the IRS did not have legal or regulatory authority to charge PTIN fees. Judge Royce C. Lamberth, of the U.S. District Court for the District of Columbia, said in his opinion that "the IRS may not regulate in this area or require that tax return preparers obtain an occupational license." He went on to say that "if tax return preparers were regulated entities required to obtain licenses, this case would be very different." The IRS may owe hundreds of millions of dollars in refunds to tax return preparers who paid to register and renew their preparer tax identification numbers. The IRS suspended registrations and renewals under its PTIN program June 5, 2017. The IRS reopened its preparer tax identification number registration and renewal portal June 21, 2017, making the service free to comply with the recent district court decision.

M. No Gain or Loss Recognized on Conversion of LLC Interest. In LTR 201722008, the IRS ruled that a subchapter S corporation will not recognize gain or loss when it converts its preferred interests in a limited liability company to common interests, given representations that the conversion will not change the fair market value of the interests, shift the capital ownership of the LLC, or cause a deemed distribution arising out of a shift in the liability allocation to the LLC's owners.

N. Partnership Distribution in Corporate Partner Liquidation Is an Exchange. In ILM 201726012, the IRS concluded that the distribution of a partnership interest as part of the complete liquidation of a corporate partner and the transfer of a partnership interest as part of the reorganization of a corporate partner constitute an exchange for purposes of Section 743 under the provisions of Section 761(e). The facts involved two unrelated parent corporations which formed a joint venture and then a partnership. The partnership later acquired stock of an unrelated corporation through the formation of a second acquisition corporation. The partnership then formed a second lower-tier partnership in which the first partnership and second corporation became holding companies. Following a series of transactions over several years involving many entities in the taxpayer group, two subsidiaries merged sideways in a transaction purported to qualify as a reorganization under Section 368(a)(1)(A) and (D). One subsidiary merged upstream into another in a transaction purported to qualify as a complete liquidation under Section 332, and another subsidiary distributed its interest in the first partnership to the upstream subsidiary in a distribution to which Section 301 and 311(b) applied. Both partnerships had a Section 754 election in place at the time of the transactions. Accordingly, the taxpayer group took the position that the reorganization, the liquidation, and the distribution resulted in transfers of partnership interests that are considered transfers by sale or exchange under Section 743(b). Therefore, the transfers, including those under the purported nonrecognition transactions, triggered a step-up in basis of partnership assets owned by the first partnership and its lower-tier partnership. In finding that the transactions constitute an exchange for purposes of Section 743, the IRS held that the regulations under Section 761 do not limit the definition of exchange to taxable exchanges for purposes of Section 743 and that no provisions limit the definition of an exchange between related parties or members of a consolidated group. Since both partnerships each had a Section 754 election in effect for the year of the transactions, the transactions were sales or exchanges for purposes of Section 743(b) that required the partnerships to adjust the basis of the partnership property regarding the transferees.

O. Limited Partner Exception from Self-Employment Tax. The IRS may soon release additional informal guidance on the Section 1402(a)(13) exception for limited partners, and a project is on the Treasury-IRS priority guidance plan. Under Section 1402(a) and Section 702, partners' net earnings from self-employment generally includes their distributive share of partnership income. Section 1402(a)(13) provides an exception for the distributive share of income or loss of a limited partner. The focus of the IRS is beginning to turn more on control than limited liability. In part, this is based on *Renkemeyer, Campbell, and Weaver LLP v. Comm.*, 136 T.C. 137 (2011), where the Tax Court determined that the Section 1402(a)(13) exception was not available to partners in a law firm that provided legal services on behalf of the partnership. The IRS subsequently released two chief counsel advice (CCA) memoranda (ILM 201436049 and ILM 201640014) applying the *Renkemeyer* decision to the specific facts involving other taxpayers. Emphasis on partnership management increased after the Tax Court in *Castigliola v. Commissioner*, T.C. Memo. 2017-62 (2017), determined that the member-managers of a law firm did not qualify for the Section 1402(a)(13) exception.

P. Lump Sum Payment Deductible as Alimony. The Tax Court, in a summary opinion, held that an individual was entitled to deduct a lump sum payment to his former wife as alimony because he would not have had an obligation to make the payment had his former wife died. *McIntee, Gary Lee v. Commissioner*; No. 30701-15S; T.C. Summ. Op. 2017-48.

Q. Temporary Regulations on Due Date Changes. The IRS has issued final and temporary regulations (T.D. 9821) that update the due dates and extensions of time to file some tax returns and information returns. The regulations reflect the new statutory requirements set by the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 and the Protecting Americans from Tax Hikes Act of 2015. The regulations affect taxpayers who file Form W-2 (series, except Form W-2G), Form W-3, Form 990 (series), Form 1099-MISC, Form 1041, Form 1041-A, Form 1065, Form 1120 (series), Form 4720, Form 5227, Form 6069, Form 8804, and Form 8870. The temporary regulations also serve as the text of concurrently released proposed regulations (REG-128483-15). The regulations are effective July 20, 2017. The amendments to section 6072(b) change the due date for filing an income tax return by a C corporation from the 15th day of the third month following the close of the tax year (March 15 for calendar year taxpayers) to the 15th day of the fourth month following the close of the tax year (April 15 for calendar year taxpayers). The amendments also change the due date for filing an income tax return by a partnership from the 15th day of the fourth month following the close of the tax year (April 15 for calendar year taxpayers) to the 15th day of the third month following the close of the tax year (March 15 for calendar year taxpayers). With some exceptions for C corporations having tax years that begin before January 1, 2026, the automatic extension of time provided by section 6081(b) to file the tax return of a C corporation is extended from three months to six months. The temporary regulations conform to amended section 6081(b) by providing a seven-month automatic extension of time to file the income tax return of any C corporation with a tax year that ends on June 30 and before January 1, 2026. Section 6071(b) is amended and new section 6071(c) is added to change the due date for information returns in the Form W-2 series, Form W-3, and any returns or statements required to report nonemployee compensation. Under section 6071(c), the new due date for returns in the Form W-2 series, Form W-3, and Forms 1099-MISC that report nonemployee compensation is January 31 of the calendar year following the calendar year for which the information is being reported, regardless of whether the returns are filed on paper or electronically. The due date for information returns on Forms 1099-MISC that do not report nonemployee compensation remains unchanged.

R. Guidance on Qualified Small Business Stock. Taxpayers who own QSBS (including founders and employees of qualified small businesses, as well as owners of QSBS through passthrough entities) can exclude up to $10 million worth of gain or 10 times their basis when they sell their QSBS, if the shares were received at original issuance on or after September 28, 2010, and held for five years. Taxpayers who received QSBS at original issuance but have not held those shares for five years can defer (rather than exclude) gain on the sale of their shares, if they reinvest the proceeds from the sale in a new qualified small business within 60 days of the original sale. To qualify for the exclusion or deferral under sections 1202 and 1045, the taxpayer must own stock in a qualified trade or business. Among other requirements, Section

1202(e)(3)(A) excludes from the definition of a qualified trade or business 11 specific industries focused on the performance of services, including health, law, engineering, architecture, accounting, or “any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees.” Until recently, the IRS had issued no regulatory or administrative guidance explaining the qualified trade or business requirement for purposes of section 1202. But first with LTR 201436001 and now with LTR 201717010, the IRS has provided two pieces of guidance that may help taxpayers determine whether their companies are qualified trades or businesses and their shares of QSBS are subject to the exclusion or deferral provisions. LTR 201436001 describes a company that researches, develops, and manufactures experimental drugs. The LTR indicates that while the company “works primarily in the pharmaceutical industry,” it “does not perform services in the health industry,” which is one of the excluded trades or businesses under Section 1202(e)(3)(A). LTR 201717010 describes a company that uses a patented technology to test for specific diseases, the results of which are analyzed and summarized in laboratory reports for healthcare professionals. The company’s reports do not diagnose or recommend treatment and the company does not explain its reports to patients. Based on these facts, the LTR concludes that for purposes of Section 1202(e)(3), the company is not in a trade or business (i) involving the “performance of services in the field of health,” or (ii) whose principal asset is “the reputation or skill of one or more of its employees.”

S. IRS Extends Tax Treatment of Some Mortgage Assistance Payments. The IRS has extended (Notice 2017-40) through the 2021 tax year the safe harbor method for computing a homeowner's deduction for payments made on a home mortgage and the information reporting penalty relief for mortgage servicers and state housing finance agencies (HFAs). Notice 2017-40 amplifies Notice 2015-77, which provided guidance on the federal income tax consequences of, and information reporting obligations for, payments made to or on behalf of financially distressed homeowners under programs designed by state HFAs with funds allocated from the Housing Finance Agency Innovation Fund for the Hardest-Hit Housing Markets (HFA Hardest Hit Fund). Notice 2017-40 also amplifies Rev. Proc. 2011-55, which specifies where state HFAs should send statements regarding the payments to homeowners. The revenue procedure also gives state HFAs the option to use Form 1098-MA, "Mortgage Assistance Payments," to provide the required information. Notice 2017-40 extends the scope and effective date of Rev. Proc. 2011-55 through calendar year 2021 for the HFA Hardest Hit Fund.

T. Treasury Delays Debt-Equity Documentation Rules by One Year.

1. The final section 385 debt-equity regulations (T.D. 9790), released in October 2016, would reclassify some debt as equity and thereby negate some interest deductions. Reg. §1.385-3 and Temporary Reg. §1.385-3T provide rules that can recharacterize purported debt of U.S. issuers as equity if the interest is among highly related parties and does not finance new investment. These rules are intended to address transactions that create significant U.S. federal tax benefits while lacking meaningful legal or economic significance. Extensive documentation requirements must be met to establish the instrument is in fact debt.

2. Treasury and the IRS announced July 28, 2017, that they will delay by one year the documentation rules under the debt-equity regulations.

3. On October 2, 2017, Treasury Secretary Steven Mnuchin issued a report containing recommended actions to withdraw, partially revoke, or revise eight regulations identified by the Treasury Department for review under Executive Order 13789, which called for the identification of tax regulations that impose an undue burden on taxpayers. The report recommends that two proposed regulations be withdrawn entirely, three temporary or final regulations be partially revoked, and three regulations be substantially revised. These regulations are listed in the report among the regulations to "consider revoking in part."

U. Penalty Relief for Late-Filed Partnership Returns. In Notice 2017-47. the IRS has provided penalty relief for some partnerships that did not timely file or timely request an extension to file specified returns for the first tax year that began after December 31, 2015, due to changes to the deadline under Section 6072 for filing those returns. The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 amended Section 6072 and changed the date by which a partnership must file its annual return from April 15 to March 15 (for calendar-year taxpayers). The new due date applies to partnership returns for tax years beginning after December 31, 2015. Many partnerships filed the returns specified in the guidance or requested an extension for those returns by the date previously required by Section 6072. If not for the Surface Transportation Act, those returns and extension requests would have been timely. Notice 2017-47 provides that the IRS will grant relief from the specified penalties for any return described in the guidance for the first tax year of any partnership that began after December 31, 2015, if the partnership filed the return or requested an extension by the date that the return would have been timely filed. Partnerships that requested an extension of time must also timely file the return by the applicable due date to qualify for relief. Partnerships that qualify for relief and have already been assessed penalties will receive a letter within the next several months notifying them that the penalties have been abated. Taxpayers who qualify for relief under this notice will not be treated as having received a first-time abatement under the IRS's administrative penalty waiver program.

V. Truncated TINs on Forms W-2. The IRS has issued proposed regulations (REG-105004-16) that amend the current rules under Sections 6051 and 6052 to allow employers to voluntarily truncate employees' Social Security numbers on copies of Forms W-2 that are provided to employees so that the truncated SSNs appear in the form of IRS truncated taxpayer identification numbers.

W. Regulations under Section 707 and Section 752 on Treatment of Partnership Liabilities. These partnership tax regulations include: (i) proposed and temporary regulations governing how liabilities are allocated for purposes of disguised sale treatment; and (ii) proposed and temporary regulations for determining whether "bottom-dollar" guarantees create the economic risk of loss necessary to be taken into account as a recourse liability. On October 2, 2017, Treasury Secretary Steven Mnuchin issued a report containing recommended actions to withdraw, partially revoke, or revise eight regulations identified by the Treasury Department for review under

Executive Order 13789, which called for the identification of tax regulations that impose an undue burden on taxpayers. The report recommends that two proposed regulations be withdrawn entirely, three temporary or final regulations be partially revoked, and three regulations be substantially revised. These regulations are listed in the report among the regulations to "consider revoking in part."

X. Section 754 Elections. The IRS has issued proposed regulations (REG-116256-17) that remove a regulatory burden in making a Section 754 election to adjust the basis of partnership property. Comments and hearing requests are due by November 13, 2017. Under the current rules, a partnership that files an unsigned section 754 election statement with its partnership return has not made a valid section 754 election. Currently, the only remedy for failing to make a proper Section 754 election is to request Section 9100 relief to make a late Section 754 election. According to the preamble, the IRS has received numerous requests for that relief, especially when returns have been filed electronically. To ease the burden on partnerships seeking to make a valid Section 754 election and to eliminate the need to seek section 9100 relief, the proposed regulations remove the signature requirement in the current rules. The amended regulation will provide that a taxpayer making a Section 754 election must file a statement with its return that provides the name and address of the partnership making the election and that contains a declaration that the partnership elects under Section 754 to apply the provisions of Section 734(b) and Section 743(b). The regulations are proposed to apply to tax years ending on or after the date final regulations are published in the Federal Register. However, taxpayers may rely on the proposed regulations for periods preceding the proposed applicability date. Thus, partnerships that filed a timely partnership return containing an otherwise valid Section 754 election statement, but for the missing signature of a partner on the statement, will not need to seek Section 9100 relief.

Y. Tax Cuts & Jobs Act. The Tax Cuts and Jobs Act, released on November 2, 2017, includes a reduction in the number of tax brackets, an increase in the standard deduction, repeal of personal exemptions, a reduced maximum rate on business income, an increase in the child tax credit and a new family tax credit, repeal of the credits for the elderly and for adoption expenses, changes to education incentives and to many deductions, including a new limit on mortgage interest, repeal of the personal casualty loss, state income and sales tax, medical expense, moving expense, tax preparation expense, and employee business expense deductions, and a dollar limit on property tax deductions. The home sale exclusion would be tightened and phased out at higher income levels. There would be many changes to retirement plan rules. The AMT would be repealed, and the basic estate tax exclusion would be doubled and the tax repealed after 2023, with beneficiaries still getting a stepped-up basis in estate property. The Act also contains extensive changes to corporate and business taxes, foreign income and persons, and exempt organizations.

1. Individual Income Taxes.

a. Tax Brackets. Consolidates the current seven brackets into four, with a bottom rate of 12 percent (aided by a higher standard deduction) while retaining the current top marginal rate of 39.6 percent. An income capture provision

("bubble rate") will phase out the 12 percent bracket for filers with income in excess of $1,000,000 ($1,200,000 for joint filers).

Single	Married	Head of Household
12.0% > $0	12.0% > $0	12.0% > $0
25.0% > $45,000	25.0% > $90,000	25.0% > $67,500
35.0% > $200,000	35.0% > $260,000	35.0% > $230,000
39.6% > $500,000	39.6% > $1,000,000	39.6% > $500,000

b. Indexing. Indexes tax bracket and other provisions to the Chained CPI measure of inflation.

c. Standard Deduction. Increases the standard deduction to $12,000 for single filers, $18,000 for heads of household, and $24,000 for joint filers (currently $6,350 for single filers, $9,350 for heads of households, and $12,700 for married filers). Eliminates the additional standard deduction and the personal exemption.

d. Itemized Deductions. Retains the mortgage interest and charitable deductions, as well as the property tax deduction (capped at $10,000), but repeals the remainder of the state and local tax deduction and other itemized deductions.

e. Other Deductions and Exclusions. Caps the mortgage interest deduction at $500,000 of principal for new home purchases. Eliminates the moving deduction, educator expense deduction, and exclusions for employer-dependent care programs, among others. Makes changes to the exclusion of capital gains on home sales.

f. Family Tax Credits. Replaces the personal exemption for dependents with an expansion of the child tax credit from $1,000 to $1,600, while increasing the phaseout threshold (from $115,000 to $230,000 for married filers). The first $1,000 would be refundable, increasing with inflation up to the $1,600 base amount. Also creates a new $300 nonrefundable personal credit and a $300 nonchild dependent nonrefundable credit, subject to phaseout. The $300 credit expires after 5 years.

g. Alternative Minimum Tax.

2. <u>Business Taxes</u>.

a. Corporate Tax Rate. Lowers the corporate income tax rate from 35 to 20 percent.

b. Pass-Through Rate. Creates a new 25 percent maximum tax rate on pass-through business income, subject to anti-abuse rules.

c. Pass-Through Anti-Abuse Rules. Begins with assumption that 70 percent of income derived from a business is compensation subject to ordinary

rates and 30 percent is business income subject to the maximum 25 percent rate for active owners. Businesses can "prove out" of the 70/30 split based on demonstrated return on business capital at the short-term applicable federal rate (AFR) plus 7 percent. Certain specified service industries, like health, law, financial services, professional services, and the performing arts are excluded from the 70/30 split and can only claim the benefit of the lower pass-through rate to the extent that they can "prove out" their business income.

d. Capital Investment. Allows full expensing of short-lived capital investment (currently subject to "bonus" depreciation), such as equipment and machinery, for five years. Increases Section 179 expensing from $500,000 to $5 million and increases the phaseout threshold from $2 million to $20 million.

e. Tax Treatment of Interest. Limits the deductibility of net interest expense on future loans to 30 percent of earnings before interest, taxes, depreciation, and amortization (EBITDA), with a five-year carryforward, for all businesses with gross receipts of $25 million or more.

f. Net Operating Loss Provisions. Allows Net Operating Losses (NOLs) to be carried forward indefinitely and increased by a factor reflecting inflation and the real return to capital, while restricting the deduction of NOLs to 90 percent of current year taxable income and eliminating NOL carrybacks, except for one-year carrybacks for certain disaster losses.

g. Business Credits and Deductions. Eliminates the Section 199 manufacturing deduction and the New Market Tax Credit, along with like-kind exchanges for personal property (retained for real property), and deductions for entertainment. Eliminates credits for orphan drugs, private activity bonds, energy, rehabilitation, and contributions for capital, among others.

h. Alternative Minimum Tax. Eliminates the corporate alternative minimum tax.

i. International Income. Moves to a territorial tax system, in which foreign-source dividends and profits of U.S. companies are not subject to U.S. tax upon repatriation. However, 50 percent of excess returns (those greater than a routine return, defined as AFR plus 7 percent) earned by controlled foreign corporations (CFCs) are included in U.S. shareholders' gross income. In addition, payments made from US corporations to a related foreign corporation are subject to a 20 percent excise tax unless the US corporation claims the transaction as effectively connected income (ECI). ECI is added to the taxable income of the US corporation, but the related foreign corporation's expenses can be deducted from this income.

j. Deemed Repatriation. Enacts deemed repatriation of currently deferred foreign profits, at a rate of 12 percent for cash and cash-equivalent profits and 5 percent for reinvested foreign earnings.

3. Estate Tax.

Increases the estate tax exemption to $10 million, which is indexed for inflation, and repeals the estate tax after six years.

4. Deferred Compensation.

Nonqualified deferred compensation. Under the Act, an employee would be taxed on compensation as soon as there is no substantial risk of forfeiture with regard to that compensation (i.e., receipt of the compensation is not subject to future performance of substantial services). A condition would not be treated as constituting a substantial risk of forfeiture solely because it consists of a covenant not to compete or because the condition relates (nominally or otherwise) to a purpose of the compensation other than the future performance of services, regardless of whether such condition is intended to advance a purpose of the compensation or is solely intended to defer taxation of the compensation. The provision would be effective for amounts attributable to services performed after 2017. The current-law rules would continue to apply to existing non-qualified deferred compensation arrangements until the last tax year beginning before 2026, when such arrangements would become subject to the Act's provision.

II. MICHIGAN

A. New Michigan Domestic Asset Protection Trust Law. On December 5, 2016, the Governor signed a new asset protection law referred to as the Qualified Dispositions in Trust Act, effective February 5, 2017. With the passage of this statute, Michigan joins 16 other states that permit domestic asset protection trusts ("DAPTs"), which are irrevocable trusts that, if certain legal requirements are met, can shield assets from the claims of a person's creditors. A DAPT should be created and the assets transferred before a claim arises.

1. Under the new law, the transferor cannot be the trustee, but can be a beneficiary of the trust. Among the rights that the transferor may retain are the following:

a. Direct trust investment decisions;

b. Remove and replace trustees;

c. Veto distributions from the trust;

d. Receive discretionary distributions of income and/or principal;

e. Receive the income from the trust;

f. Direct how the assets are to be distributed on the transferor's death provided that the assets may not be

transferred to the transferor, the transferor's creditors, the transferor's estate, or the creditors of the transferor's estate;

g. Receive the annuity or unitrust payments from a charitable remainder trust;

h. Receive the annuity or unitrust payments from a grantor retained annuity trust; and

i. Receive an annuity from the trust of not more than 5 percent of the trust's initial value.

2. Any individual resident of Michigan can serve as trustee, provided he/she is not related or subordinate to the settlor as defined in the Internal Revenue Code.

3. A transferor making a qualified disposition must sign an affidavit which includes a list of statements geared to establishing that the transfer is not an attempt to hinder, delay or defraud creditors and is not fraudulent as to his or her creditors.

4. Creditors generally must bring actions within the later of two years from the date the assets are transferred to the trust or one year from date of discovery. If the claim is brought under Michigan's Fraudulent Transfer Act ("FTA"), the FTA's six year statute applies or, if later, two years from date of discovery of the claim if it had been fraudulently concealed.

5. If the disposition occurs more than 30 days prior to marriage, or if the parties agree (such as in a prenuptial agreement) that this provision of the law applies to the transferred property, then (i) no part of the transferred property is to be considered marital property, (ii) the property cannot be considered part of the trust beneficiary's real or personal estate and (iii) the transferred property may not be awarded to the trust beneficiary's spouse in a judgment for divorce.

B. Taxability of a Qualified Settlement Fund. A qualified settlement fund as defined by IRC §468B(g) is not subject to the Michigan corporate income tax. The taxpayer was an escrow account that was established at a bank headquartered out of state as a result of the resolution of a class-action lawsuit pending in a federal court in Michigan and that was to be administered under the court's continuing supervision and control. The sole source of income generated by the funds deposited in the escrow account is interest on investments in U.S. Treasury obligations. The Michigan corporate income tax is levied on corporations, insurance companies and financial institutions which are defined as corporations; a corporation is defined as a person that is required or has elected to file as a C corporation as defined under IRC §1361(a)(2) and IRC §7701(a)(3). The IRC defines a corporation to include associations, joint-stock companies, and insurance companies but does not include S corporations. Since the QSF the taxpayer inquires about is not a joint-stock company or an insurance company, its status as a taxpayer under the corporate income tax turns on whether it is an

association. Treasury regulations interpreting IRC §7701 determine the classification of an organization recognized as a separate entity unless another provision of the IRC provides for special treatment of that organization. IRC §468B provides for special federal income tax treatment for a QSF. Because a QSF is subject to special tax treatment under the IRC, it is not subject to classification under the Treas. Reg. § 301.7701, and is therefore not an association under IRC §7701(a)(3) . Because the QSF the taxpayer inquired about is not an association under IRC §7701(a)(3) , it is not a corporation under Mich. Comp. Laws Ann. § 206.605(1) and not subject to the corporate income tax. (Michigan Letter Ruling No. 2017-2, 04/10/2017)

C. Instructions for Paying the Essential Services Assessment Using EFT Credit. The Michigan Department of Treasury has updated its instructions for paying the essential services assessment (ESA) using Electronic Funds Transfer (EFT) credit. If a taxpayer selects EFT Credit as the method of payment for ESA, the taxpayer should provide a copy of the procedure (Form 2329) to his or her EFT provider or financial institution to ensure proper formatting of EFT credit payments made to the Michigan Department of Treasury-ESA unit. Many financial institutions require at least 24 hours advance notice before a transmission is completed. Taxpayers should make sure to contact their financial institution for proper lead times and specific deadlines to ensure a timely payment is received by the Department either on or before the due date. (Instructions for Payments of Essential Services Assessment (ESA) Using Electronic Funds Transfer (EFT) Credit, Mich. Dept. Treas., 05/01/2017)

D. Certifying and Paying the Essential Services Assessment. The Michigan Department of Treasury has updated a release on how to certify and pay the essential services assessment. No later than August 15, eligible claimants must electronically submit a certified ESA statement either through Michigan Treasury Online (MTO) or through e-File and electronically submit payment of full ESA liability through MTO, e-File, or Electronic Funds Transfer (EFT) credit. An eligible claimant who fails to electronically submit a certified statement and electronically pay ESA liability by August 15 is subject to a late payment penalty at a rate of 1% per week, up to a maximum of 5%, of the total liability that remains due and unpaid. An eligible claimant may amend a previously certified ESA statement through MTO or e-File on or before September 15 of the current tax year. An eligible claimant may not amend a previously certified ESA statement after September 15. Eligible claimants who fail to submit a certified statement and pay ESA in full, including any late payment penalties, via MTO, e-File, or EFT credit by October 15 will have the Eligible Manufacturing Personal Property (EMPP) exemption rescinded. Not later than the first Monday in December, the Department is required to rescind the EMPP exemption on parcels for which ESA liability and late payment penalty have not been paid in full by the October 15 deadline. When using e-File, the electronic statement must be signed by an authorized person, the Electronic Return Originator (ERO), if applicable, as well as any paid tax preparer. The statement must be signed using Form MI-5352 (E-file Authorization for the Essential Services Assessment (ESA) MI-5352). Returns are signed by entering the taxpayer Personal Identification Number (PIN) into the software after reading the perjury statement displayed by the software. The taxpayer PIN will be selected by the taxpayer, or the taxpayer may authorize his or her tax preparer to select the taxpayer PIN. The MI-5352 will be printed and contain the taxpayer PIN. The tax preparer will retain Form MI-5352

in his or her records as part of the taxpayer's printed return. ESA e-filings submitted without a taxpayer PIN will be rejected by the Department. Taxpayers should not mail Form MI-5352 to the Department. Taxpayers should not include Form MI-5352 as an attachment to a return. (ESA Topics: ESA Statements Certify and Pay, Mich. Dept. Treas., 05/01/2017)

E. For-Profit Educational Institutions Are Entitled to Educational Personal Property Exemption. The Michigan Supreme Court has held that the personal property tax exemption under Mich. Comp. Laws Ann. § 211.9(1)(a) , which exempts from taxation the personal property of charitable, educational, and scientific institutions, is available to for-profit educational institutions. *SBC Health Midwest, Inc. v. City of Kentwood*, Mich. S. Ct., Dkt. No. 151524, 05/01/2017.

