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.

Tax Limits, Deductions and Exemptions	2016	2017
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

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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))	
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

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

1. Transfer of excess pension assets to retiree health and life insurance accounts (sec. 420(b)(4))	12/31/25

[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. <u>Estate Tax</u>.

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. <u>Military pay individual income tax exemption</u>. Military pay is exempt from Michigan individual income tax, including military retirement benefits and exit and separation pay.

2. <u>Children of veterans tuition grant</u>. 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. <u>Property tax exemption for disabled veterans or surviving spouses</u>. 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. <u>Principal residence exemption (PRE) for active duty military personnel</u>. Property owners can retain a PRE while on active duty if their property is rented or leased.

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

6. <u>Summer property tax deferment</u>. 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.