F. Tax Benefits Available to Military Members and Veterans. The Michigan Department of Treasury is reminding current and former military members of various individual income tax and property tax benefits and services they may be entitled to receive from the state. (Press Release, Mich. Dept. Treas., 05/25/2017) Current and former military members may be eligible to receive:

1. Military pay individual income tax exemption. Military pay is exempt from Michigan individual income tax, including military retirement benefits and exit and separation pay.

2. Children of veterans tuition grant. This program provides undergraduate tuition assistance to the children of a Michigan veteran. Students may receive scholarship assistance for up to four academic years for a total of up to $11,200.

3. Property tax exemption for disabled veterans or surviving spouses. Property used and owned as a homestead by a disabled veteran or his or her surviving spouse is exempt from collection of property taxes.

4. Principal residence exemption (PRE) for active duty military personnel. Property owners can retain a PRE while on active duty if their property is rented or leased.

5. Property tax relief during active military service. Property owned by a serviceperson cannot be sold to pay delinquent property taxes during a tour of active duty.

6. Summer property tax deferment. A serviceperson, veteran or widow or widower whose income outside of military compensation is no more than $7,500 per year may be eligible for a summer property tax deferment.

G. Net Operating Loss for Income Tax and Household Income Purposes. The Michigan Department of Treasury has issued a release that describes how to compute and use a net operating loss (NOL) and an NOL deduction for Michigan income tax and also describes the impact of a federal NOL on Michigan tax credits.

Under Part 1 of the Michigan Income Tax Act (MITA), a Michigan NOL occurs when a business has losses in excess of its gains in a particular tax year, referred to as the loss year. An individual, a trust, or an estate can sustain an NOL, which may be carried to certain other years to offset income in those years. The resulting offset to income in those other tax years is referred to as the NOL deduction. The Michigan NOL follows the same general format and procedures as the federal NOL, but is computed independently of the federal NOL. The release explains what is a Michigan NOL and how it differs from a federal NOL; how a Michigan NOL is computed; how a Michigan NOL can be used; the requirements for claiming a Michigan NOL; and what NOL deduction, if any, may be used to establish eligibility for certain Michigan tax credits. The release replaces Michigan Revenue Administrative Bulletin No. 1998-3, 09/01/1998. (Michigan Revenue Administrative Bulletin No. 2017-14, 06/01/2017)

H. Michigan Issues Guidance on Reciprocal Agreements. The Michigan Department of Treasury has issued a release that describes reciprocal agreements as they pertain to Parts 1 and 3 of the Michigan Income Tax Act (which cover the individual income tax and the withholding tax, respectively) and nonresident taxpayers. The release discusses current reciprocal agreements in effect with Michigan; the requirements placed on Michigan employers; the requirements placed on Michigan employees working outside of Michigan; and taxes withheld in error and remitted to Michigan by nonresident workers. The release replaces Michigan Revenue Administrative Bulletin No. 1988-17, 05/27/1988. (Michigan Revenue Administrative Bulletin No. 2017-13, 06/01/2017)

I. Michigan Community and Education Foundation Credits. The Michigan Department of Treasury has issued a release that updates the requirements for claiming community foundation and/or education foundation tax credits under the Michigan Business Tax (MBT). The community foundation and education foundation tax credits originated under the Single Business Tax (SBT) Act and the Income Tax Act. When the SBT was repealed, the credits were retained under the Michigan Business Tax Act. As a result of L. 2011, P.A. 38, the community and education foundation tax credits can no longer be claimed under the Income Tax Act after tax year 2011 and are not available under Corporate Income Tax (Part 2 of the Income Tax Act). While community and education foundation tax credits may be claimed under the MBT, the taxpayer must have made a timely MBT election under Mich. Comp. Laws Ann. § 208.1500. The taxpayer is allowed to claim up to 50% of the amount contributed to the endowment fund of a certified community foundation or a certified education foundation, not to exceed 5% of the taxpayer's overall tax liability for the tax year before claiming any credits allowed by the MBT or $5,000, whichever is less. The credit is not refundable. The release discusses the requirement for a written acknowledgment of the contribution; community foundation and education foundation certification by the Department; and how to request certification. The release replaces Michigan Revenue Administrative Bulletin No. 1995-10, 11/17/1995. (Michigan Revenue Administrative Bulletin No. 2017-11, 06/01/2017)

J. Michigan Credit for Cash Contributions to Homeless Shelters, Food Kitchens and Food Banks. The Michigan Department of Treasury has issued an updated release explaining the current status of the credit for contributions to a shelter

for homeless persons, food kitchens and food banks (the "homeless shelter tax credit"). The Michigan Legislature previously authorized the homeless shelter tax credit as a nonrefundable tax credit under the Michigan Income Tax Act and the Single Business Tax (SBT) Act. The credit was retained under the Michigan Business Tax (MBT) Act when the SBT was repealed. As a result of L. 2011 P.A. 38, the tax credit can no longer be claimed under the Michigan Income Tax Act after the 2011 tax year and is unavailable under the Corporate Income Tax (Part 3 of the Michigan Income Tax Act). The homeless shelter tax credit may now only be claimed under the MBT, but in order to claim the credit under the MBT, the taxpayer must have timely made the MBT election under MCL 208.1500. The amount of the homeless shelter tax credit is 50% of the cash contributions made to qualifying organizations, but not to exceed 5% of the taxpayer's tax liability (before credits) or $5,000, whichever is less. The release discusses qualifying donee organizations; eligibility requirements; the requirement for a written acknowledgement of the contribution; exclusions; and written determinations by the Department. The release replaces Michigan Revenue Administrative Bulletin No. 1992-10, 03/31/1992. (Michigan Revenue Administrative Bulletin No. 2017-10, 06/01/2017)

K. Eligible Manufacturing Personal Property Exemption and ESA. The Michigan State Tax Commission has released a revised Assessor Guide to Eligible Manufacturing Personal Property Tax Exemption and ESA, that provides detailed information on the eligible manufacturing personal property tax exemption, the Essential Services Assessment (ESA) and Special Act changes. The guide provides resource material and contact information. (Assessor Guide to Eligible Manufacturing Personal Property Tax Exemption and ESA, Mich. State Tax Comm'n., 06/01/2017)

L. No Nexus with Detroit and therefore Not Required to Pay City Income Tax. The Tax Tribunal found that the evidence supported the taxpayer's position that it did not have nexus with the City of Detroit and was, therefore, not required to pay the City of Detroit income tax (CDIT) for the 2010 and 2012 tax years. A private equity firm that invests in lower middle-market companies, raised funds to form a limited partnership (the "Fund"). The general partner of the Fund is Huron Capital Partners GP II. In 2006, the private equity firm identified a viable investment opportunity and recommended to the Fund that it should invest in Labstat International, ULC ("Labstat"), a Canadian company. The taxpayer was created during the acquisition of Labstat to hold the Fund's investment in Labstat. In 2010, Labstat paid a dividend to the taxpayer and the taxpayer filed a CDIT return and paid 1% CDIT on the income. The transaction giving rise to the assessment of CDIT in 2012 was the sale of Labstat to Alaris Royalty Corp. On June 6, 2012, the taxpayer sold its interest in Labstat which resulted in gain and dividends to the taxpayer. The taxpayer filed a City of Detroit income tax return and reported the 2012 gains and dividend income from the sale of Labstat. The City argued that the taxpayer had nexus with the city and owed an additional 1% CDIT, interest, and penalties for 2010 and 2012 resulting from dividends and capital gains received. The CDIT applies to the taxable net profits of a corporation doing business in the City of Detroit, being levied on such part of the taxable net profits as is earned by the corporation as a result of work done, services rendered and other business activities conducted in the City of Detroit. The city ordinance incorporates the City Income Tax Act, including Mich. Comp. Laws Ann. § 141.605 , which provides that "doing business"

means the conduct of any activity with the object of gain or benefit, with certain specified exceptions. The Tax Tribunal found the taxpayer was "doing business" under Mich. Comp. Laws Ann. § 141.605 because: (1) the taxpayer was created to hold Labstat's stock and debt and this activity, even though passive, is "any activity" under Mich. Comp. Laws Ann. § 141.605 ; and (2) the taxpayer was formed with the objective of gain or benefit. However, the Tax Tribunal found that the taxpayer was not doing business in the City of Detroit. The Tax Tribunal rejected the City's argument that nexus was established because the taxpayer's commercial domicile was in the City of Detroit. The Tax Tribunal the agreed with the taxpayer that as a passive holding company, the taxpayer does not engage in an active trade or business that requires either a physical location or express direction or management. Therefore, the City did not prove that the taxpayer's "commercial domicile" is located in the City of Detroit to justify the imposition of CDIT under this rationale. The Tax Tribunal also found that the taxpayer did not have physical presence in the City of Detroit sufficient enough to establish nexus. The taxpayer's use of professional consultants does not establish physical presence in the City of Detroit. Mich. Comp. Laws Ann. § 206.621(2)(b) expressly excludes the activities of professionals providing services if those services are not significantly associated with the taxpayer's ability to establish and maintain a market in this state. Additionally, the presence of the taxpayer's officers and directors does not create the taxpayer's physical presence in the City of Detroit as it was proven that the activities completed by the board and directors in the City of Detroit were at the direction and control of the private equity firm and not the taxpayer. The taxpayer's primary activity was holding the shares and debt of Labstat and the conduct of the officers and directors, as directed by the private equity firm, were incidental to the taxpayer's primary activity. Further, the taxpayer was not engaged in the sale of goods or services in the City of Detroit, nor was it engaged in an active trade or business as a passive holding company. The Tax Tribunal also rejected the City's argument that the taxpayer had nexus with the City of Detroit because the taxpayer was part of the private equity firm's unitary business group that was based in the City of Detroit, finding that the City's reliance on the unitary business concept misplaced as the CITA does not address that concept, nor does it provide language that allows the unitary business concept to create a nexus link to a corporation. (*Apex Laboratories International Inc. v. City of Detroit*, Mich. Tax Tribunal, Dkt. No. 16-000724, 05/02/2017)

M. Capture of State Income Taxes to Redevelop Brownfield Sites. On June 8, 2017, Michigan Governor Rick Snyder signed a legislative package that allows certain projects to capture income taxes to redevelop brownfield sites and allow certain exemptions from sales and use taxes for such projects. The bills allow for the creation of "Transformational Brownfield Plans" through December 31, 2022, allowing the capture of income taxes and the exemptions from sales and use taxes, in addition to the current permitted capture of property taxes, for certain eligible activities associated with an approved transformational brownfield plan (TBP) agreement. (L. 2017, S111 (P.A. 46); L. 2017, S112 (P.A. 47); L. 2017, S113 (P.A. 48); L. 2017, S114 (P.A. 49); L. 2017, S115 (P.A. 50), all effective 07/24/2017)

N. Notice on Michigan Business Tax Treatment of "Materials and Supplies." The Michigan Department of Treasury has announced that it will acquiesce in the result of a recent court cases that dealt with the treatment of "materials and

supplies" under the Michigan Business Tax (MBT). As a result, the Department will revise its interpretation of the MBT treatment of "material and supplies" and apply it to all tax years open under the statute of limitations. (Notice To Taxpayers Regarding "Materials and Supplies" Under the Michigan Business Tax Act, Mich. Dept. Treas., 06/09/2017) In calculating the modified gross receipts tax base under the MBT, taxpayers deduct "purchases from other firms" from gross receipts. The MBT Act defines "purchases from other firms" as including "to the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel." The MBT Act does not define the term "materials and supplies." The Department provided its interpretation of "materials and supplies" in Michigan Business Tax FAQ No. M4, 11/07/2007. The Department's interpretation was recently rejected by the Michigan Tax Tribunal in *Plastic Surgery Associates, PC v Department of Treasury*, Mich. Tax Tribunal, Dkt. No. 16-000011, 11/15/2016 and *Andrie Inc. v Department of Treasury*, Mich. Ct. Claims, Dkt. No. 15-000135-MT, 01/24/2017. Although the conclusion was the same in both cases, the *Andrie Inc*. court held that in order to deduct expenses as materials and supplies under Mich. Comp. Laws Ann. § 208.1113(6)(c) the "materials and supplies" must be "ordinary, necessary expenses actually consumed and used within the tax year in the carrying on of a trade or business." In support of its holding, the court relied on IRC §162(a). The Department will acquiesce in the result reached in *Plastic Surgery Associates, PC* and *Andrie Inc*. regarding "materials and supplies." However, to the extent that either case could be interpreted to expand "materials and supplies" beyond tangible personal property or to delay the deduction to the date of consumption or use rather than the date of the "purchase[] from [an]other firm," the Department disagrees. Rather, the Department's revised interpretation of "materials and supplies" is tangible personal property purchased in the tax year that are ordinary and necessary expenses to be used in carrying on a trade or business. The Department will apply this interpretation to all tax years open under the statute of limitations.

O. Guidance on New Exemption for Fundraising by Veterans' Organizations. The Michigan Department of Treasury is reminding taxpayers that the General Sales Tax Act was recently amended to add an exemption for sales of tangible personal property by certain veterans' organizations for the purpose of raising funds for the benefit of an active duty service member or a veteran. Prior to the enactment of amendments to Mich. Comp. Laws Ann. § 205.54o, the exemption from sales tax for community-based efforts to assist disabled and unemployed active duty service members or veterans was limited to certain nonprofit organizations and did not include veterans' organizations. Legislation enacted in 2016 extended the exemption for fundraising for active duty service members or veterans to include sales of tangible personal property by those veterans' organizations that are exempt from federal income tax under IRC §501(c)(19) . The exemption is limited to $25,000 in aggregate sales for each individual fundraising event. This exemption amount is higher than the exemption to which other entities are entitled under Mich. Comp. Laws Ann. § 205.54o. Also, a club, association, auxiliary, or other organization affiliated with a IRC §501(c)(19) veterans' organization entity is not considered a separate person for purposes of the aggregate exemption amount. If aggregate sales for a single fundraising event held by a veterans' organization eligible for the sales tax exemption exceeds $25,000, the organization holding the fund-raiser is required to pay sales tax on the excess amount sold and must report and remit the tax to the Department. The Department is also

alerting taxpayers that Michigan Revenue Administrative Bulletin No. 1995-3, 03/30/1995 and Mich. Admin. Code § R205.140 do not yet reflect the new exemption. (Michigan Treasury Update, Mich. Dept. Treas., 06/01/2017)

P. New Core Charge Exemptions. Legislation enacted in 2016 amended the General Sales Tax Act and the Use Tax Act to provide a credit or exemption for certain core charges on or after January 1, 2017. A "core charge" is similar to a bottle deposit; a customer who purchases certain vehicle parts or batteries is charged a "core charge" that is either refunded or used as credit for the purchase of a new core when the core (the part or battery) is returned. Generally, sales or use tax is imposed on the value of all consideration used in exchange for the purchase of taxable tangible personal property. This typically includes credit for any property that is traded-in (such as the part subject to the core charge). However, as of January 1, 2017, credit for a core charge attributable to a recycling fee, deposit, or disposal fee for a motor vehicle or recreation vehicle part or battery is not subject to sales or use tax so long as the core charge credit is separately stated on the invoice, bill of sale, or similar document that is given to the purchaser. (Michigan Treasury Update, Mich. Dept. Treas., 06/01/2017)

Q. Taxability of Renting Summer Cottages. The Michigan Department of Treasury is reminding taxpayers that homeowners who rent out their homes to the public for temporary lodging must remit use tax on those accommodations. Michigan's 6% use tax applies to any stay of 30 days or less. This includes the rental of a vacation home, cabin, lodge, condominium, townhouse, room in a private residence, or any other structure. The tax applies to hotel chains, bed and breakfast establishments, and private homeowners; and applies whether the accommodations are rented directly by the host, or through a third-party provider like Airbnb or HomeAway. A host providing accommodations is required to keep proper records in order to substantiate whether, and in what amount, the host may owe sales or use tax. As noted in our earlier article, if a person owes sales or use tax, he or she also needs to register with Treasury. The registration process is outlined in Form 518 (Michigan Business Taxes Registration Booklet). In some situations, a third party provider may be authorized to collect and remit taxes on behalf of a host. Hosts may want to contact the third party providers they are working with to see what policies the providers have regarding the remittance of state and local taxes. The Department advises taxpayers that if they think they may be responsible for remitting sales or use tax, the taxpayer should consult a tax advisor. (Michigan Treasury Update, Mich. Dept. Treas., 06/01/2017)

R. Dental Prosthetics. The Michigan Department of Treasury has announced that it has revoked Michigan Letter Ruling No. 85-20, 11/26/1985, which addressed sales of a specific type of prosthetic (dental ceramics). The letter ruling found that "when a dental lab manufactures a device in accordance with specifications provided by a dentist it provides a non-taxable service rather than making a [taxable] sale to the ultimate consumer." This conclusion led the Department to also find that, because there is no ultimate sale at retail, dental labs making such products are not eligible for the industrial processing exemption. When the letter ruling was issued, the sales and use tax acts exempted "any...apparatus, device, or equipment used to replace or substitute for a part of the human body...." With the passage of L. 2004, P.A. 172 and P.A. 173, a specific definition of "prosthetic device" (with a corresponding

exemption) was added to the sales and use tax acts. It defines a "prosthetic device" as "a replacement, corrective, or supportive device, other than contact lenses and dental prosthesis, dispensed pursuant to a prescription, including repair or replacement parts for that device, worn on or in the body..." Therefore, dental prosthetics are excluded from the exemption under the current definition of "prosthetic device." Upon further review of Michigan Letter Ruling No. 85-20, 11/26/1985, and in light of current law, the Department revokes the letter ruling effective July 1, 2017. For transactions prior to this date, dental labs may continue to rely on Michigan Letter Ruling No. 85-20, 11/26/1985 (i.e., treat sales of custom dental products as nontaxable sales and not claim the industrial processing exemption). However, after July 1, dental lab sales of dental prostheses are subject to sales tax based on the sales price of the prosthetic. Because the transaction will now be treated as a sale at retail, dental labs may claim the industrial processing exemption for property used in manufacturing its products, if the property used to make such dental products qualifies for the industrial processing exemption under Mich. Comp. Laws Ann. § 205.54t and Mich. Comp. Laws Ann. § 205.94o. (Michigan Treasury Update, Mich. Dept. Treas., 06/01/2017)

S. Unitary Business Groups and LaBelle Guidance.

1. The Michigan Department of Treasury is reminding taxpayers that it issued guidance to unitary business groups because the decision of *LaBelle Management Inc. v. Department of Treasury*, Dkt. No. 324062, 03/31/2016, 315 Mich App 23 (2016) had become final after the Michigan Supreme Court's denial of leave to appeal (see State & Local Taxes Weekly, Vol. 28, No. 10, 03/06/2017). The Department indicated in Notice to Taxpayers Regarding LaBelle Management Inc. v. Department of Treasury, Mich. Dept. Treas., 02/28/2017, that it would give the decision full retroactive effect. Taxpayers are directed to correct their filings pursuant to the Notice, for all open years to conform to the decision. Penalties will not be imposed for amended unitary business group returns or original stand-alone returns that directly result from compliance with LaBelle. To encourage taxpayers to take swift corrective action, the Department will waive interest for corrected returns that are filed by December 31, 2017. The Department notes that corrected filings must attach written correspondence to the return identifying it as a "LaBelle" return. If a taxpayer entitled to a refund as a result of a corrected filing desires to transfer the overpayment to former members of the group that are now filing separately, the taxpayers involved in the transfer must file (mail) their respective returns together. In the case of any request that the Department transfer a payment or overpayment, the taxpayer must attach written correspondence specifying the date the payment was made, the amount of the payment, and the manner in which the payment or overpayment is to be allocated. Finally, to ensure appropriate authorization to discuss and receive information, entities affected by the LaBelle decision should review the authorizations (e.g., Form 151) on file and, if necessary, execute and submit new forms designating authorized representatives. (Michigan Treasury Update, Mich. Dept. Treas., 06/01/2017)

2. To form a unitary group, one person must meet the control test of MCL 208.1117(6), which defines a “unitary business group” for purposes of the MBT as: “a group of United States persons, other than a foreign operating entity, 1 of which owns or controls, directly or indirectly, more than 50% of the ownership interest with voting

rights or ownership interests that confer comparable rights to voting rights of the other United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. For purposes of this subsection, flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations." The Department's RAB 2010-1 asserts that when a single person does not own more than 50%, the ownership of one person can be attributed to another to meet the control test. Thus, corporations with no common ownership can be part of a unitary business group on the basis that the owners are related persons and the Department attributes the ownership of one family member to another. The Department also attributes ownership interests between partnerships, trusts and estates. In *Labelle Management*, the Court of Appeals rejected the Department of Treasury attribution theory by rejecting both the Department's reliance on attribution provisions of the Internal Revenue Code and its own interpretation of the law. The Court of Appeals rejected the Department's reliance upon 26 USC §957, which incorporates the constructive ownership rules of Section 318 of the IRC. The Court found that indirect ownership and constructive ownership are separate concepts. The Court consulted dictionary definitions of the term "indirect" and determined that the most applicable definitions were "not done directly; conducted through intermediaries" and "possession of a thing through someone else, such as an agent." Consistent with these definitions, the Court held "that indirect ownership in MCL 208.1117(6) means ownership through an intermediary, not ownership by operation of legal fiction, as [the Department] urges." Therefore, the Court ruled in favor of the taxpayer and found that the entities at issue did not constitute a unitary business group for MBT purposes.

T. Michigan Business Tax Small Business Alternative Credit-Compensation Limit. The taxpayer was not entitled to claim the Michigan Business Tax small business alternative credit (SBAC) because the taxpayer exceeded the compensation limit imposed under Mich. Comp. Laws Ann. § 208.1417(b)(i) since the payment of a bonus must be included in the calculation of "compensation" for the year in which payment is made. Under the statute, a taxpayer is disqualified from claiming the SBAC if compensation for a shareholder or officer exceeds $180,000 for the respective tax year. The Michigan Department of Treasury argued that an officer and shareholder of the taxpayer received compensation during the tax year at issue of $193,996, which included a $30,000 bonus paid in 2008. The taxpayer argued that inclusion of a bonus in compensation for purposes of determining eligibility for the SBAC should be done based on the taxpayer's elected method of accounting. Given that the taxpayer follows an accrual method of accounting and that the taxpayer deducted the bonus in 2007, the taxpayer argued that the bonus received by the officer/shareholder should be included as compensation for 2007, placing the officer/shareholder's compensation for 2008 at $163,996. (*Four Zero One Associates LLC v. Department of Treasury*, Mich. Ct. App., Dkt. No. 332639, 06/15/2017 (unpublished).)

U. Taxpayer Cannot Attack Final Michigan Withholding Tax Assessments Using Refund Procedures. Once assessments become final, they cannot be attacked via the refund procedures set forth in Mich. Comp. Laws Ann. §

205.30. (*Jenks v. Department of Treasury*, Mich. Ct. App., Dkt. No. 332787, 06/15/2017 (unpublished).)

V. Michigan's Retroactive Repeal of Multistate Tax Compact. The U.S. Supreme Court has decided not to review a Michigan Court of Appeals decision that rejected constitutional challenges raised by the taxpayer company to Michigan's retroactive repeal of the Multistate Tax Compact. The taxpayer, a multistate business entity organized in Delaware, raised Separation of Powers and Due Process challenges to L. 2014, P.A. 282, which the legislature enacted to retroactively rescind Michigan's membership in the Compact and prevent foreign corporations, such as the taxpayer, from using a 3-factor apportionment formula previously available under the Compact. The court of appeals held that it was bound by the court decision upholding the constitutionality and applicability of Act 282 in Gillette Commercial Operations North America & Subsidiaries, et al. v. Department of Treasury, Mich. Ct. App., Dkt. No. 325258, 09/29/2015 . (*R.J. Reynolds Co., as Successor in Interest to Lorillard Tobacco Co. v. Michigan Department of Treasury*, Mich. Ct App., Dkt. No. 313256, 11/03/2015 (unpublished), cert. denied, U.S. S.Ct., Dkt. No. 16-1260, 06/19/2017.) The Michigan Department of Treasury subsequently issued a release discussing the Department's audit policy going forward; the Department's treatment of informal conferences that were held in abeyance during the litigation; as well as litigation still pending before the Michigan Tax Tribunal and the courts. (Notice to Taxpayers Regarding the Conclusion of Multistate Tax Compact Election Litigation, Mich. Dept. Treas., 07/12/2017.)

W. ESA Statements Available for Certification. The Michigan Department of Treasury has updated or generated essential services assessment (ESA) statements for all accounts on which the eligible manufacturing personal property (EMPP) exemption was claimed prior to the May 31, 2017 filing window. All statements are now available to view, update, and certify via the Department's Michigan Treasury Online (MTO). Each eligible EMPP exemption claimant must electronically certify their completed ESA statement and make full payment of ESA liability no later than August 15. Eligible claimants are highly encouraged to certify and pay at least one week prior to the August 15 deadline to allow timely notification of any filing errors that may occur. If electronic payment of ESA liability is not made in full by August 15, a late payment penalty of 1% of the outstanding ESA liability will be charged each week any liability remains outstanding, to a maximum of 5%. If ESA liability and late payment penalty is not received in full by October 15, the EMPP exemption(s) will be rescinded by the Department. Eligible claimants may certify their return either through MTO or approved e-file software and may submit ESA payments via MTO (ACH debit), Electronic Funds Transfer (EFT) credit, or e-file. (ESA Statements Available for Certification by August 15th Deadline, Mich. Dept. Treas., 06/26/2017)

X. Michigan Supreme Court Clarifies Test for Determining Charitable Institution Property Tax Exemption Eligibility. The Michigan Supreme Court held that the Michigan Tax Tribunal and Michigan Court of Appeals misapplied the supreme court's 6-part test for determining the eligibility for the charitable institution property tax exemption under Mich. Comp. Laws Ann. § 211.7o and Mich. Comp. Laws Ann. § 211.9, and vacated and remanded the case. In doing so, the Supreme Court clarified the test used to determine whether an institution qualifies as a charitable institution,

particularly as to whether an institution offers its charity on a nondiscriminatory basis. (*Baruch SLS, Inc. v. Tittabawassee Township*, Mich. S. Ct., Dkt. No. 152047, 06/28/2017) In *Wexford Medical Group v. City of Cadillac*, 474 Mich 192 , 713 NW2d 734 (2006), the Michigan Supreme Court announced the following six-part test for evaluating whether an institution is "charitable":

1. A "charitable institution" must be a nonprofit institution.

2. A "charitable institution" is one that is organized chiefly, if not solely, for charity.

3. A "charitable institution" does not offer its charity on a discriminatory basis by choosing who, among the group it purports to serve, deserves the services. Rather, a "charitable institution" serves any person who needs the particular type of charity being offered.

4. A "charitable institution" brings people's minds or hearts under the influence of education or religion; relieves people's bodies from disease, suffering, or constraint; assists people to establish themselves for life; erects or maintains public buildings or works; or otherwise lessens the burdens of government.

5. A "charitable institution" can charge for its services as long as the charges are not more than what is needed for its successful maintenance.

6. A "charitable institution" need not meet any monetary threshold of charity to merit the charitable institution exemption; rather, if the overall nature of the institution is charitable, it is a "charitable institution" regardless of how much money it devotes to charitable activities in a particular year.

The Supreme Court said that the key question a court must ask when evaluating whether an institution has met Wexford's third factor is whether the restrictions or conditions the institution imposes on its charity bear a reasonable relationship to a permissible charitable goal.

Y. Michigan Announces Additional Enhancements to Online e-Services System. The Michigan Department of Treasury has announced that business taxpayers now have even more options for conducting transactions with the state using Michigan Treasury Online (MTO) as a result of upgrades made in June 2017 that included Bulk e-File and Fast Pay Now. (Press release, Mich. Dept. Treas., 07/17/2017.) As a result of the upgrades, businesses can now bulk e-File Sales, Use and Withholding (SUW) taxes using approved tax preparation software, as well as make fast payments for corporate income tax, the Michigan Business Tax (MBT), and SUW taxes separate from filing a return. Other MTO enhancements include: (i) landing page redesigns featuring Account Services and Guest Services; (ii) links to Collections e-Services; and (iii) increased W-2 upload capacity. Through MTO, business taxpayers can:

- create and maintain personal user profiles to access web services;
- use a single sign-on for all MTO related services;

- electronically register a new or existing business for MBTs;
- manage registration information with the Department of Treasury;
- file and pay SUW taxes and the Essential Services Assessment (ESA);
- print and save tax return drafts;
- manage payments and payment information;
- view and print all filed returns;
- request fuel credit refunds;
- upload W-2 and other wage statements;
- view Department-issued correspondence and sales tax licenses; and
- digitally file Form 151 (Authorized Representative Declaration/Power of Attorney) and Form 163 (Notice of Change or Discontinuance).

Z. Uncapping of Taxable Value of Apartment Building Improper. A city's uncapping of the taxable value of the subject property, which contains an apartment building, was improper since the conveyance at issue was between commonly controlled entities, and is not considered a transfer of ownership for uncapping purposes under Mich. Comp. Laws Ann. § 211.27a(7)(m) . The city argued that the subject property was transferred to the taxpayer by land contract and quit claim deed in 2015. The city argued that the three individuals that were 20% owners each of the prior owner of the property and 25% owners each of the taxpayer do not meet the 80% control requirement of Michigan Revenue Administrative Bulletin No. 1989-48, 05/31/1989 and also failed to meet an additional requirement that each owner's interest be the same in each entity. Under Mich. Comp. Laws Ann. § 211.27a(7)(m) , a transfer of ownership does not occur in a transfer of real property among entities if the entities involved are commonly controlled. The city argued that the State Tax Commission's (STC's) Transfer of Ownership Guidelines, and its adoption of Michigan Revenue Administrative Bulletin No. 1989-48, 05/31/1989, which was promulgated for determining entities under common control for the now defunct Single Business Tax control this definition of "commonly controlled." The STC and the city also take the position that the constructive ownership rules of the Internal Revenue Service cannot apply to transfer of ownership situations because to do so would negate and render meaningless other exceptions to the definition of uncapping concerning various relationships. The Tax Tribunal held that the 80% rule found in Michigan Revenue Administrative Bulletin No. 1989-48, 05/31/1989 without attribution rules makes little sense. The Tribunal said that it is not bound by the STC's guidelines, nor by an email of one of its long-time employees. Mich. Comp. Laws Ann. § 211.27a(7)(m) does not contain the 80% ownership requirement, the 5-member control group requirement, or the requirement that each owner have an identical interest in each entity. The Tribunal held as a general rule that common control for brother-sister entities means the same owner or owners in both entities have cumulatively, more than 50% in both entities, without constructive ownership rules. Here, the three individuals hold a 60% interest in the conveying corporation and cumulatively hold a 75% interest in the taxpayer. As both entities have common control, Mich. Comp. Laws Ann. § 211.27a(7)(m) applies and the

property's taxable value remains capped. (*TRJ&E Properties LLC v. City of Lansing*, Mich. Tax Tribunal, Dkt. No. 16-000408, 06/06/2017)

AA. Theft-Loss Recovery Credit Properly Denied. A taxpayer could not claim a theft-loss recovery deduction on his Michigan income tax return because Michigan law does not allow this credit, and a late-filing penalty was properly assessed. In 2011, the taxpayer included recovered funds that he lost in a Ponzi scheme in his federal adjusted gross income, and then claimed a credit for the theft-loss recovery against his adjusted gross income on his 2011 Michigan income tax return. The taxpayer argued that he did not file an application for an extension for the time to file a return because he relied on the advice of his CPA that no tax would be owed and so an extension was unnecessary. The Michigan Tax Tribunal found that the case of Sturrus v. Department of Treasury, Mich. Ct. App., 292 Mich App 639, 809 NW2d 208 (2011), disallows the taxpayer's claimed credit and the Taxpayer's Bill of Rights specifically excludes incorrect advice by a tax advisor as a reasonable cause for failure to file. With regards to the late-filing penalty, the taxpayer provided no other rationale for his failure to timely file the tax return, and the taxpayer failed to meet his burden of showing that there was "reasonable cause" for the failure. (Goodman v. Michigan Department of Treasury, Mich. Tax Tribunal, Dkt. No. 16-005560, 06/08/2017)

BB. Conveyance of Property between Family Members Uncapped Property's Taxable Value. A 2013 transfer of the subject property out of a limited liability company (LLC) wholly owned by the owner to herself individually was not a transfer between legal entities that were commonly controlled and the 2014 transfer from the owner to the taxpayers, while reserving a life estate occurred prior to December 31, 2014, and so both conveyances resulted in an uncapping of the property's taxable value. There is no "mirror-image" rule that looks to ultimate beneficial ownership as contended by the taxpayers, except that created by the State Tax Commission (STC) in its transfer of ownership and uncapping guidelines, and the administrative law judge (ALJ) correctly noted that said guidelines do not have the force of law. A "transfer of ownership" is defined by Mich. Comp. Laws Ann. § 211.27a(6) as "the conveyance of title to or a present interest in property, including the beneficial use of the property, the value of which is substantially equal to the value of the fee interest." Under the plain language of the statute, beneficial use is not sufficient to constitute ownership, and outside of such a framework, the owner of the property and the LLC were not one in the same. Moreover, the STC's former opinion on the subject is unpersuasive given that it was, as noted by the ALJ, based on an unarticulated and unexplained policy, and subsequently abandoned when the guidelines were amended to reflect a "business purpose" requirement in situations in which entities did not qualify as commonly controlled under Michigan Revenue Administrative Bulletin No. 1989-48, 05/31/1989 in December 2014. The business-activity requirement of the RAB has been upheld by the Michigan Court of Appeals and the ALJ did not err in finding its unpublished decisions on that issue persuasive, particularly in the absence of any contradictory authority, binding or otherwise. As for the 2014 conveyance, the Tax Tribunal found that the ALJ did not err in concluding that Mich. Comp. Laws Ann. § 211.27a(7)(d) , which allows a familial exception for transfers upon the termination of a life estate, was not in effect at the time the property owner's life estate terminated in January 15, 2014 and the taxpayers' contention that the enacting section of L. 2015,

P.A. 243 somehow alters this determination is without merit. The legislature specified within the language of the statute itself, in clear and unambiguous terms, an effective date of December 31, 2014, and there can be no doubt that it intended to apply to transfers occurring after that date. (*Scott, et al. v. City of South Haven*, Mich. Tax Tribunal, Dkt. No. 15-003121, 06/12/2017)

CC. Good Jobs for Michigan Program Enacted. L. 2017, S242 (P.A. 109), effective 07/26/2017 and applicable 30 days after enactment, enacts the Good Jobs for Michigan Program that allows the transfer of the dedicated portion of withholding tax capture revenues to authorized businesses that provide certified new jobs in Michigan. An eligible business may apply to the Michigan Strategic Fund (MSF) to enter into a written agreement which authorizes the payment of withholding tax capture revenues. A business can enter into a withholding tax capture agreement only if it proposed one or more of the following: (i) creating 3,000 or more certified new jobs in Michigan, with an average annual wage that is equal to or greater than the prosperity region average wage; firms that do so can capture up to 100% of withholding tax captures for up to 10 years; (ii) creating 500 or more certified new jobs in Michigan, with an average annual wage that is equal to or greater than the prosperity region average wage; firms that do so can capture up to 50% of withholding tax capture revenues for up to five years; or (iii) creating 250 or more certified new jobs in Michigan, with an average annual wage that is equal to 125% or more of the prosperity region average wage; firms that do so can capture up to 100% of withholding tax captures for up to 10 years. The MSF can enter into no more than 15 such agreements each year and cannot disburse more than $200 million in total withholding tax capture revenues over the life of the program. No new agreements can be entered into after December 31, 2019. Tax capture would begin and the capture duration measured from the date the authorized business creates the certified new jobs as provided in the written agreement. To enter such an agreement with a business, the MSF must determine that the business will create the requisite number of jobs within five years after entering the agreement. Professional sports stadiums, casinos, retail businesses, and those portions of eligible businesses used exclusively for retail sales are not eligible to participate in the Program.

DD. Business Income Reportable on MI-1040 and MI-1041. The Michigan Department of Treasury has issued a set of frequently asked questions (FAQs) that cover the state taxation of business income for individuals. Business income included in an individual taxpayer's federal adjusted gross income and in the income of a fiduciary is generally taxable based on the location of the business activity. The FAQs provide guidance on how to source and report business income and they include statutory citations (Business Income Taxation - Individual Income Tax FAQs, Mich. Dept. Treas., 08/01/2017.)

EE. Information Flow-Through Entities Should Provide.

1. Updated Guidance. The Michigan Department of Treasury has issued guidance on additional information flow-through entities should provide partners, shareholders, and members subject to Michigan's corporate income tax (CIT) or individual income tax to properly fill out their state returns. Michigan Treasury Update, Mich. Dept. Treas., 08/01/2017.

2. Flow-Through Entity Reporting. Each year that a partnership, S corporation, or limited liability company taxed as a partnership (collectively, a "flow-through entity") has business activity in Michigan, it must report information about its tax year to its owners. Federally, information is reported on Schedule K-1 (1065 or 1120S). Partners, shareholders, and members (collectively, "owners") subject to Michigan's CIT or individual income tax need state-specific information to properly fill out their tax returns. Owners often need far more detail than what is initially provided, which can cause delays in return processing and audits.

3. Information Flow-Through Entities Should Provide. A flow-through entity may use any method to report Michigan information to owners. The Department recommends providing a supplemental attachment to the owner's federal Schedule K-1. Many states publish a mandatory state-level K-1 but Michigan does not. Some software providers have programmed their own "Michigan-equivalent K-1." While software-developed schedules will be accepted, none have been preapproved or specifically endorsed by the Department. The following information should be conveyed to the owner:

- FEIN of the flow-through entity.
- Tax year of the flow-through entity.
- Flow-through withholding paid on behalf of that owner (if applicable).
- For owners subject to individual income tax, the owner's distributive share of taxable income attributable to the flow-through entity. For owners subject to CIT, the owner's distributive share of business income and the owner's share of statutory additions and subtractions, attributable to the flow-through entity. All amounts should be reported without regard to apportionment. In the case of reporting for CIT members, "business income" is calculated as federal taxable income as if IRC §168(k) and IRC §199 were not in effect. Those sections of the Internal Revenue Code deal with bonus depreciation and the Domestic Production Activities Deduction (DPAD), respectively. A corporate owner is required to make these two adjustments to federal taxable income, even though they are attributable to its ownership in a flow-through entity. Likewise, a corporate owner must also make adjustments to its business income for statutory additions and subtractions, even though they are attributable to ownership in a flow-through entity.
- Flow-through entity's sales sourced to Michigan.
- Flow-through entity's total sales. For owners that are corporations or other flow-through entities, the flow-through entity's gross receipts. Owners will report on CIT returns their proportionate share of allocated or apportioned gross receipts from flow-through entities.

4. Sales. In the case of the flow-through entity's sales sourced to Michigan and total sales, more than the apportionment percentage is needed. CIT and

individual income tax returns require taxpayers to report Michigan sales and total sales separately, including for the apportionment of flow-through income and loss.

5. Composite Individual Income Tax Return. Information reported to a participant of a Composite Individual Income Tax Return differs slightly. Owners that are C corporations are not eligible to participate in a composite filing. For more information, taxpayers should see Form 807.

III. EMPLOYEE BENEFITS

A. 2017 Tax Inflation Adjustments.

1. Individual Retirement Accounts.

	2016	2017
Individual Retirement Accounts		
Contribution Limits – Traditional & Roth	Lesser of $5,500 or compensation	Lesser of $5,500 or compensation
Additional Catch-Up Contribution for Individuals Age 50 & Over – Traditional &	$1,000	$1,000
Modified Adjusted Gross Income Phase-Out for Contributions to Traditional IRAs *(If Covered by a Workplace Retirement Plan)*		
Single	$61,000 - $71,000	$62,000-$72,000
Married Filing Jointly	$98,000 - $118,000	$99,000-$119,000
Married Filing Separately	$0 - $10,000	$0 - $10,000
Heads of Household	$61,000 - $71,000	$62,000-$72,000
Modified Adjusted Gross Income Phase-Out for Contributions to Traditional IRAs *(NOT Covered by a Workplace Retirement Plan)*		
Single	No limit	No limit
Married Filing Jointly (Spouse Not Covered)	No limit	No limit
Married Filing Separately (Spouse Not Covered)	No limit	No limit
Married Filing Jointly (Spouse Covered)	$184,000 - $194,000	$186,000 - $196,000
Married Filing Separately (Spouse Covered)	$0 - $10,000	$0 - $10,000
Heads of Household	No limit	No limit
Modified Adjusted Gross Income Phase-Out for Contributions to Roth IRAs		
Single	$117,000 - $132,000	$118,000 - $133,000
Married Filing Jointly	$184,000 - $194,000	$186,000 - $196,000
Married Filing Separately	$0 - $10,000	$0 - $10,000
Heads of Household	$117,000 - $132,000	$118,000 - $133,000

2. Qualified Plans.

	2016	2017
Qualified Plans		
Elective Deferrals – 401(k) and 403(b) Pre-Tax Contributions; 457(b); 402(g)(3))	$18,000	$18,000
Catch-up Contributions – 401(k), 403(b) Pre-Tax Contributions; 457(b); SARSEP Plans	$6,000	$6,000
Highly Compensated Employee – 414(g)	$120,000	$120,000
Annual Compensation Limit – 401(a)(17), 404(l), 408(k)(3)(C), 408(k)(6)(D)(ii)	$265,000	$270,000
Key Employee – 416(i)(1)(A)(i), Top Heavy and 409A Specified Employee	$170,000	$175,000
Defined Contribution Plan Total Annual Contributions – 415(c)	$53,000	$54,000
Defined Benefit Plan Maximum Benefit – 415(b)	$210,000	$215,000
ESOP – for Determining Lengthening of Five Year Period	$210,000	$215,000
ESOP – Maximum Subject to Five Year Distribution	$1,070,000	$1,080,000

B. Employer Matching Contributions Are Subject to Risk of Forfeiture. In ILM 201645012, the IRS determined that under a deferred compensation agreement, the salary that an employee could have elected to receive as compensation may be treated as subject to a substantial risk of forfeiture under Section 409A even if the employer provides a matching contribution. The employee and employer entered into an agreement to defer $15,000 of salary that would otherwise have been paid during 2015. Payment of the deferred amount will be made as a lump sum payment on January 1, 2018, but only if the employee continues to provide substantial future services until December 31, 2017. In addition to a biweekly salary reduction, the employer credits matching amounts to the employee's deferred compensation account of 25 percent of each salary reduction. Section 409A generally provides that if specified requirements concerning the timing of elections, distributions, and funding are not met at any time during a tax year, amounts deferred under a nonqualified deferred compensation plan for that year and all previous tax years are currently includable in gross income to the extent they are not subject to a substantial risk of forfeiture and not previously included in gross income. By regulation, an amount will be considered subject to a substantial risk of forfeiture beyond the date or time at which the recipient otherwise could have elected to receive the amount of compensation if the present value of the amount subject to a substantial risk of forfeiture is "materially greater" than the present value of the amount the recipient otherwise could have elected to receive absent the risk of forfeiture. The IRS concluded that because the present value of the amount deferred by the employee is 25 percent greater than the amount the employee otherwise could have received absent the addition of the substantial risk of forfeiture, the combined deferred amount of salary plus the deferred amount of the employer's matching contribution is subject to a substantial risk of forfeiture for purposes of section 409A until December 31, 2017.

C. Exemption from User Fee for Small Employer Benefit Plans. Effective January 1, 2017, the Internal Revenue Service (IRS) is providing an exemption from a user fee for some small employer benefit plans seeking a determination letter about their qualified status. In Notice 2017-1, the agency in late December 2016 said that to simplify eligibility for user-fee exemptions, an application for a determination letter related to a pension, profit-sharing, stock bonus, annuity, or employee stock ownership plan (ESOP) maintained by a small employer will be treated as being filed within a qualifying open remedial amendment period if the plan didn't exist before January 1 of the 10th calendar year before the year in which the application is filed. Small-employer plans are defined by the IRS in the notice as having no more than 100 employees. In the past, the Code's user-fee exemption did not apply if the letter request was made after the last day of the fifth plan year of the plan's existence, or after the end of any qualifying open remedial amendment period.

D. Use of Forfeitures to Fund Safe Harbor Contributions. On January 18, 2017, the IRS issued proposed regulations that permit forfeitures to be used to fund safe harbor contributions, QNECs, and QMACs. This guidance reverses the IRS's relatively recent interpretation of statutory language to require that such contributions be nonforfeitable at the time they are contributed to a plan. Many plan sponsors and administrators faced challenges when working with plans in which forfeitures existed, but which only intended to fund safe harbor contributions. This was particularly problematic for plans attempting to use the top-heavy exemption. Plans are exempt from the top-heavy rules if they consist solely of deferrals and safe harbor contributions. If any forfeitures are reallocated to participants (rather than reduce the safe harbor contribution) then the top-heavy exemption is lost. This proposed regulation would allow the forfeitures to be used to reduce the safe harbor contribution thereby allowing the plan to continue to be exempt from the top-heavy rules. The proposed regulations will amend Treas. Reg. §1.401(k)-6 to provide that QNECs and QMACs, and by extension safe harbor contributions, must be nonforfeitable when they are allocated to participant accounts, rather than at the time they are contributed to the plan. The proposed regulations also coordinate the definition of QNECs and QMACs to provide a consistent definition throughout the regulations.

E. 5-Year Rule Applies to IRA Distribution after Beneficiary Change. The IRS ruled in LTR 201706004 that following a court order approving the change of the beneficiary designation on a decedent's IRA from a trust to the surviving spouse, the IRA will not be an inherited IRA, there won't be a "designated beneficiary," and the entire interest in the IRA must be distributed using the five-year rule under section 401(a)(9)(B)(ii). The IRS' conclusion was based on a determination that a court order cannot create a "designated beneficiary" for purposes of Section 401(a)(9) because the surviving spouse was not the designated beneficiary of the IRA as of the date of the decedent's death. Accordingly, there is no "designated beneficiary" of the IRA for purposes of Section 401(a)(9). The look through rule applicable to trusts apparently did not apply in this situation. The beneficiary forms on file with the IRA custodian provided that the pay on death beneficiary for the IRA was an inter vivos trust created by the decedent. However, there was no evidence that the decedent created the trust. The IRA custodian did not keep a copy of the trust in its file when it accepted the decedent's beneficiary designation. The surviving spouse looked through the decedent's records but was unable to find any evidence that a trust had been created.

F. Easier Option for Substantiating Hardship Withdrawals. On February 23, 2017, the IRS issued a memorandum to its employee plan examiners setting forth substantiation requirements for 401(k) plan safe-harbor hardship distributions. The memorandum describes alternative (and less burdensome) ways that a plan administrator can demonstrate that a hardship distribution is "deemed to be on account of an immediate and heavy financial need." This memorandum is also pertinent to employers maintaining 403(b) tax-sheltered annuities and similar types of defined contribution plans permitting hardship withdrawals. Rather than retaining source documents, a plan administrator may retain a summary of information contained in source documents. To rely on such a summary, the employee obtaining a hardship distribution must be provided a notice containing information specified in the IRS memorandum, such as the tax consequences of a hardship distribution and the participant's obligation to preserve source documents relating to the hardship. All summaries must include general information about the hardship distribution, including the participant's name, total cost of the event causing hardship, amount requested and a participant certification that the information provided is true and accurate. In addition, each summary must include basic information specific to the type of hardship distribution. For example, a summary for a hardship distribution for funeral and burial expenses must include the name of the deceased, the relationship to the participant, date of death, and the name and address of the service provider (i.e., cemetery or funeral home).

G. Changes to IRS Employee Plan & Exempt Organization Exam Documentation Request Procedures. New procedures announced in the February 27, 2017, "Memorandum for all TE/GE Examiners On New Process for all Information Document Requests" (h_ps://www.irs.gov/pub/foia/ig/spder/tege-04-1116-0028.pdf) and scheduled to take effect April 1, 2017, seek to expedite the examination process and reduce backlogs. To accomplish this, the new procedures impose specific, tightened timelines for responding to Information Document Requests. As a consequence of these changes, the new procedures shorten the time that the examiners will issue early subpoena warnings and subpoenas to compel taxpayers to produce requested data.

H. New DOL Fiduciary Rules. The U.S. Department of Labor ("DOL") new fiduciary rule defining investment advice became effective June 9, 2017 ("Fiduciary Rule"), as did the Best Interest Contract ("BIC") Exemption and other related exemptions. The DOL has issued a temporary enforcement policy ("FAB No. 2017-02") and a new set of Conflict of Interest FAQs (the "FAQs") that focus on the transition period, from June 9, 2017 to January 1, 2018. This action follows its April 7, 2017 final rule (the "Delay Rule") which delayed the applicability date by 60 days from April 10, 2017 to June 9, 2017.

1. As a result, June 9th is the date on which persons who provide investment advice (including rollover advice) for a fee or other compensation (direct or indirect) will be deemed to be fiduciaries under the Fiduciary Rule. During the shortened transition period (June 9, 2017 to January 1, 2018), financial institutions wishing to rely on the BIC Exemption, the Class Exemption for Principal Transactions or Prohibited Transaction Exemption 84-24 in order to receive variable compensation

related to the advice they give, need only comply with the respective Impartial Conduct Standards ("ICS") in these exemptions.

2. For the BIC Exemption, the ICS consists of three component standards: (i) receiving no more than reasonable compensation, (ii) refraining from making materially misleading statements, and (iii) providing advice in accordance with the best interest standard of care. The best interest standard has two chief components: prudence and loyalty. The FAQs state that under the prudence standard, advice given must meet a professional standard of care as set forth in the BIC Exemption, and that "under the loyalty standard, the advice must be based on the interests of the customer, rather than the competing financial interest of the adviser or the firm."

3. June 9th is also the date on which the definition of investment education under DOL Interpretive Bulletin 96-1 ("IB 96-1") is no longer applicable. While the "safe harbor" in IB 96-1 covers participant education only, investment education under the Fiduciary Rule includes investment education delivered to plan sponsors and IRA owners as well. Asset allocation models and interactive materials must not recommend or reference a specific investment option, unless they are being provided to a defined contribution plan with investment options that are subject to oversight by a plan fiduciary. Additionally, investment options with similar return-risk characteristics must be identified, and a statement must be provided explaining how more information can be obtained on investment options.

4. The FAQs provide additional information on DOL and IRS enforcement during the June 9, 2017, to January 1, 2018, transition period. FAB No. 2017-02 provides that during the transition period the DOL will not pursue claims (and the IRS will not assess the excise tax) against fiduciaries who are working diligently and in good faith to comply with the Fiduciary Rule and related exemptions.

5. On August 9, 2017, the Department of Labor (“DOL”) announced that it is submitting for interagency review a proposed 18-month extension, to July 1, 2019, of the transition period and delay of applicability dates for the best interest contract exemption, the principal transactions exemption, and PTE 84-24. It did this in a notice of administrative action in *Thrivent Financial for Lutherans v. Acosta*, Case No. 16-cv-03289-SRN-DTS (“Thrivent”). While not certain, the filing means that the 18-month extension of the transition period is likely.

I. Court Upholds Controversial IRA-DISC Transaction. In *Summa Holdings Inc. v. Commissioner*, No. 16-1712, the Sixth Circuit reversed the Tax Court's finding that the transactions should be recharacterized because they had been used to avoid the income limits on Roth IRA contributions. In *Summa*, a family used a DISC to transfer money from their family-owned company to two Roth IRAs owned by their sons. DISCs were designed by Congress to encourage companies to export goods by deferring and lowering taxes on export income. Export companies can avoid corporate income tax by paying commissions to a DISC, which pays no tax on the commission income. Money can exit the DISC as dividends to shareholders. The court said that a DISC's shareholders are often the same individuals who own the export company. "In

those cases, the net effect of the DISC is to transfer export revenue to the export company's shareholders as a dividend without taxing it first as corporate income," according to the court. In this case, *Summa* paid commissions to a DISC, which distributed the money as a dividend to a holding company that was the DISC's sole shareholder. The holding company then distributed dividends to its two shareholders, which were two Roth IRAs. The IRS issued a notice of deficiency for tax year 2008 and used the substance-over-form doctrine to reclassify the commission payments as dividends. *Summa* was required to pay income tax on the DISC commissions it had deducted. The agency also found that each Roth IRA had received a contribution of over $1 million and that because both sons had made over $500,000 in 2008, they were not eligible to contribute to their Roth IRAs. The Tax Court upheld the commissioner's determinations. The circuit court reversed, finding that transactions at issue in this case are expressly authorized by the Code.

J. Definitely Determinable Cash Balance Plan Benefit Formulas. On April 7, 2017, the IRS issued a memorandum providing guidance to EP staff reviewing benefit formulas in cash balance defined benefit plans. In general, a qualified plan "within the meaning of section 401(a) is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement." § 1.401-1(b)(1)(i), Income Tax Regulations. According to the IRS Memo, a cash balance plan formula based on partial compensation, such as a special bonus or compensation for a specific month (e.g., March), is definitely determinable regardless of the employer's inherent ability to determine an employee's "special bonus" or "March pay" outside the terms of the plan. On the other hand, if the terms of the plan specifically allow the employer to vary the employee's compensation used in the benefit formula (e.g., an employee's annual compensation less an amount designated by the employer"), the plan would violate the definitely determinable rule.

K. S Corporation Denied Deduction for Amount Payable to ESOP Participants. In *Petersen, Steven M. et ux. et al. v. Commissioner* (148 T.C. No. 22), the Tax Court concluded that an S corporation and its employees who participate in an employee stock ownership plan (ESOP) are considered to be related parties, meaning that, an accrual basis S corporation could only deduct amounts payable to those employees in the year the amounts were actually paid. Tax rules generally prevent related parties that utilize different methods of accounting from capitalizing on that difference to accelerate deductions while deferring income. In particular, Section 267(a)(2) defers deductions for amounts paid to a related party until the year in which the payment is includable in the related party's income. The key to the case was whether an ESOP is considered a trust for purposes of these related party rules. Under constructive ownership rules, beneficiaries of a trust are considered to directly own their proportionate share of assets owned by a trust. Therefore, to the extent an ESOP is considered to be a trust, its participants would be considered direct owners of the S corporation, which would in turn invoke the expense deferral the IRS sought. The court concluded that an ESOP is a trust for this purpose and ruled in favor of the IRS.

L. Deferred Compensation Plan Failed Section 409A. In ILM 201725027, the IRS concluded that a deferred compensation plan failed to satisfy the requirements

of Section 409A because payments were triggered by a service provider's employees separating from service, the plan did not satisfy the back-to-back arrangement exception, and the plan failed to make payments in accordance with plan requirements. Under Section 409A(a)(1)(A), if election timing, distributions, and funding requirements are not met, amounts deferred under a nonqualified deferred compensation plan for the current tax year and all prior tax years are currently includable in income to the extent not subject to a substantial risk of forfeiture. Section 409A(a)(2) provides that compensation deferred under a plan may not be distributed earlier than death, disability, separation from service, a fixed date in the plan, or as prescribed by regulation. According to the IRS, a payment to a service provider cannot be triggered by the separation from service of another service provider, such as the payments triggered from the foreign corporation to the entity when the entity's employee separates from service. An exception in Treas. Reg. section 1.409A-3(i)(6) for back-to-back arrangements does allow the payment, but the amount of the payment from the foreign corporation to the entity may not exceed the amount paid by the entity to the separating employee, the IRS said. The IRS determined that the requirements of Treas. Reg. Section 1.409A-3(i)(6) are not met because the agreement between the foreign corporation and the entity allows payments that could exceed the amount paid by the entity to its employee. The plan fails to satisfy the requirements of section 409A, the IRS concluded. The IRS also determined that the plan between the entity and the foreign corporation failed to satisfy the requirements of Section 409A(a) because it was not operated in accordance with the requirements of Section 409(a)(2)(A). Payments under the plan were not made at the time and in the amount specified by the plan.

M. Preapproved Plan Letter Process Streamlined, Deadline Extended. On June 30, 2017, the IRS provided two of the three required pieces of guidance for preapproved plan opinion letters, streamlined the process for requesting those letters, and delayed the beginning of the submission cycle until October. Rev. Proc. 2017-41, 2017-29 IRB 1, provides further adjustments and clarifications to the determination letter program as it stands for preapproved plans following amendments to the program in Rev. Proc. 2015-36, 2015-25 IRB 1234, and Rev. Proc. 2016-37, 2016-29 IRB 136. The new revenue procedure removes the differences between master and prototype plans and volume submitter plans and combines them into a single preapproved plan. Instead, it distinguishes only between standardized plans and nonstandardized plans, and between plans with and without adoption agreements. The IRS has stopped issuing determination letters for most amendments to individually designed plans. While the submission cycle for preapproved plans was scheduled to begin in August, Rev. Proc. 2017-41 delays the next cycle's beginning until October. Rev. Proc. 2017-41 was accompanied by an updated cumulative amendments list (Notice 2017-37, 2017-29 IRB 1). The new list adds guidance regarding changes following the decision in *Obergefell v. Hodges*, 135 S.Ct. 2584 (2015); normal retirement age regulations published last year; guidance permitting midyear changes to safe harbor section 401(k) plans; proposed regulations on qualified nonelective contributions and qualified matching contributions, released January 18; and an amendment to section 408(p)(1)(B) in the tax extenders bill enacted late in 2015. The IRS released the list (Notice 2016-80, 2016-52 IRB 1) of required amendments for individually designed plans in December. The third piece that plan sponsors need is a list containing IRS sample language. The new revenue procedure allows for preapproved plans that combine employee stock ownership plans

with section 401(k) plans and allow some cash balance plans to use an actual rate of return. It also has a new fee structure, charging $16,000 for a plan document with one adoption agreement and $11,000 for each additional adoption agreement, or $28,000 for a single plan document with no adoption agreements.

N. Church Plans. On June 5, 2017, the Supreme Court unanimously held in favor of three religiously-affiliated hospitals, each of which claim the church plan exemption from the Employee Retirement Income Security Act of 1974 (ERISA). In *Advocate Health Care Network v. Stapleton*, No. 16–74, 817 F. 3d 517; No. 16–86, 810 F. 3d 175; and No. 16–258, 830 F. 3d 900, reversed, the Supreme Court ruled that ERISA's definition of "church plan" extends to a plan maintained by a church-related entity—referred to by the Court as a "principal-purpose organization"—regardless of who established the plan. The ruling put to rest the question of whether a church plan must be established by a church in order to be exempt from ERISA and provides welcome relief to many church plan sponsors. Nonetheless, the Supreme Court's decision did not rule on two significant issues that remain to be decided by the lower courts: first, whether the hospitals are sufficiently "associated with" their respective churches to claim church plan status, and second, whether the hospitals' internal benefits committees or boards qualify as "principal-purpose organizations" within the meaning of the ERISA church plan exemption.

O. Suspension-of-Benefits Application. The IRS has revised (Rev. Proc. 2017-43) the procedures (Rev. Proc. 2016-27) to apply for a suspension of benefits under a multiemployer defined benefit pension plan that is in critical and declining status under section 432(e)(9). Rev. Proc. 2016-27 was issued in conjunction with final regs (T.D. 9765) on the suspension of benefits under multiemployer pension plans that are projected to have insufficient funds at some point to pay the full benefits to which individuals will be entitled under the plans. The final regs also provided guidance on the administration of a vote by pension plan participants on the suspension of benefits. Rev. Proc. 2016-27 (which replaced Rev. Proc. 2015-34) explained how a multi-employer defined benefit pension plan in critical and declining status may apply for approval of a proposed suspension of benefits. The guidance also provided a model notice that a plan sponsor proposing a benefit suspension could use to satisfy the content and readability requirements of section 432(e)(9)(F)(ii) and (iii)(II). Rev. Proc. 2017-43 supersedes Rev. Proc. 2016-27 and applies to submissions made on or after September 1, 2017. Therefore, plan sponsors should follow the application process prescribed in the new revenue procedure for an application for approval of a proposed benefit suspension submitted on or after that date.

P. TE/GE Memo on Maximum Qualified Plan Loan Amount. The IRS Tax-Exempt and Government Entities division has revised (TEGE-04-0717-0020) a prior memorandum (TEGE-04-0417-0016) that provided guidelines for employee plans examinations employees on determining the amount available for a loan under section 72(p)(2) when the participant has received multiple loans from a qualified plan during the past year. In general, IRC § 72(p)(1) provides that a loan from a plan will be treated as a distribution to the participant. IRC § 72(p)(2)(A) excepts a loan that when added to the outstanding balance of all loans, does not exceed the lesser of:

(1) $50,000, reduced by any excess of:

(A) the highest outstanding balance of loans during the 1-year period ending on the day before the date on which such loan was made, over

(B) the outstanding balance of loans on the date on which such loan was made; or

(2) the greater of:

(A) half of the present value of the vested accrued benefit, or

(B) $10,000.

Under IRC § 72(p)(2)(A)(i), if the initial loan is less than $50,000, the participant generally may borrow another loan within a year if the aggregate amount does not exceed $50,000. The $50,000 is reduced by any outstanding loan balance, and then again reduced by the excess of the highest outstanding balance of loans during the 1-year period ending the day before the second loan is made, over the outstanding balance on the date of the second loan. The discussion above assumes that to meet other IRC § 72(p)(2) requirements, the participant has a vested accrued benefit of more than $100,000, and the loan is repayable in 5 years and requires substantially level amortization. For example, a participant borrowed $30,000 in February which was fully repaid in April, and $20,000 in May which was fully repaid in July, before applying for a third loan in December. The plan may determine that no further loan would be available, since $30,000 + $20,000 = $50,000. Alternatively, the plan may identify "the highest outstanding balance" as $30,000, and permit the third loan in the amount of $20,000.

Q. Treasury Announces Steps to Wind Down myRA Program. The U.S. Department of the Treasury announced on July 28, 2017, that it will begin to wind down the myRA program after a thorough review by Treasury that found it not to be cost effective. According to Treasury, demand for and investment in the myRA program has been extremely low, and American taxpayers have paid nearly $70 million to manage the program since 2014. Former President Barack Obama first proposed the myRA (for "my retirement account") program as a way for small savers to accumulate up to $15,000 (interest on which would be tax-free). The sums could then be transferred into a private-sector Roth IRA. Treasury in 2015 noted a 2015 Federal Reserve report that found 31 percent of non-retired Americans had no retirement savings or pension.

R. Bifurcated Distribution Options. The IRS has issued guidance in Notice 2017-44 providing model amendments that a sponsor of a qualified defined benefit plan may use to amend its plan document to offer bifurcated benefit distribution options to participants in accordance with final regulations (T.D. 9783) under Section 417(e) that were issued in September 2016. To facilitate the payment of benefits partly in the form of an annuity and partly as a single sum (or other accelerated form), Treasury and the IRS amended the Section 417(e) rules to allow plans to simplify the calculation of the amount of some optional forms of benefit. The final regulations provide two acceptable

bifurcation methods — explicit and implicit — that a plan sponsor may choose to include in plan terms. The appendix to Notice 2017-44 provides model language that may be used for each of the bifurcation methods, as applicable to the plan. The model language provides for the payment of the minimum amounts required to be paid to comply with the applicable rules under Section 417(e). A plan may provide for amounts that exceed those minimum amounts, but the treatment specified in the guidance does not apply to a plan amendment that differs from the model language to provide greater amounts. Plan sponsors may but are not required to use the model language in Notice 2017-44. Adoption of a plan amendment incorporating the language in either of the model amendments in the notice won't cause a plan to violate the requirements of Section 417(e) and the applicable rules under that section. Such a plan amendment that is adopted before January 1, 2018, is eligible for the limited relief from the application of the anti-cutback provisions of section 411(d)(6). A plan sponsor that currently provides for bifurcated distributions under plan terms that comply with the applicable provisions of Section 417(e), regarding implicit or explicit bifurcation, does not need to amend those plan terms. In addition, use of the model language by an employer that has adopted a preapproved plan will not cause the plan to fail to be identical to the preapproved plan. The guidance specifies some conditions that must be met, permitted modifications to the model amendments, and permitted plan designs using the model amendments.

S. IRS Extends Temporary Nondiscrimination Relief. The IRS has issued Notice 2017-45 extending temporary nondiscrimination relief for closed defined benefit plans by making the relief available for plan years beginning before 2019 if specified conditions are satisfied. Notice 2014-5 allows some employers that sponsor a closed defined benefit plan and a defined contribution plan to demonstrate that the aggregated plans comply with the nondiscrimination requirements of Section 401(a)(4) on the basis of equivalent benefits, even if the aggregated plans do not meet the current eligibility conditions for testing on that basis. Notice 2015-28 and Notice 2016-57 extended the temporary nondiscrimination relief provided in Notice 2014-5 by applying that relief to plan years beginning before 2018 if the conditions of Notice 2014-5 are met. Proposed regulations published in January 2016 provide relief for closed plans under the Section 401(a)(4) regulations and include other proposed nondiscrimination rules (REG-125761-14). The proposed regulations provide that taxpayers are allowed to apply some provisions of those regulations (including all of the provisions that apply specifically to closed plans) for specified plan years beginning before the proposed applicability date. The IRS and Treasury anticipate that the final regulations will include many significant changes in response to comments on the proposed regulations and will not be published in time for plan sponsors to make plan design decisions before expiration of the relief provided under Notice 2014-5 (as last extended by Notice 2016-57). Accordingly, the relief provided under Notice 2014-5 is extended for another year. Also, the final regulations are expected to provide that the reliance granted in the preamble to the proposed regulations may be applied for plan years beginning before 2019.

T. Cure Period Rules for Missed Plan Loan Installment Payments. In legal memorandum ILM 201736022, the IRS discussed two situations in which the cure period in Treas. Reg. §1.72(p)-1, Q&A-10, applies and prevents missed installment payments to a retirement plan loan from causing a deemed distribution. Section

72(p)(1) provides that a retirement plan participant that receives a direct or indirect loan from a qualified employer plan is treated as receiving a distribution from the plan equal to the amount of the loan. Section 72(p)(2) provides an exception to the rule in section 72(p)(1) that includes among its requirements that the loan be repaid within five years, include substantially level amortization over the loan term, and have at least quarterly payments. The IRS said that failure to make any installment payment violates the level amortization requirement but that Treas. Reg. §1.72(p)-1, Q&A-10, permits a plan administrator to allow a cure period up to the last day of the calendar quarter following the calendar quarter that the missed installment payment was due. Using a fact pattern to explain how the cure prior rules work, the IRS said that installment payments missed on March 31, 2019, and April 30, 2019, followed by normal installment payments made May 31, 2019, and June 30, 2019, will satisfy the cure period rules. The cure period for the missed March payment ends June 30, 2019, but is cured by the May 31, 2019, payment. Likewise, the cure period for the missed April installment payment is cured by the June 30, 2019, payment, the IRS said. According to the IRS, the regulations treat the May and June installment payments as missed because they were applied to earlier missed installment payments. The fact pattern also provides that the participant made an installment payment equal to three installment payments on July 31, 2019, which cures the deemed missed May and June payments and satisfies the July installment payment. The IRS used a second fact pattern to explain how a participant can refinance a loan to cure missed installment payments. According to the IRS, a participant that missed installment payments on October 31, 2019, November 30, 2019, and December 31, 2019, must cure the missed payments by March 31, 2020, because the missed payments occur in the same calendar quarter. Treas. Reg. §1.72(p)-1, Q&A-20, permits participants to refinance outstanding loans. The entire outstanding loan balance, including the missed payments, will be paid off and replaced by another loan if the participant in the fact pattern refinances the loan before the end of the cure period. According to the IRS, the level amortization requirement in Section 72(p)(2)(C) is not violated in either fact pattern and no deemed distribution under Section 72(p)(1) occurs.

U. IRS Finalizes New Mortality Table Rules for Pension Plans. The IRS and Treasury issued final regulations and other guidance on the mortality tables that apply to defined benefit plans for the purpose of minimum funding, lump-sum and other accelerated distribution options, and related calculations. 82 Fed. Reg. 46388 (Oct. 5, 2017), Notice 2017-60, Rev. Proc. 2017-55. This guidance brings to a close the contentious process to update the pension plan mortality tables for 2018, which involved a significant amount of back-and-forth between Treasury and the actuarial and plan sponsor community. The update in the tables was dictated by the Pension Protection Act of 2006, which requires Treasury to update these tables at least every ten years to reflect pension plan experience and projected trends in experience. The last update was effective for 2008. As was expected, the new mortality table generally reflects lower mortality rates than the existing table, which will generally increase the present value of plan liabilities and the minimum funding requirements for many plans. Most significantly, the effective date of the new mortality table rules was not postponed and the rules will generally become effective beginning in 2018.

V. Missing Participants and Beneficiaries and Required Minimum Distributions. The IRS has issued a Memorandum to its Employee Plans Exams

Employees (Control Number: TE/GE-04-1017-0033, dated October 19, 2017) providing that, for purposes of IRC § 401(a)(9), EP examiners shall not challenge a qualified plan for violation of the RMD standards for the failure to commence or make a distribution to a participant or beneficiary to whom a payment is due, if the plan has taken the following steps:

1. Searched plan and related plan, sponsor, and publicly-available records or directories for alternative contact information;

2. Used any of the search methods below:

   a. a commercial locator service;
   b. a credit reporting agency; or
   c. a proprietary internet search tool for locating individuals; and

3. Attempted contact via United States Postal Service (USPS) certified mail to the last known mailing address and through appropriate means for any address or contact information (including email addresses and telephone numbers).

IV. HEALTH CARE

A. 2017 Tax Inflation Adjustments.

	2016	2017
High Deductible Plans, Health Savings Accounts and FSA Limits		
High Deductible Health Plan Limits		
Annual Deductible – Minimum	$1,300/$2,600	$1,300/$2,600
Out-of-Pocket Expenses (HSA) – Maximum	$6,550/$13,100	$6,550/$13,100
Out-of-Pocket Expenses (ACA) – Maximum	$6,850/$13,700	$7,150/$14,300
HSA Contribution Limit – Individual/Family	$3,350/$6,750	$3,400/$6,750
HSA Contribution Catch-Up	$1,000	$1,000
FSA (Flexible Spending Account)	$2,550	$2,600
Small Employer Health Insurance Credit Phase-out Level:	$25,900	$26,200

B. Expanded HRAs for Small Businesses.

1. On December 13, 2016, the President signed into law the 21st Century Cures Act. The law addresses a number of health care issues such as streamlining the process for FDA approval of drugs and medical devices, addressing treatment for mental health, substance abuse and eating disorders, and providing funding for the National Institutes of Health.

2. The 21st Century Cures Act also includes amendments to the Affordable Care Act and Internal Revenue Code to permit stand-alone health reimbursement arrangements (HRAs) for small employers. Small employers who do not wish to offer their own health plan to employees can now provide employees a pre-tax subsidy of individual health insurance premiums by establishing a Qualified Small Employer Health Reimbursement Arrangement (QSEHRA) beginning on or after January 1, 2017.

3. Guidance interpreting the Affordable Care Act has taken the position that the ACA prohibits employers from adopting stand-alone HRAs for employee medical coverage because they are employer health plans that do not comply with the ACA requirements regarding annual and lifetime coverage limits. Under this guidance, an employer HRA program is permitted only if it is integrated with another health plan sponsored by the employer that complies with these requirements, or if it meets another exception (such as covering only retirees or covering only excepted benefits such as dental and vision). Violating these requirements could subject an employer to an excise tax of $100 per day for each participant under Section 4980D of the Internal Revenue Code.

4. The 21st Century Cures Act excludes a Qualified Small Employer HRA from these requirements. A Qualified Small Employer HRA must meet a number of requirements. These are:

a. It can only be offered by small employers. To qualify, the employer must not be an “applicable large employer” which is defined in Section 4908H(c)(2) of the Internal Revenue Code as an employer who employed an average of at least 50 full-time employees on business days during the preceding calendar year.

b. It can only be offered by small employers who do not offer any group health plan to any employees.

c. The program must be provided on the same terms to all eligible employees. Differences are permitted based on the cost of an employee’s individual health insurance coverage which may vary based on factors such as age or the number of family members covered.

d. The program must be solely employer funded. No employee salary reduction contributions (including pre-tax cafeteria plan deductions) are permitted. The employee must pay for additional costs for the individual health insurance coverage outside the program.

e. The program must be limited to qualifying health expenses described in section 213(d) of the code for the employee and eligible family members.

f. The benefits available under the program cannot exceed $4,950 per year for single employees and $10,000 for family coverage. These limits are prorated for partial years of coverage and include cost of living adjustments after 2016.

5. The program is permitted to exclude from coverage:

a. Part-time and seasonal employees;

b. New employees with less than 90 days of service;

c. Employees younger than age 25;

d. Union employees; and

e. Non-resident aliens.

6. There are a number of reporting and disclosure requirements that apply to a Qualified Small Employer HRA. These include:

a. The employer must provide a notification to each eligible employee no later than 90 days prior to the beginning of each year (or for employees not eligible, the date they first become eligible). This notice must include:

i. A statement of the amount available from the HRA for the year.

ii. A statement that the eligible employee must disclose that amount to any exchange from which they are receiving coverage. (Premium credits may be impacted by amounts provided by the HRA).

iii. A statement that an employee not covered by minimum essential coverage may be subject to tax.

b. The employer must include the HRA benefits in the W-2 reporting of health benefits after December 31, 2016.

7. The new law also provides an exemption from COBRA for Qualified Small Employer HRAs. These programs will not be subject to the COBRA notice requirements or the extension of coverage after the employee's coverage would end.

8. Small employers adopting a Qualified Small Employer HRA need to be sure to document their compliance with these requirements and the other requirements that apply generally to HRA programs. Employers should formally adopt plan documents addressing these requirements and not run the program informally through premium reimbursements made outside a formal plan or through incomplete descriptions of the program in employee handbooks or other employment policies.

C. DOL's Final Rules for Disability Claims Procedures. On December 19, 2016, the U.S. Department of Labor (DOL) issued final rules revising the claims procedures for ERISA plans that make disability determinations affecting plan benefits. The DOL noted that nearly two-thirds of all ERISA litigation involves claims under long-

term disability plans, and the final rules are intended to improve the "full and fair review" of disability claims under ERISA § 503 and ERISA Reg. § 2560.503-1 by expanding the procedural requirements. The final rules generally make the disability claims procedures more consistent with the procedures for group health plans as modified by the Affordable Care Act (ACA), although the unique timelines for disability procedures remain intact, there is no fraud or material misrepresentation exception for a rescission of disability coverage, and there is no requirement for an external review process. If the ACA is repeal or replaced, the claims procedures for group health plans may become less comprehensive than the disability claims procedures which may not be affected by ACA repeal or replacement. The new disability claims procedures become effective for disability claims filed on or after January 1, 2018. This effective date is not affected by the plan year, so a plan with a plan year that runs from July 1st to June 30th still has to comply with these requirements on January 1, 2018. On that date, the existing disclosure requirement for internal criteria relied upon in making an adverse benefit determination (or a statement that it doesn't exist) will also become automatic, and the plan can no longer indicate it will provide the criteria upon request. In order for the new rules to apply, both of the following must be true: (i) the plan must make disability determinations affecting plan benefits; and (ii) the plan must be subject to ERISA's claims procedures. For example, it seems obvious that disability plans make disability benefit determinations, but not all disability plans are subject to ERISA's claims procedures. Unless funded or fully-insured, many short-term disability (STD) plans qualify for ERISA's payroll practices exception under ERISA Reg. § 2510.3-1(b) and are exempt from ERISA's claims procedures.

D. IRS Issues Warning on Tax Treatment of Wellness Program Rewards. In IRS Chief Council Advice Memorandum 201622031, the IRS addresses the tax treatment of three different situations in which wellness benefits result in taxable income to employees.

1. Situation 1. The employer provides health coverage, with a separate no-cost wellness program that provides health screenings and other services that generally qualify as a tax-favored accident and health plan under Internal Revenue Code (Code) Section 106. Employees that participate in the wellness program may also earn cash rewards and other benefits that do not qualify as Section 213(d) medical expenses, such as gym memberships. Those cash rewards are taxable income to the employee and subject to income tax withholding and employment taxes. Similarly, benefits not otherwise excludible from income, such as the payment of gym membership fees, are included in employee's gross income at fair market value and are also subject to income tax withholding and employment taxes.

2. Situation 2. The same as situation 1, except that to participate in the wellness program, employees pay pre-tax premiums through a Section 125 cafeteria plan. According to the CCA, the use of the cafeteria plan makes no difference as to the tax treatment of cash rewards and other benefits not excludible from income. They are taxable income subject to income tax withholding and employment taxes.

3. Situation 3. The same as situation 2, but with the added wrinkle that the wellness program benefits include reimbursement of the wellness program

premiums made by the employee. The IRS found the reimbursements should be included in the employee's gross income and be subject to income tax withholding and employment taxes.

4. Prior Guidance. The IRS reviewed similar wellness plan arrangements in IRS Chief Council Advice Memorandum 201703013. In that CCA, the IRS addressed the tax treatment of fixed indemnity cash payments paid by a wellness plan without regard to the amount of medical expenses incurred by the employee, where the employee is paying premiums to participate in the wellness program. Fixed-indemnity plans pay a flat (fixed) dollar amount when certain health-related events occur, regardless of the amount of medical expenses incurred. If the premiums are paid on a pre-tax basis through a Section 125 cafeteria plan, any amounts paid by the plan are included in the employee's gross income and subject to income tax withholding and employment taxes.

E. SPD and Trust Agreement Constitute ERISA Plan. In *Mull v. Motion Picture Indus. Health Plan*, (9th Cir. Aug. 1, 2017), the US Court of Appeals for the Ninth Circuit vacated a district court decision ruling that an ERISA health plan was not entitled to reimbursement for payments it made on behalf of a covered dependent who was injured in a car accident. The district court concluded that the plan's reimbursement provision was not legally enforceable under ERISA because it was found only in the SPD and not in any document that constituted an ERISA plan. As a result, the district court enjoined the plan from enforcing the reimbursement provision and directed the plan to reimburse the participant for approximately $1,900 in benefits it had already recouped. On appeal, a three-member panel of the Ninth Circuit concluded that the district court erred in determining that the SPD was not part of the plan. The Ninth Circuit acknowledged that although the plan's trust agreement satisfied most of ERISA's requirements for a written plan document (29 U.S.C. § 1102(b)), it failed to specify the basis on which payments would be made to and from the plan. Instead, the trust agreement instructed that this provision would be specified in writing by a board resolution. In the Ninth Circuit's view, the board carried out the trust's directive by adopting the SPD, which detailed the basis for payments. The Ninth Circuit therefore concluded that the ERISA plan consisted of two documents: the trust agreement and the SPD. The court cited several SPD provisions reflecting the board's "clear design" to have the trust agreement and SPD together constitute the ERISA plan – including an SPD provision stating that the SPD constituted both the plan document and the SPD. The Ninth Circuit reasoned that its conclusion was not contrary to *CIGNA Corp. v. Amara*, 563 U.S. 421 (2011), in which the Supreme Court held that an SPD's terms, which were more favorable to participants than the terms of the written instrument, could not be enforced as the terms of the plan itself. The court noted that *Amara* addressed only circumstances where both a governing plan document and an SPD existed and the plan administrator attempted to enforce the SPD's terms over those of the plan document. However, *Amara* did not address a situation like this one where a plan administrator sought to enforce the SPD as the only formal plan document. As a result, the Ninth Circuit reasoned, an SPD may constitute a formal plan document (consistent with *Amara*) if it does not add to or contradict the terms of existing plan documents.

F. Trump Administration Rolls Back ACA Contraceptive Mandate. Tri-agency interim final rules issued October 6, 2017, greatly expand the availability of religious exemptions from the Affordable Care Act's (ACA) preventive services contraceptive coverage mandate for nongrandfathered plans. Additionally, a separate interim final rule says that certain entities and individuals can now claim exemption because of moral convictions. The interim rules — issued by the Departments of Health and Human Services, Treasury, and Labor — are effective immediately.

G. IRS Guidance on Health Care Reporting Requirements. The IRS has stated that it will not accept Forms 1040 for the 2017 tax year if the taxpayer does not report on the ACA's health coverage reporting requirements. This is the first year that the IRS has put in place system changes to its Form 1040 review process that would reject tax returns during processing in instances where the taxpayer does not provide this information.

V. ESTATE PLANNING

A. 2017 Tax Inflation Adjustments.

	2016	2017
Basic Exclusion Amount for Estates	$5,450,000	$5,490,000
Annual Exclusion for Gifts	$14,000	$14,000
Annual Exclusion of Gifts to Noncitizen Spouse	$148,000	$149,000
Threshold for Reportable Gifts from Foreign Corporations and Partnerships (Annual Reportable Gift from Nonresident Alien or Foreign Estate remains at $100,000)	$15,671	$15,797

B. Account Transcript May Substitute Estate Tax Closing Letter. The IRS has issued Notice 2017-12 providing that estates and their authorized representatives can request an account transcript in lieu of an estate tax closing letter to confirm that the IRS examination of an estate tax return has been completed and is closed. An estate tax closing letter from the IRS specifies the amount of the net estate tax, the state death tax credit or deduction, and any generation-skipping transfer tax for which the estate is liable. While not a formal closing agreement, an estate tax closing letter generally indicates that, for purposes of determining the estate tax liability of the decedent's estate, the IRS examination of the estate tax return is closed. Before June 1, 2015, the IRS generally issued an estate tax closing letter for every estate tax return filed. But for estate tax returns filed on or after that date, the IRS will issue an estate tax closing letter only at the request of an estate. Treasury and the IRS are aware that executors, local probate courts, state tax departments, and others have come to rely on estate tax closing letters for confirmation that the IRS examination of the estate tax return has been completed and the IRS file has been closed. Estate tax closing letters continue to be available on request, but an account transcript may substitute for an estate tax closing letter and is available at no charge. An account transcript provides current account data with transaction codes along with a description of those codes. An

account transcript that includes transaction code "421" and the explanation "Closed examination of tax return" indicates that the IRS's exam of an estate tax return is complete and closed. Thus, Notice 2017-12 provides that an account transcript showing a transaction code of "421" can serve as the functional equivalent of an estate tax closing letter. The guidance describes how and when to request an account transcript or an estate tax closing letter. The guidance provides that the IRS may reopen the examination of the estate tax return after the issuance of a closing letter or the entry of transaction code "421" on the account transcript to determine the estate tax liability of a decedent in a circumstance described in both the closing letter and Rev. Proc. 2005-32 or to determine the transfer tax liability of the surviving spouse of a decedent when portability has been elected.

C. Tax Consequences of Trust Modification. The IRS ruled in PLR-10420116 that trust modifications requested by an independent trustee due to unforeseen circumstances making it unduly burdensome for the grantors to pay tax on the trust's income will not cause the trust property to be included in the grantors' or beneficiaries' gross estates, and that the modifications will not cause a deemed transfer.

D. Phantom Stock Held by Partnership Receives Capital Gains Treatment. The Tax Court, in an unpublished order, held that phantom stock a widow inherited from her husband and transferred to a partnership was a capital asset and the partnership recognized long-term capital gain upon termination of the stock plan; the court held that the partnership's basis was the fair market value of the stock on the date of the widow's death. *Hurford Investments No. 2 Ltd. et al. v. Commissioner*, No. 23017-11.

E. Same-Sex Spouse Guidance Addresses Applicable Exclusion Amount. The IRS has provided guidance on the application of the *Windsor* decision and the holding of Rev. Rul. 2013-17 to the rules on the applicable exclusion amount under Sections 2010(c) and 2505 and the generation-skipping transfer tax (GSTT) exemption under Section 2631, as they relate to gifts, bequests, and generation-skipping transfers by (or to) same-sex spouses. In particular, Notice 2017-15 provides special administrative procedures allowing some taxpayers and the executors of their estates to recalculate the taxpayer's remaining applicable exclusion amount and remaining GSTT exemption to the extent an allocation of that exclusion or exemption was made to transfers made while the taxpayer was married to a person of the same sex. The guidance addresses the applicable exclusion amount applied to a transfer between spouses that did not qualify for the marital deduction for federal estate or gift tax purposes at the time of the transfer because of the Defense of Marriage Act, noting that taxpayers will be permitted to establish the transfer's qualification for the marital deduction and to recover the applicable exclusion amount previously applied on a return because of the transfer. The taxpayers may take the action even if the limitations period applicable to that return for the assessment of tax or for claiming a credit or refund of tax under Section 6501 or Section 6511 has expired. In the interest of providing certainty and to ease the administrative burden on both the taxpayer and IRS, a taxpayer must recalculate the remaining applicable exclusion amount on a Form 709 (preferably, the first Form 709 required to be filed by the taxpayer after the issuance of Notice 2017-15), an amended Form 709 (if the limitations period under section 6511

has not expired), or Form 706 for the taxpayer's estate if not reported on a Form 709. The taxpayer must also attach a statement supporting the claim for the marital deduction and detailing the recalculation of the remaining applicable exclusion amount as directed in forms and instructions issued by the IRS. However, if a qualified terminable interest property election or qualified domestic trust election is required to obtain the marital deduction, a separate request for relief must be submitted. The guidance also addresses a taxpayer's GSTT exemption that was allocated to transfers made before the recognition of same-sex marriages for federal tax purposes to or for the benefit of one or more persons in a same-sex marriage or any other persons whose generation assignment is determined under section 2651 with reference to a same-sex spouse. Some exemption allocations to transfers to persons now recognized to be non-skip persons as defined in section 2613(b) will be deemed void. Accordingly, taxpayers who made such a transfer will be permitted to recalculate the amount of their remaining GSTT exemption.

F. No Nontax Reason for FLP. In *Estate of Holliday v. Commissioner*, T.C. Memo. 2016-51, the Tax Court held that the full value of property transferred to a family limited partnership was properly includable in the decedent's estate because the decedent had a retained right in the property and there were no significant nontax reasons for making the transfer. An exception to Section 2036 is a transfer based on a bona fide sale for adequate consideration in money or money's worth. In the case of an FLP, the estate must also show a legitimate and significant nontax reason for creating the FLP. The estate argued the following significant nontax reasons for the creation of Oak Capital: to protect the assets from "trial attorney extortion"; to protect the assets from the "undue influence of caregivers"; and to preserve the assets for the benefit of the decedent's heirs. The IRS argued that the facts surrounding the creation of Oak Capital indicate that there were no significant nontax reasons for its creation and that the transfer was not an arm's-length transaction. The IRS contended that the claims of attorney extortion and risk of undue influence were invalid because decedent lived in a nursing home and had never been sued, and there was no evidence of undue influence by a caregiver. With the assistance of her adult children in managing her financial affairs, litigation risk was minimal. The IRS also argued that there was an implied agreement that decedent could access the assets if she wanted. The court agreed.

G. Estate Tax Lien Changes.

1. Section 6324 imposes an automatic lien on all assets of a decedent's gross estate that are reported on a Form 706, "United States Estate (and Generation-Skipping Transfer) Tax Return." The lien does not need to be recorded and becomes effective on the decedent's date of death. Practitioners can file Form 4422, "Application for Certificate Discharging Property Subject to Estate Tax Lien," to transfer assets subject to the estate tax lien before filing Form 706 and receiving a closing letter.

2. Requesting a lien release using Form 4422 used to be a routine process. Practitioners would file Form 4422 requesting the IRS to release the lien, and that request would typically be granted within 10 days. It is common practice for estates seeking to sell real property to provide a buyer's title company with the lien release so the property can pass free of the lien. In June 2016, practitioners began receiving letters

that imposed new conditions on the lien releases in response to Form 4422. The IRS is now requiring the entire net proceeds from the sale of the property to be deposited into an escrow account or into the estate's estate tax account with the IRS. Also, the IRS may not agree to release the escrowed sale proceeds until making a final determination of the estate tax. The new procedure allows the IRS to keep the proceeds until the Form 706 is filed, audited, and the estate is closed, which could take several years.

3. The IRS has now issued the following statement in response to questions about whether it will modify how estate tax lien releases are now processed: "In response to feedback from some practitioners on how estate tax lien discharge requests are being considered, the IRS is currently reviewing the estate tax lien discharge process and is considering suggestions made by practitioners. The IRS understands the concerns and continues to work closely with the practitioner community to arrive at an optimal approach that protects the government's interests without unduly burdening the taxpayer or tax professional. The IRS expects to complete this review soon."

4. On April 5, 2017, the IRS Small Business/Self-Employed Division issued interim guidance (SBSE-05-0417-0011) for specialty collection advisory and specialty examination estate and gift tax employees on processing applications requesting a discharge of the estate tax lien made after June 2016. Historically, the advisory group and the examination estate and gift group shared responsibility for processing applications requesting a discharge of the estate tax lien. In June 2016, responsibility for working all applications requesting a discharge of the estate tax lien was transferred to advisory and centralized in the estate tax lien group. The interim guidance was issued because the processing of requests for discharge of the estate tax lien, which are often necessary in order to sell real estate, has been moved from one department to another within the IRS and the new department was applying different criteria for granting discharges. Among other things, the guidance notes that in many instances, in determining whether to grant an estate tax lien discharge, the issue an agent will need to consider is not whether the estate tax liability has been paid, but whether it has been adequately provided for, meaning that the government's interest in collecting the estate tax is secured under Section 6325(c) and the accompanying Treasury Regulations.

H. Transfers to Limited Partnership Are Included in Decedent's Estate. In *Estate of Nancy H. Powell et al. v. Commissioner*; No. 24703-12; No. 24731-12; 148 T.C. No. 18, the Tax Court held that the value of cash and securities a decedent's son transferred to a limited partnership on her behalf shortly before her death in exchange for a 99 percent limited partner interest that was then transferred to a charitable lead annuity trust (CLAT) was included in her gross estate under section 2036(a)(2) or 2035(a). Nancy H. Powell's son, acting on her behalf, transferred $10 million in cash and securities from her revocable trust to a limited partnership in exchange for a 99 percent limited partner interest. The son, then acting under a power of attorney, assigned the 99 percent interest to a CLAT. On Powell's death the remaining assets in the CLAT were to be divided between two trusts for her sons. Powell died shortly after the transfers were made. The IRS determined estate and gift tax deficiencies against Powell's estate, maintaining that the value of the limited partner interest and the

remainder interests in the CLAT were undervalued for gift tax purposes and that her estate included the transferred assets or the limited partner interest because she retained rights to them. The estate petitioned the Tax Court for review, and both sides sought summary judgment. The Tax Court held that the value of cash and securities Powell transferred to the limited partnership was included in her estate because the transfer was subject to a right described in Section 2036(a)(2). The court found that she had a retained life estate because she could designate the persons who would possess or enjoy the property or the income from the property. According to the court, Powell's ability to dissolve the limited partnership along with her sons was a right to designate persons who could possess or enjoy the property. The court also concluded that the transfer was not a bona fide sale. Regarding the transfer of the decedent's limited partner interest to the CLAT, the court concluded that it was either void or revocable because her son didn't have authority to make the transfer in an amount that exceeded the federal gift tax exclusion. Further, the court found that the value of the limited partner interest was includable under section 2035(a) because it was made within three years of her death. The court then discussed the application of Section 2043 to limit the amount includable in the gross estate. The court concluded that when Section 2036(a)(2) or 2035(a) requires the inclusion of the value of assets transferred to an FLP in a decedent's gross estate, under Section 2043(a) the amount included must be reduced by the value of the partnership interest the decedent received. As stated by the court: “The illogic of including in the value of a decedent's gross estate both the assets transferred to a family limited partnership and the partnership interest received in return seems to have been widely recognized, but the precise legal grounds that prevent such illogical ‘double taxation’ have gone unarticulated,” the court said. “The present cases — relatively unique in that respondent challenges the validity of the gift by which decedent disposed of her interest in the family limited partnership — provide us the opportunity to fill that lacuna and explain why a double inclusion in a decedent's estate is not only illogical, it is not allowed.”

I. Simpler Portability Extension Procedure. Rev. Proc. 2017-34 provides a simpler method to obtain an extension of time to make a portability election. A portability election allows a deceased taxpayer to transfer any unused gift/estate tax exemption amount (the maximum is $5,490,000 in 2017) to their surviving spouse. Many estates are not required to file a Form 706 due to the value of the gross estate and adjusted taxable gifts being below the filing threshold. These estates may still file a 706 return in order to make the portability election. Before the new procedure, in order to make a portability election, the executor of the estate had to elect portability on a timely filed estate tax return which is due nine months after the date of death (unless they asked for the automatic six month extension). If you missed this filing date, you lost the ability to elect portability. The IRS later came out with a procedure to allow the executor to make a late election by filing for a Private Letter Ruling, but this was both time consuming and costly. Many estates still did file for a Private Letter Ruling which inundated the IRS with additional requests. This is part of the reason for the new Revenue Procedure. Rev. Proc. 2017-34 allows estates that would otherwise not have to file an estate return to get more time to make a portability election without requesting a Private Letter Ruling. Under the new revenue procedure, the executor of the estate must file an estate tax return by January 2, 2018, or the second anniversary of the decedent's death, whichever is later. The return must state at the top "Filed Pursuant to

Rev. Proc. 2017-34." By doing this the 706 return will be treated as timely filed and the election for the portability to be allowed. This simplified method is available as long as certain requirements are met: (i) the decedent must have a surviving spouse, (ii) the decedent must have died in 2011 or later, (iii) the decedent must have been a U.S. citizen at the date of death, and (iv) the estate must not have a requirement to file the Form 706 other than to make the portability election. If a Form 706 has already been timely filed without making the portability election, this new Revenue Procedure isn't available. However, estates that are not eligible for portability election relief may still be able to submit a private letter ruling (PLR) request. This new method is especially beneficial to smaller estates that may not have been aware of the benefits of the portability election; didn't realize they should have filed and missed the deadlines; or didn't want to pay the costs of a Private Letter Ruling request.

J. Gift to Foundation Not Self-Dealing. In LTR 201723005, the IRS ruled that a proposed gift to a private foundation through a revocable trust's transfer of nonvoting interests in a limited liability company, whose only asset is a promissory note from a disqualified person regarding the foundation, will not constitute self-dealing.

K. Section 2704 Proposed Regulations.

1. Key Provisions of Proposed Regulations. The proposed regulations, issued on August 4, 2016, could dramatically expand the scope of Section 2704, particularly as it applies to transfers of limited partnership interests, non-managing membership interests, and non-voting stock. REG-163113-02, 81 Fed. Reg. 51413-02 (Aug. 4, 2016). The key provisions of the extensive proposed regulations would, in part:

a. Extend Section 2704(a), dealing with lapses of rights to liquidate or vote, to transfers of partnership interests to an assignee, unless the transfer occurs three years or more before the transferor’s death;

b. Limit the use of limited partnership interests, non-managing membership interests, and nonvoting stock to generate valuation discounts, expanding the scope of Section 2704(b) and the rules on applicable restrictions by ignoring as a restriction imposed by state law only those made mandatory by state law, rather than those set as default rules under state law; and

c. Limit the use of limited partnership interests, non-managing membership interests, and nonvoting stock to generate valuation discounts, by adding a new category of disregarded restrictions that have the same tax effect as applicable restrictions, but that exceed certain restrictions delineated by the regulations.

2. Executive Order. In response to the President’s Executive Order of April 21, 2017, the Internal Revenue Service has issued Notice 2017-38, 2017, designating the Proposed Regulations under Section 2704 of the Internal Revenue Code as imposing an undue financial burden or adding undue complexity (or both).

3. Proposed IRS Budget. The proposed IRS budget, which would be reduced by $149 million from current law, is part of a much larger $20.23 billion appropriations bill. It came less than two months after President Trump signed into law the Consolidated Appropriations Act, 2017 (P.L. 115-31). That $1.1 trillion omnibus spending measure, which keeps the federal government operating through September 30, included $11.2 billion for the IRS. The bill doesn't just set funding levels for the IRS; it also includes several provisions to prohibit the use of funds for specific activities. While most of those prohibitions were carried over from previous appropriations bills, the new bill includes significant new prohibitions. Among the new provisions, the bill would prohibit the IRS from finalizing, implementing, or enforcing proposed estate tax valuation regulations.

4. Treasury Regulatory Reform Report. Treasury Secretary Steven Mnuchin issued a report on October 2, 2017, containing recommended actions to withdraw, partially revoke, or revise eight regulations identified by the Treasury Department for review under Executive Order 13789, which called for the identification of tax regulations that impose an undue burden on taxpayers. The report recommends that two proposed regulations be withdrawn entirely, three temporary or final regulations be partially revoked, and three regulations be substantially revised. In the regulations to be withdrawn entirely are included the proposed regulations under Section 2704.

5. Regulations Withdrawn. The IRS withdrew the proposed regulations as of October 20, 2017. FR Doc. 2017-22776 Filed: 10/17/2017 4:15 pm; Publication Date: 10/20/2017.

L. Federal Tax Liens Have Priority. In *United States v. Raelinn M. Spiekhout et a*l.; No. 1:15-cv-01097, a U.S. district court adopted a magistrate judge's report and recommendation and overruled an objection filed by the surviving spouse and personal representative of a decedent's estate, holding that federal tax liens have priority over other claims to the estate's assets.

M. Examination of Predeceased Spouse's Estate Tax Return. In the *Estate of Minnie Lynn Sower et al. v. Commissioner,* No. 32361-15; 149 T.C. No. 11, The Tax Court held that the IRS could examine a predeceased husband's estate tax return to determine the deceased spousal unused exclusion (DSUE) amount available to his wife's estate, finding that the statute of limitations didn't apply regarding the husband's estate and a letter accepting the husband's estate tax return wasn't a closing agreement. Frank Sower died in February 2012. His estate's timely filed estate tax return reported a DSUE of $1,256,033 and elected portability to allow his surviving wife, Minnie, to use it. The IRS issued a Letter 627, "Estate Tax Closing Document" in November 2013, accepting the return as filed. Minnie died in August 2013 and her estate claimed the DSUE on its return. Neither Frank's nor Minnie's estates reported any taxable gifts, although they had made taxable gifts in 2003 - 2005. The IRS began an examination of Minnie's return and as a result opened an examination of Frank's estate tax return, which resulted in a reduction of the DSUE claimed on Minnie's return. The IRS also adjusted her taxable estate to include lifetime taxable gifts and a reduction for funeral costs. The adjustments resulted in a $788,165 tax deficiency. The estate filed a petition challenging the deficiency in the Tax Court. Judge Ronald L. Buch, writing for

the Tax Court, explained that Section 2010 provides for a unified credit against estate tax and provides for the DSUE amount in the case of a surviving spouse. Buch further explained that section 2010(c)(5)(B) allows the IRS to examine a predeceased spouse's estate tax return to determine the DSUE amount, regardless of whether the period of limitations for assessment has expired for the predeceased spouse. The court found support for its conclusion in the temporary regulations in effect at the time of the Sowers' deaths and in Section 7602, which provides the IRS authority to examine books, papers, records, or data to determine the correctness of an estate tax return. The Tax Court rejected the estate's claim that the estate tax closing letter the IRS sent to Frank's estate operated as a closing agreement under Section 7121 that precluded the IRS's examination of Frank's estate tax return. The court found that there was no agreement between the estate and the IRS.

VI. MERGERS & ACQUISITIONS

A. IRS 'North-South' Spinoff Ruling. Rev. Rul. 2017-09, 2017-21 IRB 1, considered two situations in which a parent corporation owns stock in a distributing corporation that owns stock in a controlled corporation. In situation 1, the parent transfers an active trade or business to the distributing corporation, followed by a Section 355 spinoff of its controlled subsidiary to the parent. In situation 2, the controlled corporation transfers money or other property to the distributing corporation in accordance with a plan of reorganization under Sections 368(a)(1)(D) and 355. The question is whether the IRS respects the transactions as separate or deems them as integrated. Practitioners have been concerned that in situation 1 the transactions would be integrated and treated as a taxable exchange between the parent and distributing corporation, but the IRS concluded that the transactions are not integrated, and it respected the tax-free Section 351 and Section 355 transactions. In situation 2, the controlled corporation transfers money and property to the distributing corporation and at a later date, distributing corporation transfers property to controlled corporation and distributes all of controlled corporation's stock to the parent in a transaction that qualifies as a reorganization under Section 368(a)(1)(D) and Section 355. The question is whether the distribution from controlled corporation to the distributing corporation is governed by Section 301 or treated as boot subject to gain under Section 361. The IRS ruled that Section 361 applied to the transfer from the controlling corporation to distributing corporation made in accordance with the plan of reorganization, and therefore would be treated as boot, consistent with the congressional intent of the statute.

B. Exchange of Net Value for Nonrecognition. The IRS has withdrawn (REG-139633-08) the remaining part of a notice of proposed rulemaking (REG-163314-03) issued in 2005 that contained proposed regulations that would have required an exchange or distribution of net value for specified corporate formations and reorganizations to qualify for nonrecognition treatment. The proposed regulations being withdrawn also addressed the treatment of some distributions not qualifying for tax-free treatment under Section 332. Other parts of the original notice of proposed rulemaking were previously adopted as final regulations (T.D. 9434) in 2008. The 2005 proposed regulations generally would have provided that the nonrecognition rules in subchapter C of chapter 1 of subtitle 1 do not apply unless there is an exchange (or, in the case of

Section 332, a distribution) of net value. Those regulations also provided that Section 332 would apply only if the recipient corporation receives some payment for each class of stock it owns in the liquidating corporation. Lastly, the 2005 proposed regulations included guidance on the circumstances in which, and the extent to which, creditors of a corporation are treated as proprietors of the corporation in determining whether continuity of interest is preserved in a potential reorganization (creditor continuity of interest). The creditor continuity of interest provisions were adopted as the 2008 final regulations and minor portions of the 2005 proposed regulations reflecting statutory changes to Sections 332 and 351 were adopted as additional final regulations (T.D. 9759) in 2016. Because the IRS and Treasury believe current law is sufficient to ensure that the reorganization provisions and Section 351 are used to accomplish readjustments of continuing interests in property held in modified corporate form, they have decided to withdraw the remainder of the 2005 proposed regulations.

VII. REAL ESTATE

A. Proposed Changes to Fractions Rule.

1. Background. Proposed regulations (REG-136978-12) issued by Treasury on November 22, 2016, modify the fractions rule so that common allocations that don't have an abusive purpose will not cause tax-exempt investors in real estate partnerships to recognize unrelated business taxable income. The Section 514(c)(9)(E) fractions rule is part of an exception to the debt-financed UBTI rules of Section 514. The rule provides that a partnership may incur debt to acquire real property without causing its tax-exempt qualified organization partners to recognize UBTI if the partnership does not disproportionately allocate income to a tax-exempt partner (such as pension funds and university endowments) or losses to a taxable partner. However, many common arrangements in real estate deals -- including partnership agreements with targeted allocations, situations in which one investor negotiates a lower management fee, and arrangements that provide a catch-up allocation for an investor that comes in at a later stage -- run the risk of violating the rule.

2. Preferred Returns. The proposed regulations expand the preferred return exception and permit related allocations to be disregarded even if the accompanying distribution is not made currently. Instead, the proposed regulations mandate only that the partnership agreement requires that the first distributions be used to pay any unpaid preferred return to the extent not reversed with interim losses and that any unpaid distribution should compound.

3. Management Fees. The proposed regulations expand the list of permitted items that will not trigger fraction rule problems to include management and similar fees allocated among partners as long as such fees, taken together, don't exceed 2 percent of the partner's aggregate committed capital.

4. Staged Closings. The regulations also address staged closings, which occur when one investor comes in on day one and another investor comes in a year later, for example. When the new investor comes in, the changes in allocations

and interest paid to the original investor could cause a fractions rule violation. Treasury said such allocation changes will not violate the fractions rule as long as they meet the following conditions:

a. The new investor comes in within 18 months of the fund's formation;

b. The partnership agreement and applicable fund documents contemplate the staged closing process, set forth the fund raising period, state the amount of capital the fund intends to raise, and set forth the method of computing the interest factor as well as the manner in which equalizing allocations will be made to the later partners; and

c. The interest factor is not greater than 150 percent of the highest applicable federal rate.

5. Tiered Partnerships. The current regulations provide that if a qualified organization holds an indirect interest in real property through a tiered partnership structure, the partnerships within the relevant tiers must also satisfy the fractions rule. Under the proposed regulations, where the allocations of an upper tier partnership satisfy the fractions rule on a stand-alone basis, an arrangement with a lower tier partnership should not cause a fractions rule violation with respect to the other investments of the upper tier partnership, even where no separate allocations are made.

6. De Minimis Thresholds. Treasury made two changes to the de minimis thresholds in the rules. The original regulations turned off the fractions rule in cases in which the tax-exempt investors (specifically, those that are qualified organizations under section 514(c)(9)(C)) hold no more than 5 percent of the capital or profits of the partnership. The proposed regulations add a new de minimis exception in cases in which the taxable investors (those that aren't qualified organizations) hold no more than 5 percent of the capital or profits interests in the partnership.

B. IRS Won't Acquiesce in Bartell Holding on Like-Kind Exchange. In an action on decision (AOD 2017-06 2017-33 IRB 194), the IRS has announced it won't acquiesce in the Tax Court's holding in *Estate of George H. Bartell, Jr. v. Commissioner*, 147 T.C. 140 (2016) regarding the characterization of real estate sale and acquisition. In *Bartell*, the Tax Court held that a taxpayer's sale and acquisition of business property qualifies as a like-kind exchange under Section 1031 even though 17 months before the purported exchange an accommodating party facilitating the transaction acquired title to the replacement property and the taxpayer acquired the benefits and burdens of ownership of the property.

EMPLOYER'S GUIDE TO UIA TAX FILINGS & RESPONDING TO CLAIMS

By: Kaitlin A. Brown, Esq.

I. EMPLOYEE ELIGIBILITY & DISQUALIFICATION CRITERIA

A. Eligibility Criteria:

1. To be eligible for benefits, Michigan law requires that the unemployment agency must find all of the following:

   a. The individual has registered for work, has continued to report in accordance with unemployment agency rules, and is actively engaged in seeking work. MCL 421.28(1)(a). Registering to work means that individual files resume with the Michigan Talent Bank. Reporting is required to the local Michigan Works! Agency service center. Notably, the work search conducted by the individual is subject to random audit by the unemployment agency. MCL 421.28(7). Currently, "actively engaged in seeking work" means that the individual must conduct a systematic and sustained search for work in each week the individual is claiming benefits, using any of the following methods to report the details of the work search:

      i. Reporting at monthly intervals on the unemployment agency's online reporting system the name of each employer and physical or online location of each employer where work was sought and the date and method by which work was sought with each employer. MCL 421.28(6)(a).

ii. Filing a written report with the unemployment agency by mail or facsimile transmission not later than the end of the fourth calendar week after the end of the week in which the individual engaged in the work search, on a form approved by the unemployment agency, indicating the name of each employer and physical or online location of each employer where work was sought and the date and method by which work was sought with each employer. MCL 421.28(6)(b).

iii. Appearing at least monthly in person at a Michigan works agency office to report the name and physical or online location of each employer where the individual sought work during the previous month and the date and method by which work was sought with each employer. MCL 421.28(6)(c).

b. The individual has made a claim for benefits in compliance with legal requirements of section 32 and provided the unemployment agency with his or her social security number. MCL 421.28(1)(b).

c. The individual is able and available to appear at an unemployment agency location for evaluation of eligibility for benefits, if required, and to perform suitable full-time work of a character which the individual is qualified to perform by past experience or training, which is of a character generally similar to work for which the individual has previously received wages, and for which the individual is available, full time, either at a locality at

which the individual earned wages for insured work during his or her base period or at a locality where it is found by the unemployment agency that such work is available. MCL 421.28(1)(c).

d. The individual participates in reemployment services, such as job search assistance services, if the individual has been determined or redetermined by the unemployment agency to be likely to exhaust regular benefits and need reemployment services pursuant to a profiling system established by the unemployment agency. MCL 421.28(1)(e).

2. Exceptions to eligibility criteria: Individuals do not need to meet all the above requirements upon:

a. Death of an individual's immediate family member (a spouse, child, stepchild, adopted child, grandchild, parent, grandparent, brother, or sister of the individual or his or her spouse; and the spouse of any of such persons): Under these circumstances, the eligibility requirements of availability and reporting shall be waived for the day of the death and for 4 consecutive calendar days thereafter. MCL 421.28(1)(d).

b. Temporary layoff not exceeding 45 calendar days: If the employer notifies the unemployment agency (in writing or by computerized data exchange) that the layoff is temporary and that work is expected to be available for the individual within a declared number of days, not to exceed 45 calendar days following the last day the individual worked, the requirements that the individual must report, must register for work, must be available to

perform suitable full-time work, and must seek work may be waived by the unemployment agency. This waiver shall not be effective unless the notification from the employer has been received by the unemployment agency before the individual has completed his or her first compensable week following layoff. If the individual is not recalled within the specified period, the waiver shall cease to be operative with respect to that layoff. MCL 421.28(1)(a). Note: This waiver of seeking work shall not apply to weeks in a claim for extended benefits if section 64(8)(a)(ii) is in effect (interstate claim), unless the individual is participating in approved training. MCL 421.28(4).

c. Suitable work unavailable both in the locality where the individual resides and in those localities in which the individual has earned wages during or after the base period: Except for a period of disqualification or if claimant is enrolled and attended classes as a full-time student, under these circumstances, the unemployment agency may waive the requirement that the individual seek work. MCL 421.28(1)(a).

d. Unemployment agency's waiver the requirements of registration and seeking work requirements under MCL 421.28(1)(a): In weeks during which such waivers apply, an individual is considered to have satisfied the requirement of personal reporting at an employment office if the individual has satisfied the personal reporting requirement with respect to a preceding week in that period and the individual has reported with respect to the

week by mail in accordance with the rules promulgated by the unemployment agency. MCL 421.28(1)(a).

e. Individual's failure during a benefit year to notify or update a chargeable employer with telephone, electronic mail, or other information sufficient to allow the employer to contact the individual about available work: Under these circumstances, the individual will be considered unavailable for work. MCL 421.28(1)(c)(i).

f. Individual's failure, without good cause, to respond to the unemployment agency within 14 calendar days of the later of the mailing of a notice to the address of record requiring the individual to contact the unemployment agency or of the leaving of a telephone message requesting a return call and providing a return name and telephone number on an automated answering device or with an individual answering the telephone number of record: Under these circumstances, the individual will be considered unavailable for work. MCL 421.28(1)(c)(ii).

g. Mail sent to the individual's address of record returned as undeliverable and the telephone number of record disconnected or changed or otherwise no longer associated with the individual: Under these circumstances, the individual will be considered unavailable for work. MCL 421.28(1)(c)(iii).

h. Individual's participation in training approved by unemployment agency: Under these circumstances, an otherwise eligible individual shall not be ineligible because of such participation in the approved training, and for each week of participation on such approved

training and satisfactorily pursuing such approved course, the unemployment agency shall: waive the requirements of being available for work and seeking work under (1)(a) and (c); and find good cause for any failure to apply for suitable work, report to former employer for interview concerning suitable work, or accept suitable work under sections (1)(c), (d), and (e). MCL 421.28(3). However, the unemployment agency may only authorize vocational training to an individual with an unexpired benefit year if: (a) reasonable opportunities for employment in occupations for which the individual is fitted by training and experience do not exist in the locality in which the individual is claiming benefits; (b) the vocational training course relates to an occupation or skill for which there are, or are expected to be in the immediate future, reasonable employment opportunities; (c) the training course has been approved by a local advisory council on which both management and labor are represented, or if there is no local advisory council, by the unemployment agency; (d) The individual has the required qualifications and aptitudes to complete the course successfully; (e) The vocational training course has been approved by the state board of education and is maintained by a public or private school or by the unemployment agency. MCL 421.28(2).

i. Individual's participation in training approved under section 236(a)(1) of the trade act of 1974, or leaving to participate in such training if the work left is not suitable employment: Under these circumstances, an otherwise eligible individual shall not be denied benefits for weeks in such training. MCL 421.28(5). Furthermore, an

otherwise eligible individual shall not be denied benefits because of the application to any such week in training of provisions of this act, or any applicable federal unemployment compensation law, relating to availability for work, active search for work, or refusal to accept work. MCL 421.28(5).

B. Disqualification Criteria

1. An individual is disqualified from receiving benefits under MCL 421.29 if he or she did any of the following:

   a. Left work voluntarily without good cause attributable to the employer or employing unit. An individual who left work is presumed to have left work voluntarily without good cause attributable to the employer or employing unit. MCL 421.29(1)(a). For example, an individual *shall* be considered to have voluntarily left work without good cause attributable to the employer under the following circumstances:

      i. Absence from work for a period of 3 consecutive work days or more without contacting the employer in a manner acceptable to the employer and of which the individual was informed at the time of hire;

      ii. An individual who becomes unemployed as a result of negligently losing a requirement for the job of which he or she was informed at the time of hire.

      iii. An individual claims to have left work involuntarily for medical reasons, but has not done all of the

following before the leaving: secured a statement from a medical professional that continuing in the individual's current job would be harmful to the individual's physical or mental health; unsuccessfully attempted to secure alternative work with the employer; and unsuccessfully attempted to be placed on a leave of absence with the employer to last until the individual's mental or physical health would no longer be harmed by the current job.

b. Was suspended or discharged for misconduct connected with the individual's work or for intoxication while at work. MCL 421.29(1)(b).

c. Failed without good cause to apply diligently for available suitable work after receiving notice from the unemployment agency of the availability of that work or failed to apply for work with employers that could reasonably be expected to have suitable work available. MCL 421.29(1)(c). In determining whether work is “suitable”, the unemployment agency shall consider the degree of risk involved to the individual's health, safety, and morals, the individual's physical fitness and prior training, the individual's length of unemployment and prospects for securing local work in the individual's customary occupation, and the distance of the available work from the individual's residence. Additionally, the unemployment agency shall consider the individual's experience and prior earnings. MCL 421.29(6). For example:

i. An unemployed individual who refuses an offer of work, even if determined to be suitable, shall be denied benefits if the pay rate for that work was at least 70% of the gross pay rate received immediately before becoming unemployed. MCL 421.29(6).

ii. After an individual has received benefits for 50% of the benefit weeks in the individual's benefit year, work shall not be considered unsuitable because it is outside of the individual's training or experience or unsuitable as to pay rate if the pay rate for that work meets or exceeds the minimum wage, is at least the prevailing mean wage for similar work in the locality for the most recent full calendar year for which data are available as published by the department of technology, management, and budget as "wages by job title", by standard metropolitan statistical area, and is 120% or more of the individual's weekly benefit amount. MCL 421.29(6)..

iii. Work is not suitable if the position offered is vacant due directly to a strike, lockout, or other labor dispute. MCL 421.29(7)(a).

iv. Work is not suitable if the remuneration, hours, or other conditions of the work offered are substantially less favorable to the individual than those prevailing for similar work in the locality. MCL 421.29(7)(b).

v. Work is not suitable if as a condition of being employed, the individual would be required to join a company union or to resign from or refrain from joining a bona fide labor organization. MCL 421.29(7)(c).

d. Failed without good cause while unemployed to report to the individual's former employer or employing unit within a reasonable time after that employer or employing unit provided notice of the availability of an interview concerning available suitable work with the former employer or employing unit. MCL 421.29(1)(d).

e. Failed without good cause to accept suitable work offered to the individual or to return to the individual's customary self-employment, if any, when directed by the employment office or the unemployment agency. This direction would occur after an employer responds to a monetary determination by notifying the unemployment agency of the availability of suitable work with the employer. MCL 421.29(1)(e).

f. Lost his or her job due to absence from work resulting from a violation of law for which the individual was convicted and sentenced to jail or prison, unless either the conviction results in a sentence to county jail under conditions of day parole or the conviction was for a traffic violation that resulted in an absence of less than 10 consecutive work days from work. MCL 421.29(1)(f).

g. Is discharged, whether or not the discharge is subsequently reduced to a disciplinary layoff or suspension, for participation in either (i) a strike or other

concerted action in violation of an applicable collective bargaining agreement that results in curtailment of work or restriction of or interference with production or (ii) a wildcat strike or other concerted action not authorized by the individual's recognized bargaining representative. MCL 421.29(1)(g).

h. Was discharged for an act of assault and battery connected with the individual's work. MCL 421.29(1)(h).

i. Was discharged for theft connected with the individual's work. MCL 421.29(1)(i).

j. Was discharged for willful destruction of property connected with the individual's work. MCL 421.29(1)(j).

k. Committed a theft after receiving notice of a layoff or discharge, but before the effective date of the layoff or discharge, resulting in loss or damage to the employer who would otherwise be chargeable for the benefits, regardless of whether the individual qualified for the benefits before the theft. MCL 421.29(1)(k).

l. Was employed by a temporary help firm (an employer whose primary business is to provide a client with the temporary services of one or more individuals under contract with the employer, to perform services for a client of that firm if certain statutory conditions are met). MCL 421.29(1)(l).

m. Was discharged for illegally ingesting, injecting, inhaling, or possessing a controlled substance on the premises of the employer; refusing to submit to a drug test that was required to be administered in a nondiscriminatory

manner; or testing positive on a drug test, if the test was administered in a nondiscriminatory manner. If the worker disputes the result of the testing, and if a generally accepted confirmatory test has not been administered on the same sample previously tested, then a generally accepted confirmatory test shall be administered on that sample. If the confirmatory test also indicates a positive result for the presence of a controlled substance, the worker who is discharged as a result of the test result will be disqualified under this subdivision. A report by a drug testing facility showing a positive result for the presence of a controlled substance is conclusive unless there is substantial evidence to the contrary. MCL 421.29(1)(m).

n. Theft from the employer that resulted in the employee's conviction, within 2 years of the date of the discharge, of theft or a lesser included offense. MCL 421.29(1)(n).

o. Direct involvement in an active labor dispute (included a related shutdown or start-up operation caused by the labor dispute) at the last place of employment, which causes the total or partial unemployment. MCL 421.29(8)(a, c, d).

p. Receipt or seeking unemployment benefits under an unemployment compensation law of another state or of the United States, such that the individual will be disqualified in any week or part of a week in which the individual has received, is receiving, or is seeking such payments. If the appropriate agency of the other state or of the United States finally determines that the individual

is not entitled to unemployment benefits, the disqualification described in this subsection does not apply. MCL 421.29(10).

2. The following exceptions apply, such that the following conditions do not disqualify an individual under MCL 421.29 and benefits paid in any of these circumstances shall not be charged to the experience account of the employer the individual left, but shall be charged instead to the nonchargeable benefits account (pooled reserves of all employers, used to pay benefits not charged directly against any particular employer's account).

    a. The individual has an established benefit year in effect and during that benefit year leaves unsuitable work within 60 days after the beginning of that work. MCL 421.29(1)(a)(i).

    b. The individual is the spouse of a full-time member of the United States armed forces, and the leaving is due to the military duty reassignment of that member of the United States armed forces to a different geographic location. MCL 421.29(1)(a)(ii).

    c. The individual is concurrently working part-time for an employer or employing unit and for another employer or employing unit and voluntarily leaves the part-time work while continuing work with the other employer. MCL 421.29(1)(a)(iii).

3. If disqualified from benefits, the individual shall not receive benefits starting from the week in which the act or discharge that caused the disqualification occurred. MCL 421.29(2). The disqualified individual shall remain disqualified until the

individual either completes the required number of requalifying weeks or earns a certain amount. A "requalifying week" is a week in which the individual either (i) earns or receives remuneration in an amount equal to at least 1/13 of the minimum amount needed in a calendar quarter of the base period for an individual to qualify for benefits, rounded down to the nearest whole dollar or (ii) otherwise meets all of the requirements to receive a benefit payment if the individual was not disqualified under subsection (1). MCL 421.29(3)(d). The disqualified individual must complete the following to requalify:

a. If disqualified under subsection (1)(a): Earn at least 12 times the individual's weekly benefit rate for employment with an employer liable for providing benefits under the unemployment compensation law of Michigan or another state. MCL 421.29(3)(f).

b. If disqualified under subsection (1)(b): Earn at least 17 times the individual's weekly benefit rate for employment with an employer liable for providing benefits under the unemployment compensation law of Michigan or another state. MCL 421.29(3)(g).

c. If disqualified under subsection (1)(c), (d), (e), (f), (g), or (l): Complete 13 requalifying weeks after the disqualifying act. MCL 421.29(3)(d).

d. If disqualified under subsection (1)(h), (i), (j), (k), (m), or (n): Complete 26 requalifying weeks after the disqualifying act. MCL 421.29(3)(d).

II. HOW TO PROTEST CLAIM FOR UNEMPLOYMENT INSURANCE BENEFITS: HEARING & APPEAL PROCESS

A. Overview of process:

1. Filing Claim: Employees can file a claim for unemployment by telephone or on the internet. An individual filing a new claim for benefits who reports the reason for separation from a base period employer as a voluntary leaving shall be presumed to have voluntarily left without good cause attributable to the employer and shall be disqualified unless the individual provides substantial evidence to rebut the presumption. MCL 421.29(3)(h). If deemed eligible and not disqualified, employees will need to regularly report to certify continued eligibility for benefits.
2. Monetary Determination: After a claim is filed, the unemployment agency sends a Monetary Determination to the employee and any related employer. This document shows whether the employee qualifies based on monetary requirements, the reported reason for separation, the weekly amount of benefits, and the number of weeks over which benefits may be paid. Maximum is $324 per week for 20 weeks. This determination also includes a request that the employer identify any amounts paid to the claimant after the benefit year beginning date (*e.g.*, earnings, holiday, vacation, severance, sick, lost earnings, commission, pension).
3. Employee Information Packet: The unemployment agency sends the employee a package describing benefit rights and responsibilities.
4. Employer Protest: Employers have 10 days from issuance of the Monetary Determination to submit a protest based on

termination or 30 days from issuance of this determination to submit a protest based on voluntary resignation.

5. Request for Information Relative to Possible Ineligibility or Disqualification: The unemployment agency sends an additional form requesting specific details about disqualification or ineligibility, either upon its own review of the claim or after review of the employer's protest. The responding party has 10 days to provide additional information.

6. Notice of Determination: A separate notice is issued on each potential issue of disqualification or ineligibility. A party may protest or appeal the determination within 30 days.

7. Notice to Chargeable Employer of Claim Renewal: An employer is advised through this filing that an individual has renewed a claim for benefits and has unused benefit entitlement on a claim including wages with the employer.

8. Notice to Employer of Claim Renewal: An employer is advised through this filing that an individual has renewed a claim for benefits and benefits may be charged to the employer account.

9. Protest: Explain factual and legal basis for protest, with related documents enclosed. If the employer submits its protest to the unemployment agency beyond the time limits prescribed, and the unemployment agency concludes that benefits should not have been paid, the claimant shall repay, without interest, the benefits paid during the entire period of ineligibility or disqualification. MCL 421.29(9).

10. Notice of Redetermination: A separate notice is issued on each potential issue of disqualification or ineligibility. The parties may appeal the redetermination made by the Unemployment Insurance Agency by filing an appeal to the Michigan

Administrative Hearings System within 30 days from issuance of the Redetermination.

11. Appeal: Explain factual and legal basis for appeal, with related documents enclosed.

12. Appearance: Legal counsel for either party should file an appearance with the Michigan Administrative Hearings System.

13. Request for Media File: The Michigan Administrative Hearings System will provide you with a full copy of the file provided to them upon appeal.

14. Notice of Telephone Hearing: This notice will state the date, time, call in phone number, and administrative law judge ("ALJ") who will preside over the hearing. Hearings are conducted by telephone. This notice will also identify the specific issue to be addressed at the hearing.

15. Request for Adjournment of Telephone Hearing: To request an adjournment, a party must submit a fax to the ALJ, identifying the date and time of the scheduled hearing, the appeal number, and the reason for requesting the adjournment. If granted, a new Notice of Telephone Hearing will be issued with the new date.

16. Exhibits and Witnesses: Parties must submit to the judge and other party "in time to ensure the documents are received before the date of the scheduled hearing" (at least three business days in advance of the hearing), any papers or records that they wish to reference at the hearing and request to be incorporated into the record. Parties may also present witnesses to testify on their behalf, but any witness must have direct knowledge of the issue in dispute.

17. Telephone Hearing: Parties may be represented by counsel or other advocate (*e.g.*, through Advocacy Program) at the hearing. Failure to retain an advocate for the hearing will not entitle the party to an adjournment. The telephone hearing is recorded.

   a. The hearing begins with the ALJ announcing the case and the parties, entering appearances on the record, and typically stating the procedural history and issues to be addressed at the hearing. Failure to appear may result in an adverse determination against the non-appearing party dismissing the case. Upon request by a party or a party's advocate, the ALJ may grant an opportunity to provide opening statements.

   b. The party with the burden of proof will present its evidence and witnesses first. For example, an individual claiming benefits under this act has the burden of proof to establish that he or she left work involuntarily or for good cause that was attributable to the employer or employing unit. MCL 421.29(1)(a). The ALJ will recite an oath, whereby the witness swears to tell the truth. On the other hand, if the employer is protesting based on misconduct, the employer must prove that the worker engaged in misconduct and that the misconduct occurred in connection with work. Unless the act was egregious, employers are typically expected to establish the company policy, show that employee was aware of the policy, and explain how the action was harmful to employer.

   c. To constitute misconduct, the individual's actions must be harmful to the interests of the employer, and must be

done intentionally or in disregard of the employer's interests. Grossly negligent actions also constitute misconduct. It may be enough to have either a single incident of misconduct or gross misconduct (*e.g.*, lying to employer by providing request for bereavement leave and supporting it with false documentation) or series of multiple minor infractions related to work (*e.g.*, consistent tardies without justifiable excuse), but the final incident in a series must show intentional disregard for the employer's interests. An isolated instance of bad judgment or poor performance is not enough for disqualification from benefits. Similarly, actions unrelated to work will not constitute a basis for disqualification.

d. When referencing exhibits, the party presenting the evidence should confirm that the other party or witness has a copy of the document referenced. The document will not become part of the record, however, until a party moves for the document to be entered into the record. An ALJ may not admit the evidence into the record based on the general rules of evidence, such as hearsay or lack of foundation. The parties may also place objections on the record during the hearing. Sometimes there is an opportunity for closing arguments, but it is not guaranteed.

18. Order: The Order becomes final unless either party (a) files a request for rehearing/reopening based on good cause, (b) files an appeal directly with the Michigan Compensation Appellate Commission (nine commissioners appointed by governor, not part of Unemployment Insurance Agency), or (c) files a direct

appeal, upon stipulation, with the Circuit Court. The deadline for any such action is identified in the order, 30 days after the mailing date.

19. Statement of Unemployment Benefits Charged or Credited to Employer's Account: Employers have 30 days from the mailing date to protest the determination. Notably, the benefit entitlement of an individual disqualified under subsection (1)(a) or (b) is not subject to reduction as a result of that disqualification. MCL 421.29(4)(d). Rather, a benefit payable to the individual disqualified or separated under disqualifying circumstances under subsection (1)(a) or (b), shall be charged to the nonchargeable benefits account, and not to the account of the employer with whom the individual was involved in the separation. MCL 421.29(3)(h). Moreover, benefits payable to an individual determined by the unemployment agency to be separated under disqualifying circumstances shall not be charged to the account of the employer involved in the disqualification for any period after the employer notifies the unemployment agency of the claimant's possible ineligibility or disqualification. MCL 421.29(3)(h). If a disqualifying act or discharge occurs during the individual's benefit year, any benefits that may become payable to the individual in a later benefit year based on employment with the employer involved in the disqualification shall be charged to the nonchargeable benefits account. MCL 421.29(3)(h).

20. Summary Statement of Unemployment Benefits Charged to Employer's Account: This document includes a note at the bottom of the payments made each quarter on various claims.

21. Restitution: List of overpayments.

III. ACTION PLAN OF PROTECTIVE MEASURES TO LIMIT LIABILITY

A. Determine whether company is liable as an employing unit to pay unemployment taxes in Michigan. An employing unit becomes liable when it pays $1,000 or more in wages for covered employment in a calendar year, when it has employees in 20 different calendar weeks in a calendar year, or when it acquires another existing business, including the employees/personnel/payroll ("organization"), customers/accounts ("trade"), products/services ("business"), or 75% or more of the assets of another organization, trade, or business.

B. If a liable employing unit, accurately complete the necessary forms to meet your statutory obligations and prevent inadvertent (and certainly do not engage in intentional) SUTA Dumping. SUTA Dumping refers to the process of an employing unit avoiding a history of unemployment benefit charges, resulting in an increased tax rate, when transferring payroll vertically, horizontally, or acquisition with another employer. The following is a list of UIA forms that should be filed, when applicable:

1. Form UIA 518 – Registration for Michigan Taxes: Complete if liable employer. This includes, new business, reinstating an existing account, hiring a new employee, purchasing an existing business, acquiring or transferring part or all of a business, adding a new location, PEO client reporting, or other relevant reason.
2. UIA Schedule A: Mandatory for all employing units.
3. UIA Schedule B: Mandatory for all employing units. This is a successorship reporting requirement, but employing units must complete this form, even if no acquisition was made. Also confirm that all disclosures are met in advance of transfer.

4. Form UIA 1710 – Notice to all Employees: Post in a location where it may be easily seen by employees, except that homeowners may inform domestic employees of registration with the UIA.

5. Form UIA 1028 – Employer's Quarterly Wage/Tax Report: Submit online through MiWAM if contributing employer or hard copy. The UIA must receive the form by the 25th day following the end of the calendar quarter (*i.e.*, first quarter – April 25; second quarter – July 25; third quarter – October 25; and fourth quarter – January 25). If you make an error, file an amended form as soon as possible and pay any resulting additional taxes.

6. Form UIA 1711 – Unemployment Compensation Notice to Employee: Provide this notice to any worker separated from employment for any reason.

7. Form UIA 1772 – Discontinuance or Transfer of Payroll Assets in Whole or Part: File this when company is being dissolved, transferred, or when no longer any employees in Michigan.

8. Form UIA 1763 – Reimbursing Employer Billing for Benefit Charges

9. Form UIA 1710 – Notice to All Employees

10. Employer Filed Claim: Required if 1,000 or more of employer's workers filed new and/or additional claims for unemployment benefits in each of the previous 3 calendar years.

C. Maintain accurate payroll records for employees, and document legitimate bases for classifications of independent contractors.

D. Be familiar with additional payments upon which unemployment benefits might similarly be owed or after which benefits might be reduced.

1. Strategically decide structure of severance pay. If goal is to have benefits reduced over time, consider offering pay continuation so that unemployment benefits are reduced in each week that severance payments were made instead of the one week in which a lump sum would be reduced.

E. If creating a new entity, evaluate the structure that is most cost efficient and effective in meeting company goals. Is goal to have one UIA account for all employees (management company) or to maintain separate UIA accounts for each entity to which it leases employees (PEO)? PEOs are regulated by the Michigan Professional Employer Organization Regulatory Act, which contains a detailed description of what constitutes a PEO. For unemployment purposes, Administrative Rule 190 includes the following definitions:

1. An “Employee leasing company (ELC)," also known as a "professional employer organization," means an independently established business entity that does all of the following: (i) Provides employees to a client entity. (ii) Pays the wages of the employees. (iii) Reports and withholds applicable taxes from the wages of the employees. (iv) Administers the benefits for the employees. (v) Provides other payroll, human resources, and other management assistance services that are agreed upon with its client entity. The employees provided to the client entity may have previously been employed directly by the client entity. The relationship between the client entity and ELC is intended to be long-term or continuing, rather than temporary or intermittent, and the employees are, generally, not subject to reassignment. The majority of the workers at a client entity's worksite, or a majority of workers in a specialized group within that workforce, consists of employees assigned by the leasing company.

2. A captive provider refers to “an employee leasing company which limits itself to providing services and employees to only 1 client entity and the entity's subsidiaries and affiliates and which does not hold itself out as available to provide leasing services to other client entities that do not share an ownership relationship with the employee leasing company.”

3. A common paymaster is an arrangement under which an employee works for two or more related companies and the payroll for that employee is reported by one of the companies. With common paymasters, the highest unemployment tax rate of the two corporations shall apply.

4. "Payrolling" is the practice of establishing a related or associated company for the purposes of reassigning the employee payroll functions from 1 business entity to the related business entity, usually to take advantage of the lower unemployment tax rate of the related business entity. Direction and control of the involved employees are not transferred along with the payroll to the related business entity, and the related entity is not an employee leasing company. The related business entity to which the payroll is assigned is not the employer for unemployment insurance tax purposes. The entity for which services are performed and which exercises direction and control over the employee is the employer.

F. Follow additional requirements if PEO (*e.g.*, notify UIA within 30 days of acquiring a new entity; notify UIA within 30 days of ending a PEO relationship; submit a Quarterly Wage/Tax Report on behalf of each listed client entity).

G. Monitor actions of employees receiving benefits and report to the UIA any change that would deem another employer liable or the employee ineligible.

STATUS OF ACA – THE RASH THAT WON'T GO AWAY

By Marc S. Wise, Esq.

I. LATEST PROPOSALS IN CONGRESS

The Republicans in Congress have been trying since the enactment of the Affordable Care Act to repeal the Affordable Care Act ("ACA"). With the election of President Trump in 2016 and the Republican's controlling both the House and Senate, the repeal of the ACA should have been a slam dunk. Contrary to the repeal efforts prior to the 2016 presidential election, the Congressional Republicans have been unable to unify around the repeal efforts.

President Trump has executive action without the assistance of Congress.

A. Executive Orders and Announcements.

1. President Trump signed an Executive Order on October 12, 2017 authorizing certain changes to the ACA. Among the changes are the following:

a. The order directs the Secretary of Labor to consider expanding access to Association Health Plans ("AHP"s), which could potentially allow American employers to form groups across State lines.

A broader interpretation of the Employee Retirement Income Security Act ("ERISA") could potentially allow employers in the same line of business anywhere in the country to join together to offer healthcare coverage to their employees.

It could potentially allow employers to form AHPs through existing organizations, or create new ones for the express purpose of offering group insurance.

Employers participating in an AHP would not be able to exclude any employee from joining the plan and cannot develop premiums based on health conditions.

b. The order directs the Departments of the Treasury, Labor, and Health and Human Services to consider expanding coverage through low cost short-term limited duration insurance ("STLDI").

STLDI is not subject to the ACA mandates and rules. The Executive Order referenced one study that found that on average STLDI costs one-third the price of the cheapest ACA Marketplace plans.

The main groups who benefit from STLDI are people between jobs, people in counties with only a single insurer offering exchange plans, people with limited coverage networks, and people who missed the open enrollment period but still want insurance.

c. The order directs the Departments of the Treasury, Labor, and Health and Human Services to consider changes to Health Reimbursement Arrangements (HRAs) so employers can make better use of them for their employees.

HRAs are employer-funded accounts that reimburse employees for healthcare expenses, including deductibles and copayments on a tax-free basis.

2. On May 4, 2017, President Trump issued an Executive Order directing the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Health and Human Services to consider issuing amended regulations, consistent with applicable law, to address conscience-based objections to the preventive-care mandate.

3. In response to the May 4, 2017 Executive Order, the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Health and Human Services issued interim final rules on October 6, 2017, that provide conscience protections to Americans who have a religious or moral objection to paying for health insurance that covers contraceptive/abortion services.

   Under the first of two companion rules released, entities that have sincerely held religious beliefs against providing such services would no longer be required to do so. The second rule applies the same protections to organizations and small businesses that have objections on the basis of moral conviction which is not based in any particular religious belief.

4. On October 13, 2017, President Trump announced that his administration will stop paying cost-sharing reduction ("CSR") payments to health insurers. The CSR payments are used by the insurance companies participating in the health care marketplace to reduce out-of-pocket costs for low-income individuals.

   The CSR payments have been in dispute for a number of years. The Republican-controlled House of Representatives sued the Obama administration in 2014, arguing the payments were illegal since they were being appropriated by the executive branch instead of Congress, which never authorized them. In order to keep the initial cost of the Affordable Care below the promised one trillion dollars for its first ten years, the Democratic-controlled Congress wrote the ACA to require the annual CSR appropriation as opposed to including required annual funding.

   A federal court ruled in favor of the House, but the Obama administration appealed the ruling, allowing the payments to continue. The Trump administration had previously allowed the

continued payment of the CSR while the case was on appeal and appropriated the payments on a monthly basis, attempting to use it as leverage in multiple negotiations with Democrats.

In August, a federal judge ruled that 17 states and the District of Columbia could continue the lawsuit even if the Trump administration pulled out of the appeal since the end of the payments would directly affect residents. This could allow the payments to continue despite the announced decision to end them.

B. Democrat Party Solution to the Health Care Problem.

The Democrats want to fix the errors in the ACA. One of the big fixes relates to the CSR payments that the law requires annual appropriations for. Longer term, they have other ideas on dealing with health care.

On September 13, 2017, Senator Bernie Sanders introduced the Medicare for All Act of 2017. In his press conference on introducing the bill, Senator Sanders was accompanied by 1/3 of the Senate Democrats. Senator Sanders did not have any co-sponsors when he introduced a similar measure in 2013. He had 16 Democratic co-sponsors for his current proposal, including several other high-profile Democratic senators who are being talked about as potential 2020 presidential candidates. Expect this issue to gain steam by the Democratic presidential candidates as we move closer to the 2020 presidential elections.

Although the plan is called "Medicare for All," it is really just a slogan. The plan would greatly expand Medicare and overhaul it. It would greatly expand the type of coverage offered and also eliminate deductibles, copays and premiums. Although private insurance companies are currently a part of the Medicare system, the proposed plan would eliminate private insurance companies.

There's no exact plan for how to pay for Sanders' bill, but Senator Sanders did release a list of potential payment options. Among the proposals: a 7.5 percent payroll tax on employers, a 4 percent individual income tax and an array of taxes on wealthier Americans, as well as corporations. In addition, the Senator said the end of big health insurance-related tax expenditures, like employers' ability to deduct insurance premiums, would save trillions of dollars. In a 2016 report on his presidential campaign's "Medicare for All" plan, the Urban Institute estimated that the plan would cost $32 trillion over 10 years.

The Medicare for All Act of 2017 will not have any chance of being enacted into law during the current Republican administration.

II. GROWING UP TO BE A LARGE EMPLOYER

While many of us have been crossing our fingers, hoping that the Affordable Care Act's employer reporting and shared responsibility penalties would be repealed, many small businesses have crossed the threshold to applicable large employer (ALE) status as a result of hiring or business ownership changes. A business that averaged 50 or more full-time employees (including full-time equivalent employees) in 2017 is an ALE for reporting and penalty purposes in 2018. The ALE determination is made looking at prior calendar year data.

A. Determining whether a business is an ALE is a four-step process:

1. **First**, for each month in 2017, count the number of employees who were employed to work on average at least thirty hours per week. Count all full-time common law employees (including seasonal employees) who work for all entities treated as part of the same controlled group or affiliated service group.

2. **Second**, for each month of 2017, add the total number of hours for all other employees not counted in step one and divide each

monthly sum by 120 – the result is the number of full-time equivalents for each month.

3. **Third**, add the results of steps one and two to obtain twelve sums, one for each month of 2017.

4. **Fourth**, determine the average of the sums obtained in step three by adding them up and dividing by twelve (do not round up). If the result is less than fifty, you are not an ALE. If the result is fifty or more, there is another step: you still might not be an ALE if you had more than fifty employees for no more than four months during 2017 and you exceeded fifty in those months due to your seasonal employees.

If the business has crossed the threshold to ALE status, the company is vulnerability to the (nondeductible) employer penalties. If the company does not offer group health coverage in 2018 to at least 95% of its full-time employees (and their children) and a full-time employee obtains subsidized "Marketplace" coverage for a given month, the business will be subject to a penalty equal to $193.33 per full-time employee in excess of 30 for that month ($2,320 per year) (Penalty A). Alternatively, if the company did offer group health coverage to at least 95% of its full-time employees (and dependents) but a full-time employee declined your coverage and instead obtained subsidized Marketplace coverage for a given month, the business will be subject to a penalty for that month equal to the lesser of the Penalty A amount or $290.00 ($3,480 per year) for each full-time employee who had subsidized Marketplace coverage (Penalty B).

A full-time employee can obtain subsidized Marketplace coverage and trigger the employer penalty for a given month if the employer

did not offer group health coverage that meets the minimum value and affordability tests.

An ALE that escapes the penalty still is subject to the ACA's Form 1094/1095 employer reporting requirements.

III. ACA PENALTIES – 1094/1095, ASSESSMENTS AND ERROR REPORTS

A. Form 1094/1095 Reporting and Disclosures.

1. **In general:**

   a. ***For Small employers with fully-insured group health plan,*** the carrier will prepare, distribute to employees, and transmit, as appropriate, the Forms 1094-B and 1095-B.

   b. ***For Small employers with self-funded group health plans,*** the plan itself is the issuer of coverage. The employer/plan sponsor will need to prepare, distribute to employees, and transmit, as appropriate, the Forms 1094-B and 1095-B.

   c. ***For Large employers (including employers with 50-99 FTEs) that maintain fully-insured group health plan*** the employer must prepare, distribute to employees, and transmit, as appropriate, the Forms 1094-B and 1095-C.

   d. ***In* the case of a large employer that maintains a self-funded group health plan,** the employer will prepare, distribute to employees, and transmit, as appropriate, the Forms 1094-C and 1095-C (including Part III), which will include the information ordinarily included in the Forms 1094-B and 1095-B.

2. There are also special rules in the instructions if the employer maintains a health reimbursement plan or when employees have been offered COBRA.

3. For multiemployer plans, the employer can take credit for the union employees eligible under the plan. There are specials codes to use in completing the Form 1095-C.

4. Detailed information will be needed to prepare the Form 1095-C. Employers need to review the forms and instruction and determine how they will be able to obtain this information to report to the IRS.

B. Form 1094/1095 Electronic Reporting Requirements.

1. If the employer is not using a service to prepare the required filings, you should note that employers that are filing 250 or more forms 1095-C must file electronically.

2. These employers must file under the IRS Affordable Care Act Information Returns System (AIR).

3. Employers who utilize a payroll vendor, CPA, or other entity may have a limited role in the filing process if the third-party is considered a transmitter. Employers should confirm with the entity that it is the transmitter and that the employer will not be obligated to complete the electronic filing application process.

4. Employers who process payroll in-house that plan to file the forms on their own should familiarize themselves with IRS Publication 5165.

C. Form 1094/1095 Reporting Requirements – Controlled Group Issues.

1. Each entity in the controlled group must issue its own Forms W-2 to its employees. When employees work for multiple employers in the

controlled group, separate Forms W-2 must be issued by each employer.

2. Each entity in the controlled group must issue its own Forms 1095-C to the employees. This rule applies even if the entities in the controlled group all participate in the same group health plan.

3. When an employee works for and is paid separately by more than one entity in the controlled group, separate FICA, FUTA and SUTA wage bases apply.

4. We have seen a number of employers using captive administrative service companies for all of its employees to avoid all of the separate filing requirements.

5. The captive service company is the common law employer of the employees and it retains the sole authority over the assigned employees. The captive service company contracts with the various employers in the controlled group to provide employees.

6. The captive service company handles all human resources and employee administrative functions. All reporting is handled by the captive administrative service company.

D. Form 1094/1095 Reporting Deadlines.

2018 ACA Reporting Deadlines

ACA Requirement	**Deadline Date**
1095-C forms delivered to employees	1/31/2018
Paper Filing All with IRS	2/28/2018
eFiling All with IRS	4/02/2018

E. ACA Assessments and Error Reports.

1. Overview of Required Reporting. IRC §6055 applies to providers of minimum essential coverage (MEC), which generally includes health insurance issuers, self-insured plan sponsors and government-sponsored programs. IRC §6055 reporting will be accomplished using Forms 1094-B and 1095-B.

   IRC §6056 applies to applicable large employers (ALEs) subject to the ACA's employer shared responsibility rules. Under IRC §6056, ALEs will use Forms 1094-C and 1095-C to satisfy their reporting obligations.

2. The IRS May be Looking for You. The IRS has started sending out letters to potential non-compliant Applicable Large Employers using IRS Letter 5699. This letter requests missing ACA information from potentially non-compliant ALEs based on 2015 W-2 data. IRC §6056 requires ALEs to file ACA information returns with the IRS (Form 1094-C) and provide statements to full-time employees relating to the health insurance coverage offered (Form 1095-C).

   The IRS will use the information provided by the taxpayer in its response to the IRS letter to identify ALEs that failed to file reports in violation of IRC §6056 and assess penalties.

3. The employer may be notified that is ACA filing was accepted with errors. The IRS requires correction to the errors it has identified and that a copy of the corrected return should be furnished to the recipient.

   Many times the payroll records do not match the information contained in the Social Security Administration ("SSA") records.

Employers can use the SSN Verification Service to verify that the employee and Social Security Number match the SSA records.

F. Penalties. A reporting entity that fails to comply with the IRC §6055 or IRC §6056 reporting requirements may be subject to the general reporting penalties under the tax code for:

1. Failure to file correct information returns (under IRC §6721); and

2. Failure to furnish correct payee statements (under IRC §6722).

Penalties may be reduced if the reporting entity corrects the failure within a certain period of time. In addition, lower annual maximums apply for reporting entities that have average annual gross receipts of up to $5 million for the three most recent taxable years.

G. Adjusted Penalty Amounts. Effective for returns and statements required to be filed in 2016, the Trade Preferences Extension Act of 2015 significantly increases the penalties for reporting entities that fail to comply with the IRC §6055 or Section 6056 reporting requirements. The increased penalty amounts are as follows:

1. General penalty amount:

   a. $250 for each return (increased from $100), up to an annual maximum of $3 million per calendar year (increased from $1.5 million).

   b. The annual maximum for employers with up to $5 million in annual gross receipts is $1 million (increased from $500,000).

   c. Violations corrected within 30 days (Large Employers): $50 for each return (increased from $30), up to an annual

maximum of $500,000 per calendar year (increased from $250,000).

d. Violations corrected within 30 days (Small Employers): $50 for each return (increased from $30). The annual maximum for employers with up to $5 million in annual gross receipts is $175,000 (increased from $75,000).

e. Violations corrected before Aug. 1: $100 for each return (increased from $60), up to an annual maximum of $1.5 million per calendar year (increased from $500,000). The annual maximum for employers with up to $5 million in annual gross receipts is $500,000 (increased from $200,000).

f. Violations due to intentional disregard: $500 for each return (or, if greater, 10 percent of the aggregate amount of the items required to be reported correctly) (increased from $250), with no annual maximum.

All numbers subject to cost of living increases.

H. Non-Compliant Employer Case Examples.

1. Example 1 – ABC Manufacturing Company offered health insurance during 2015 to its 110 employees that was not considered affordable as defined by ACA. The Owner of ABC decided not to increase the employer health insurance subsidy to make it “affordable” under the ACA. It was also decided not to file the 1094-C nor provide 1095-C forms to employees for the 2015 nor 2016 reporting years because everyone expected the ACA to be repealed.

The penalties for not reporting by the deadline for 2015 reporting would amount to $250 for each form ($250 x 110 employees = $27,500). In addition, the failure to send the Forms 1095 to the ABC employees would amount to another $250 for each form ($27,500), for a total of $55,000.

If the IRS determines that ABC's failure to file and send Forms 1095 to its employees was an intentional disregard for the mandate, the penalty rises from $250 to $500 per form, totaling $55,000. So, for reporting year 2015, the penalty alone could be as high as $110,000.

For reporting year 2016, the same penalty would be assessed ($1,000 x 110) for a grand total of $220,000 in penalties for both reporting years, if intentional. The penalty for 2016 will only be $55,000 if not intentional.

In addition, the IRS assessment for not providing affordable health insurance would also be applied.

2. Example 2 – XYZ Service Company offered health insurance during 2015 that was also not affordable as defined by ACA. The Owner of XYZ did not increase its health insurance subsidy for the insurance to make it "affordable" under the ACA. However, it did file the Form 1094-C to the IRS, and it provided Forms 1095-C forms to its employees for both reporting years.

   There would be no reporting penalties imposed on XYZ because it reported to the IRS on time and further complied by sending Forms 1095 to its employees. XYZ will only be responsible for the IRC 4980H "Pay or Play" penalty for the failure to offer affordable health insurance.

IV. 2018 RATES AND PENALTIES

A. Affordability Percentage – 9.56% for 2018 (down from 9.69% in 2017).

B. Affordability Amount under FPL Safe Harbor - $96.08 for 2018 (down from 97.38 in 2017).

C. Employer Mandate "A" Penalty - $2,320 ($193.33/month) (up from $2,260 in 2017).

"A" penalty (IRC 4980H(a)) – applies if an employer does not offer at least "minimum essential coverage" (MEC) to at least 95% of full-time employees, and at least one full-time employee buys health insurance in the Marketplace and receives a subsidy. The original penalty amount in 2015 was $166.67/month times the total number of full-time employees the employer had in that month (minus 30 employees), times 12 for the entire year. (12 x $166.67 is $2,000.04).

D. Employer Mandate "B" Penalty – $3,480 ($290/month) (up from $3,390 in 2017).

"B" penalty (IRC 4980H(b)) – applies if an employer offers coverage to employees, but for one or more full-time employees the coverage is either not "affordable" or does not meet "minimum value." The original penalty amount in 2015 was $250/month for each full-time employee for whom coverage was either not affordable or did not provide at least minimum value. (12 x $250 = $3,000). An important difference from the "A" penalty is that the "B" penalty calculation does not include all full-time employees, but only those for whom coverage is either not affordable or does not provide at least minimum value. Additionally, the "B" penalty cannot be more than the "A" penalty would have been if it applied. The 2018 amount will be $3,480 ($290/month).

Example - 4980H Penalty Analysis

For 2017, assuming 3 employees received subsidized government health care from the Marketplace, if no coverage was offered to the employees, the annual “A” penalty would be $180,800 (110-30*$2,260). The annual “B” penalty would be $10,170 (3*$3,390). This employer should at least offer unaffordable coverage and avoid the “A” penalty. The employer would then be subject to the “B” penalty of $10,170.

HONEY WE CAN CANCEL OUR TRIP TO THE COOK ISLANDS – MICHIGAN HAS AN ASSET PROTECTION TRUST STATUTE!

By: Geoffrey N. Taylor, Esq.

I. INTRODUCTION

A. On my list of favorite estate planning myths, number one is certainly that having a will avoids probate (it doesn't). A close second is the belief that having a trust avoids creditor claims (it doesn't).

B. Clients seeking legal advice often look for air-tight solutions. For asset protection, they don't exist. But as a practical matter, disincentives for creditors to pursue collection efforts can easily be created. I like to think of it as creating road blocks. If I cannot create a road block, I try to create speed bumps.

C. Michigan residents can avail themselves of many asset protection strategies, including:

1. Prenuptial agreements or post nuptial agreements.

2. Tenancy by the entireties for married couples.

3. IRAs.

4. Cash value and proceeds of life insurance payable to the debtor's spouse or his children or to a trust for their benefit.

5. LLCs. Assets in an LLC can be protected if debtor is not the sole member. Even if the creditor is successful, he will generally get only a "charging order" entitling him only to the debtor's financial rights and not entitling him

to participate in the management of the LLC. The creditor will also face possible phantom income issues.

D. Looming in the background of any asset protection planning is the Michigan Fraudulent Transfer Act. Under the Act, certain transfers of property are considered fraudulent, meaning that a creditor has a legal right to undo the transfer and recover the property from the transferee.

1. With respect to existing creditors (i.e., creditors whose claims arose before after the transfer was made), a transfer is fraudulent if (i) the debtor does not receive (or to the extent he does not receive) a reasonably equivalent value in exchange for the transfer, and (ii) the debtor was insolvent at that time or became insolvent as a result of the transfer. For this purpose, insolvency means liabilities in excess of assets (measured at the time of transfer).

2. With respect to existing or future creditors (i.e., creditors whose claims arose either before or after the transfer was made), a transfer is fraudulent if the debtor (i) had an actual intent to hinder, delay, or defraud any creditor, or (ii) failed to receive (or to the extent he does not receive) a reasonably equivalent value in exchange for the transfer and intended, believed, or reasonably should have believed, that he would incur debts beyond his ability to pay as they became due. For this purpose, a creditor is anyone with a claim, and a claim includes any right to payment, whether mature or unmatured, and whether fixed or contingent. In determining actual intent, consideration is given to whether the transfer was made

to an insider (e.g., a family member), whether the debtor transferred substantially all of his assets, and whether the debtor was rendered insolvent as a result of the transfer.

3. Note that the remedy for the creditor is a legal right to undo the transfer.

II. TRUSTS IN ASSET PROTECTION PLANNING

A. Traditionally in all states, a person cannot protect his assets from the claims of his creditors by simply transferring his assets into a trust for his benefit. Public policy says you shouldn't be able to do this. Shouldn't have cake and eat it too.

B. Michigan case law, codified in MCL 700.7506(1)(c), provides that creditors of the grantor of a self-settled trust (i.e., a trust in which the grantor is also a beneficiary) can reach the maximum amount that can be distributed to or for the grantor's benefit in satisfaction of the creditors' claims. For example, let's say I create and fund a self-settled trust under which I can receive distributions in a third party trustee's discretion. My creditors can compel the trustee to distribute all assets to them in satisfaction of their claims. If the amount distributable to me were limited to $1 / day, the creditors would be subject to that limit (i.e., the maximum amount that can be distributed to me).

C. In the late 1990s, states began enacting "asset protection trust" statutes. States saw this is as a way to increase trust business in the state by attracting business from other states or at a minimum retain in-state trust business.

1. Delaware and Alaska led the charge.

2. Currently about 17 states offer protection.

3. Nevada is a popular choice.

4. Even Ohio recently joined the mix.

D. These statutes enable a grantor to transfer assets to a trust and retain certain beneficial interests in the trust, while preventing the grantor's creditors from reaching the assets in satisfaction of their claims. These statutes often except certain transfers from the afforded protection, including transfers made in bad faith or with the intent to defraud.

E. Most asset protection state statutes require that the trust be irrevocable, must have spendthrift provisions prohibiting a beneficiary from assigning his interest in the trust, and at least one trustee must be a resident of the state of creation. Since Michigan law did not previously provide this protection, a Michigan resident who wanted to establish such a trust had to do so elsewhere.

1. Another state. Generally have to pay a local, corporate trustee a significant annual fee. This trustee is often trustee in name only, having little to no administrative duties.

2. Off-shore. This can be scary for a lot of clients. "Sure I don't want my creditors to reach these assets, but I NEED TO BE ABLE TO REACH THEM!"

III. MICHIGAN JUMPS ON BOARD - ENACTS THE QUALIFIED DISPOSITIONS IN TRUST ACT

A. Michigan enacted the Qualified Dispositions in Trust Act. The Act became effective March 8, 2017. If certain form and funding requirements are satisfied, a Michigan resident can create and transfer assets to a trust having another Michigan resident as trustee, continue to receive benefits from the assets, and protect the assets from claims of the grantor's creditors

B. The Act is significant in that it provides statutory authority for protection. However, because the legislation is new there are no Michigan cases interpreting it and not likely to be any for many years to come. There is very little judicial guidance in other states too.

C. The asset protection afforded by the Act is significant in several respects.

1. Creditors generally must bring claims within two years after the date of transfer and must prove fraud, either actual or constructive. Solvency is an issue.

2. The standard of proof for establishing actual or constructive fraud is clear and convincing evidence. This is significantly higher than the typical preponderance of evidence (i.e., greater than 50%).

3. Remedy is return of debt amount to the grantor.

IV. REQUIREMENTS

A. Like any good statute, the Act is riddled with defined terms. Here are some of the key ones.

B. “Qualified Trust Agreement.”

1. These requirements are typical of most irrevocable trusts executed for tax reduction purposes.

2. The trust must:

   a. be irrevocable. Irrevocable means the grantor must have no power, directly or indirectly, to amend or revoke the trust, although the grantor can retain a limited power of appointment over the trust assets (discussed below).

   b. contain a spendthrift provision. A spendthrift provision prohibits a trust beneficiary, including the grantor, from voluntarily or involuntarily assigning any interest the beneficiary has in the trust.

   c. expressly incorporate Michigan law to govern the validity, construction, and administration of the trust.

C. “Qualified Disposition.”

1. As the title of the Act indicates, it all starts with a “qualified disposition.” The grantor must transfer property to a “qualified trustee” (see below) subject to a trust agreement under which the grantor has only rights that are permitted under the Act.

2. A transfer is not a qualified disposition if the grantor is in arrears on a child support obligation by more than 30 days at the time of transfer. If the grantor subsequently falls behind more than 30 days, the trust assets are not available to satisfy the grantor’s child support obligations.

3. A transfer is not a qualified disposition with respect to the grantor’s spouse if the transfer is less than 30 days before the marriage. If more than 30 days, the trust assets are not considered part of the marital estate.

4. Affidavit - The grantor must sign an affidavit stating generally that the grantor is solvent and the transfer is not an attempt to defraud creditors. Specifically, the affidavit must state:

   a. The Transferor has full right, title, and authority to transfer the Property.

   b. The transfer of the Property to the Trust will not render the Transferor insolvent.

   c. The Transferor does not intend to defraud a creditor by transferring the Property to the Trust.

   d. The Transferor does not know of or have reason to know of any pending or threatened court actions against the Transferor.

   e. The Transferor is not involved in any administrative proceedings.

   f. The Transferor is not currently in arrears on a child support obligation by more than 30 days.

   g. The Transferor does not contemplate filing for relief under the bankruptcy code, 11 USC 101 to 1532.

   h. The Property being transferred to the Trust was not derived from unlawful activities.

D. “Qualified Trustee.”

1. The trust must have at least one “qualified trustee."

a. An unrelated individual who is a Michigan resident is a qualified trustee.

b. A bank or trust company authorized to do business in Michigan.

c. The qualified trustee must maintain some of the trust property and records in Michigan.

2. This may be the most significant feature of the Act because now a Michigan resident does not have to appoint a bank or trust company.

3. The grantor cannot be trustee.

4. Can a family member be a trustee? Should a family member be a trustee?

IV. RETAINED RIGHTS

A. What rights can the grantor do and what rights can the grantor retain? The answer is A LOT.

B. Permitted administrative rights:

1. Direct investment decisions. This is especially significant for business owners, because they can continue to run the business. This often (and understandably) is a huge stumbling block for clients.

2. Veto a distribution. The grantor will normally want to include family members as beneficiaries, especially a spouse because

trust distributions can provide benefits to the marital household in lieu of direct distributions to the grantor. The trust agreement can contain a provision requiring the grantor be notified prior to a distribution being made. With this power, if grantor doesn't like it, distribution does not get made.

3. Appoint the trust assets effective on the death of the grantor. This allows the grantor to change the ultimate distribution of the trust assets and provides great flexibility for changed circumstances; e.g., a grantor who has two children, one of whom becomes the next Bill Gates and the other of whom becomes the next Mother Teresa. However, great care must be taken in drafting the provisions lest the trust assets become available to the grantor's creditors upon death.

4. Remove a trustee and appoint a new trustee. Can the grantor simply reappoint friendly trustee if the current trustee is not doing the grantor's will?

C. Permitted beneficial rights:

1. Income. The grantor can retain the right to receive income.

2. Principal. The grantor can retain the right to receive principal.

3. Principal distributions must be pursuant to a discretionary or support provision.

   a. A support provision means a provision in a trust that provides the trustee shall distribute principal for the health, education, support, or maintenance of a trust beneficiary.

b. A discretionary provision means a provision in a trust that provides a trustee has discretion whether to distribute principal.

V. TAX ISSUES

A. Although the ultimate motivation in creating this type of trust is asset protection, these trusts also have certain federal income, gift, and estate tax implications.

B. Income Taxes. An asset protection trust is typically designed to be a "grantor trust" for federal income tax purpose, meaning the grantor will be taxable on all of the trust's items of income and gain (a grantor's ability to receive income and/or principal usually creates this result). This can remove additional assets from the grantor's taxable estate through the payment of income taxes on trust income and gain (which income and gain would not again be taxable to the ultimate recipient thereof).

C. Gift Taxes. Ordinarily a transfer to an irrevocable trust is a completed gift, meaning that the grantor will be liable for gift tax on the taxable value of the gift. The taxable value of the gift equals the fair market value of all property transferred, less any ascertainable interest the grantor retains therein. If the value of the interest retained by the grantor is not sufficiently ascertainable (which is preferable from an asset protection perspective, but not from a gift tax perspective), the taxable value of the gift will comprise all assets transferred by the grantor to the trust. This can be avoided by having the grantor retain the testamentary power of appointment.

D. Estate Taxes. Generally, assets over which a taxpayer has completely relinquished dominion and control are excluded from his taxable estate. As mentioned above, however, under the Act a

grantor can retain the right to receive trust income and principal. This will cause the trust assets to be included in the grantor's estate for federal estate tax purposes under Internal Revenue Code Section 2036. Similarly, the retention of a limited power of appointment will cause the trust assets to be included in the grantor's estate for federal estate tax purposes under Internal Revenue Code Sections 2036 and 2038.

CONTROLLED AND AFFILIATED SERVICE GROUPS – A QUICK OVERVIEW

By: Charles M. Lax, Esq.

I. WHY MUST YOU DETERMINE CONTROLLED GROUP ("CG") OR AFFILIATED SERVICE GROUP ("ASG") STATUS?

A. In general if two or more entities are part of either a CG or ASG, they must be aggregated for qualified retirement plan purposes.

B. Areas where it is pertinent:

1. 401(g) contribution limit – the maximum deferral limit for 401(k) plans

2. Top heavy testing – all plans of a CG or ASG are counted in the determination of top heavy status and if the group of plans are top heavy, minimum contributions are required for all of those plans.

3. 415 contribution limits – maximum contribution or benefit limits must be determined for participants who participate in more than one plan for CGs or ASGs.

4 401(k) safe harbor compliance – 401(k) safe harbor contributions required for all 401(k) participants in 401(k) plans of a CG or ASG.

5. Generally, all service for eligibility and vesting credit must be counted for employees who move between members of a CG or ASG.

6. Employees may not be eligible for distributions from a 401(k) plan or pension plan when they move from one member of a CG or ASG.

7. Limits of loans (i.e., $50,000) - are aggregated among all plans of a CG or ASG.

8. Minimum coverage rules and other types of discrimination testing must be conducted using all members of a CG or ASG.

II. WHAT ARE CONTROLLED GROUPS?

A. The rules apply to both corporations and other entities:

1. Proprietorships.

2. Partnerships.

3. Limited Liability Companies.

B. There are two types of CGs:

1. Parent–Subsidiary.

2. Brother–Sister.

C. What are parent-subsidiary CGs?

1. One or more entities connected through ownership with a common parent.

a. The parent entity must own at least 80% of at least one other entity.

b. The group also includes all other entities that are owned at least 80% by other entities in the group.

2. Example 1

Alpha Corporation owns:

95% of the stock of Beta Corporation

85% of the stock of Gamma Corporation

75% of the stock of Delta Corporation

Unrelated persons own the percentage of stock not owned by Alpha Corporation

Alpha Corporation owns 80% or more of the stock of Beta and Gamma Corporation; therefore, Alpha Corporation is the common parent of a parent-subsidiary CG consisting of Alpha Corporation, Beta Corporation and Gamma Corporation. Delta Corporation is not a member of the CG because Alpha Corporation's ownership is less than 80%.

3. Example 2

Assume the same facts as Example 1 and assume further that Gamma Corporation owns a 90% profits interest in Epsilon Partnership.

Alpha Corporation is the common parent of a parent-subsidiary CG consisting of Alpha Corporation, Beta Corporation, Gamma Corporation and Epsilon Partnership. Note that the results would be the same if Alpha Corporation, rather than Gamma Corporation owned the 90% interest in Epsilon Partnership.

D. What are brother-sister CGs?

1. Groups of two or more entities with common ownership.

a. The same five or fewer owners must:

i. have some ownership interest in each entity;

ii. have at least 80% ownership in each entity; and

iii. have identical ownership of more than 50% in each entity.

b. Note that there can also be CGs made up of both a parent-subsidiary group and a brother-sister group.

2. Example 3

Mash Corporation and 4077, Inc. are owned by four shareholders, in the following percentages:

Shareholder	% of Mash Corporation	% of 4077, Inc.
H. Pierce	80%	20%
TJ McIntyre	10%	50%
M. Klinger	5%	15%
M. Houlihan	5%	15%
Total:	100%	100%

To meet the first part of the test for a brother-sister CG, the same five or fewer common owners must own at least 80% of the stock or some interest in all members of the CG.

In this example, the four shareholders together own 80% or more of the stock of each corporation and the first test is met, since the shareholders own 100% of the stock of each corporation.

3. Example 4

Assume the same facts as is Example 3.

To meet the second part of the test for brother-sister CGs the same five or fewer common owners must own more than 50% of each Corporation, taking into account the stock ownership of each person only to the extent such stock ownership is identical with respect to each such corporation.

Shareholder	Identical Ownership Percentage In Both Corporations
H. Pierce	20%
TJ McIntyre	10%
M. Klinger	5%
M. Houlihan	5%
Total:	40%

In this example, although four shareholders together own 80% or more of the stock of each corporation, they do not own more than 50% of each corporation, taking into account only the identical ownership of each corporation as demonstrated above.

4. Example 5

Eight individuals each own 12%-13% of the stock of Tiger Corporation and also Briggs, Inc.

Shareholder	% of Tiger Corporation	% of Briggs, Inc.
Al K.	12%	12%
Mickey L.	12%	12%
Justin V.	12%	12%
Miggy C.	12%	12%
Norm C.	13%	13%
Jack M.	13%	13%
Lou W.	13%	13%
Alan T.	13%	13%
Total:	100%	100%

Any group of five shareholders will own more than 50% of the stock in each corporation and all shareholders in any grouping will own identical amounts, but Tiger and Briggs, Inc. are not members of a brother-sister CG because the same five or fewer individuals do not own at least 80% of each of the corporation's stock.

E. Attribution Rules for CGs.

1. Generally they use the attribution rules contained in IRC §1563(a).

2. Family Attribution.

a. Generally there is attribution of ownership among spouses, with the exception of:

i. Spouses that are legally separated, or

ii. The other spouse (x) has no direct ownership, (y) has no participation as an employee or in management and (z) no more than 50% of the gross income of the entity is from passive sources.

iii. Example 6

Wilma and Fred are married. Fred is a doctor owning 100% of his medical practice. Wilma is also a doctor and owns 80% of a separate medical practice (the other 20% is owned by Barney).

Fred is not an employee or owner of a direct interest in Wilma's practice and less than 50% of

the gross income in Wilma's practice is from passive investments. Fred, however, is in charge of significant management activities for his wife's practice.

Wilma does not directly own an interest or participate in Fred's practice and less than 50% of the income from Fred's practice is from passive investments.

Fred has attributed the 80% that Wilma owns in her practice (due to his participation in Wilma's practice). Additionally, Wilma is not attributed to any ownership interest in Fred's practice. Also note that the practices are members of a brother-sister CG due to Fred's ownership/deemed ownership of at least 80% of each practice.

b Children to parents.

i. Parent is deemed to own their child's interest if child is under age 21.

ii. Parent is deemed to own their child's interest if parent already controls more than 50% of the entity.

c. Parents to children.

i. Child is deemed to own their parent's interest if child is under age 21.

ii. Child is deemed to own their parent's interest if the child already controls more than 50% of the entity.

d. Example 7

Little Ricky, age 25 is the son of Lucy. Lucy owns 75% of Tropicana Corporation and Little Ricky owns the remaining 25%.

Since Lucy owns more than 50% of Tropicana Corporation, her ownership is attributed to Little Ricky.

Since Little Ricky does not own more than 50% of Tropicana Corporation, his ownership is not attributed to Lucy.

e. Example 8

Sam and Diane are dentists and each own 100% of their own dental practice. Neither Sam nor Diane has any involvement with the other's practice. Sam and Diane also have a baby son, Norm, who's four months old. Because Norm is a minor, he is deemed to own 100% of Sam's practice and 100% of Diane's practice. As such, Sam's practice and Diane's practice are considered to be a CG.

f. Example 9

The facts are the same as Example 11 except Norm is now ten and Sam and Diane divorced (Sam marries Rebecca and Diane marries Frasier). Because Norm is still a minor, he is still deemed to own both practices and, as such, both continue to be members of a CG.

3. Corporation to shareholder.

   a. Only if the shareholder owns at least 5% of the corporation.

   b. The shareholder will be attributed its proportionate share of the ownership.

   c. <u>Example 10</u>

      George owns 70% of the stock of Vanderlay Industries, Inc. Jerry owns 20% of the stock and four other individuals (Kramer, Elaine, Newman and Kenny) each own less than 5% of the remaining 10%. Vanderlay Industries, Inc. has a 30% stock ownership in Kramerica Industries, Inc.

      The Kramerica Industries, Inc. stock is attributed to George and Jerry in proportion to their ownership interest in Vanderlay Industries, Inc. as follows:

         George is treated as 21% owner of Kramerica Industries, Inc. 70% (George's interest in Vanderlay Industries, Inc.) times 30% (Vanderlay Industries Interest in Kramerica Industries, Inc.).

         Jerry is treated as a 6% owner of Kramerica Industries, Inc. 20% (Jerry's interest in Vanderlay Industries, Inc.) times 30% (Vanderlay Industries, Inc. interest in Kramerica Industries, Inc.).

         Kramer, Elaine, Newman and Kenny are not treated as owning any interest in Kramerica Industries, Inc. inasmuch as they own less than 5% of Vanderlay Industries, Inc.

4. Partnership to partners and trusts to beneficiaries.

   a. Generally the rules work the same as corporations where the 5% threshold is exceeded.

   b. Partners and trust beneficiaries will receive a proportionate share of the ownership.

III. WHAT ARE AFFILIATED SERVICE GROUPS?

A. There are three types of ASGs.

   1. A-Organization Groups ("A-Orgs")

   2. B-Organization Groups ("B-Orgs")

   3. Management Service Groups ("MSGs")

B. What are A-Orgs?

   1. It is comprised of a First Service Organization ("FSO") and at least one A Organization.

   2. The first component member is a FSO.

      a. The entity must be a service organization.

      b. Capital may not be a material income producing factor.

      c. Certain organizations are deemed to be a service organization including: accounting, actuarial science, architecture, consulting, engineering, health, insurance, law and performing arts.

   3. The second component member is an A Organization.

      a. This organization must also be a service organization.

b. This organization must have an ownership interest in the FSO (regardless of its percentage of ownership).

c. This organization must regularly perform services for the FSO or with the FSO in performing services for third parties.

4. Example 11

Lonee Anderson, CPA, a certified public accountant, is incorporated as Lonee Anderson, P.C. and this professional corporation is a partner in Anderson and Arthur, CPAs. Lonee Anderson and Lonee Anderson, P.C. are regularly associated with Anderson and Arthur, CPAs in performing accounting services for third parties.

Anderson and Arthur, CPAs is an FSO. Lonee Anderson, P.C. is an A-Org because it is a partner in the accounting firm and is regularly associated with Anderson and Arthur, CPAs in performing accounting services for third parties.

Accordingly, Lonee Anderson, P.C. and Anderson and Arthur, CPAs would constitute an ASG.

As a result, the employees of Lonee Anderson, P.C. and Anderson and Arthur, CPAs, must be aggregated and treated as if they were employed by a single employer.

C. What are B-Orgs?

1. It is comprised of a FSO and at least one B Organization.

2. An entity is a B Organization if:

   a. A significant portion of its business is performing services for an FSO.

      i. This is determined on a facts and circumstance basis.

      ii. The safe harbors are: (x) if less than 5% - not significant and (y) if more than 10% - it is significant.

   b. The services are the type historically performed by employees.

   c. At least 10% of the B Organization must be owned by Highly Compensated Employees (as defined in Core Section 414(q) of the FSO.

3. <u>Example 12</u>

   Drysdale Industries is a financial service organization that has two 50% partners, Jed and Jethro. Jed and Jethro also own all of the stock of Ellie May Services, Inc. Jed owns 95% of Ellie May Services, Inc. and Jethro owns 5%. Ellie May Services, Inc. provides services to Drysdale Industries of a type historically performed by employees in the financial services field. A significant portion of the business of Ellie May Services, Inc. consists of providing services to Drysdale Industries.

   Considering Drysdale Industries as an FSO, Ellie May Services, Inc. is a B-Org because:

i. A significant portion of its business is the performance of services for Drysdale Industries of a type historically performed by employees in the financial services field, and

ii. More than 10% of the interests in Ellie May Services, Inc. is held by a highly compensated employee of the FSO (Jed).

Accordingly, Drysdale Industries and Ellie May Services, Inc. constitutes an ASG. Therefore, the employees of Drysdale Industries and Ellie May Services, Inc. must be aggregated and treated as if they were employed by a single employer.

D. What are Management Organizations?

1. It is comprised of two organizations.

a. The first organization performs management functions for the second organization.

b. The principal business of the Management Organization is:

i. Performing management functions on a regular and continuing basis.

ii. To a recipient organization.

2. There is no need to have overlapping or common ownership.

3. Examples of management functions include:

a. Running daily business operations.

b. Hiring and firing of employees.

c. Determining compensation benefits and conditions of employment.

d. Critical future planning.

4. How is the “principal business” of the organization determined?

a. Generally on a “facts and circumstances basis.”

b. In withdrawn IRS regulations, the test was based upon:

i. A two year rolling average.

ii. The performance of management functions constituted at least 50% of its activities during that period.

E. Attribution Rules for ASGs.

1. Generally they use the attribution rules contained in IRC §318 (differences exist between attribution for ASGs and CGs).

2. Family attribution.

a. Generally there is attribution of ownership among spouses - no exception for limited involvement.

b. Generally parents are deemed to own their children’s interest - no exception for age or ownership interest.

c. Generally children are deemed to own their children’s interest - no exception for age or ownership interest.

3. Corporation from shareholder.

a. If a shareholder owns directly or indirectly at least 50% of the stock of a corporation.

b. The corporation is deemed to own the stock of such shareholder.

4. Stock owned by a partner or beneficiary of an estate is deemed to be owned by the partnership or the estate.

5. Generally stock owned by a beneficiary of a trust is deemed to be owned by the trust.

6. Stock owned by a corporation (where a shareholder owns at least 50% of the stock), a partnership or trust shall be deemed to be owned proportionately by its shareholders, partners or beneficiaries. [CML review this.]

7. <u>Example 13</u>

Marcus Welby, M.D. is the sole shareholder of Marcus Welby, P.C. Dr. Welby personally holds a 2% ownership interest in Kiley Surgical Center. Dr. Welby regularly refers his patients to the surgical center for surgical procedures.

Dr. Welby's 2% interest in Kiley Surgical Center is attributed to Marcus Welby, M.D., P.C., and as such, an ASG exists in this case. Kiley Surgical Center is the FSO. Marcus Welby, P.C. is an A-Org since it is deemed to own the 2% interest in Kiley Surgical Center (through attribution of the interest owned by Dr. Welby) and is regularly associated with Kiley Surgical Center in performing services for patients. Note that there is no minimum interest that must be owned by Dr. Welby for attribution to have occurred.