TWENTIETH ANNUAL TAX SYMPOSIUM

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Dear Tax Symposium Participants:

Welcome to our Twentieth Annual Tax Symposium. We are delighted that you have joined us this morning. For many of us at Maddin Hauser, it is hard to believe this will be the twentieth program we have presented. The years have truly flown by.

Our world is, of course, completely different. The internet, computers, smartphones, tablets, and other devices have changed our lives dramatically. In 1992, Microsoft Works was first released, Jerry Seinfeld was the biggest name in television, Bill Clinton was elected President, gasoline cost $1.05 a gallon, and the Dow Jones Industrial Average closed at 3300.

Since then, Maddin Hauser has grown from twenty-four attorneys to more than fifty. Our practice has expanded from a few well defined practice groups (real estate, professional liability defense, and taxation) to a "full service law firm."

Also, the tax environment in which we practice has changed significantly. At our first Tax Symposium on May 30, 1992:

- The estate tax lifetime exemption was $600,000 (and there were proposals to reduce it to $200,000).
- Age-weighted profit sharing plans were on the "cutting edge" of retirement planning for closely held businesses.
- The Michigan Single Business Tax was still new, and there were many unanswered questions about its operation.
- Capital gains rates reached 28%, however, dividend and ordinary income rates were capped at 31%.

We at Maddin Hauser plan to be holding this Program for at least the next twenty years and hope that you will be attending. It is unimaginable at this point what our lives will be like, let alone what our tax environment will be, however, let's just enjoy the ride together.

Please visit our website at www.maddinhauser.com to find out more about the firm. As always, we appreciate your attendance at this Program and welcome your comments and suggestions.

Very truly yours,

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

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TWENTIETH ANNUAL TAX SYMPOSIUM PROGRAM

**** Seminar Qualifies for Four CPE Credits ****

KICKING THE TAX CAN DOWN THE ROAD

By: George V. Cassar, Jr.

President Obama signed a multi-billion dollar tax cut package, the Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act), on December 17, 2010. The new law extended the Bush-era individual and capital gains/dividend tax cuts for all taxpayers for two years. The bill also provided for an AMT "patch," a one-year payroll tax cut, 100% bonus depreciation through 2011, a top federal estate tax rate of 35% with a $5 million exclusion, and more.

But before we get into the details and the effect of those changes on our clients, the key here is the “uncertainty” going forward. Again, our politicians have chosen to kick the proverbial tax can down the road. Instead of simply allowing the Bush tax cuts to expire and thus return to 2001 tax rates/laws, and worse yet, instead of enacting a more permanent fix to the problem (although what's permanent these days anyway?), the 2010 Tax Relief Act simply puts off the sunset until January 1, 2013. In doing so, President Obama put his own changes into effect, but continued the political gamesmanship by specifically choosing to punt the ultimate fate of the Bush tax cuts to 2012, another presidential election year. Thus, we continue to kick this can down the road.

I. DYING DEPENDS ON THE DAY?

From a tax perspective, this is a very true statement. As you'll recall, the Bush tax cuts (EGTRRA), gradually reduced over a period of years and then abolished the federal estate tax for decedents dying in 2010. The pre-EGTRRA estate tax (with a maximum tax rate of 55% and a $1 million applicable exclusion amount) was scheduled to be revived after 2010. Additional EGTRRA changes affected the gift and generation skipping transfer (GST) tax.

A. Estate Tax Compromise.

The 2010 Tax Relief Act revives the estate tax for decedents dying after December 31, 2009 but at a significantly higher applicable exclusion among and lower tax rate than had been scheduled under EGTRRA. The maximum estate tax rate is 35% with an applicable exclusion amount of $5 million. This new estate tax regime, however, is itself temporary and is scheduled to sunset on December 31, 2012.

Together with the revival of the estate tax, the 2010 Tax Relief Act eliminates the modified carryover basis rules and replaces them with the stepped-up basis rules that had applied until 2010. Property with a stepped-up basis receives a basis equal to the property's fair market value on the date of the decedent's death (or on an alternative valuation date). Under a modified carryover basis that EGTRRA had put into place for 2010, the executor may increase the basis of property only by a total of $1.3 million, with other estate property taking a carryover basis equal to the lesser of the decedent's basis or the fair market value of the property on the decedent's death. An executor may increase the basis of assets passing to a surviving spouse by an additional $3 million (for a total of $4.3 million).

In addition, the 2010 Tax Relief Act reunified the estate and gift tax exemptions for 2011 and 2012 (recall that part of EGTRRA was that the gift tax exemption remained at $1 million while the estate tax exemption continued to rise, even in 2010 when the estate tax was eliminated). Hence, taxpayers can now transfer up to $5 million gift tax-free during their lifetime as well. More on that later.

<table>
<tr><th>Year</th><th>Estate Tax Exemption</th><th>Basis Method</th><th>GST Tax Exemption</th><th>Top Estate/GST Tax Rate</th><th>Gift Tax Exemption</th><th>Top Gift Tax Rate</th></tr>
<tr><td>2009</td><td>$3,500,000</td><td>Step-up in basis</td><td>$3,500,000</td><td>45%</td><td>$1,000,000</td><td>45%</td></tr>
<tr><td rowspan="2">2010</td><td>- 0 -</td><td>Modified carryover basis</td><td>- 0 -</td><td>0%</td><td rowspan="2">$1,000,000</td><td rowspan="2">35%</td></tr>
<tr><td>$5,000,000</td><td>Step-up in basis</td><td>$5,000,000</td><td>35%</td></tr>
<tr><td>2011</td><td rowspan="2">$5,000,000</td><td rowspan="2">Step-up in basis</td><td rowspan="2">$5,000,000</td><td rowspan="2">35%</td><td rowspan="2">$5,000,000</td><td rowspan="2">35%</td></tr>
<tr><td>2012</td></tr>
<tr><td>2013</td><td>$1,000,000</td><td>Step-up in basis</td><td>$1,000,000[4]</td><td>55%</td><td>$1,000,000</td><td>55%</td></tr>
</table>

B. Options for 2010.

Many of us are continuing to deal with decedent's estates for decedent's who died in 2010. The 2010 Tax Relief Act gives estates of decedents dying after December 31, 2009 and before January 1, 2011, the option to elect not to come under the revived estate tax. The new law gives those estates the option to elect to apply (1) the estate tax based on the new 35% top rate and $5 million applicable exclusion amount, with stepped up basis or (2) no estate tax and modified carryover basis rules under EGTRRA. An election would be revocable with the consent of the IRS.

<u>EXAMPLE</u>: Charlie, who is unmarried, died on September 30, 2010. Charlie's estate is valued at $15 million. Charlie's estate can elect not to have the revived estate tax apply (with a maximum estate tax rate of 35% and a $5 million applicable exclusion amount). If Charlie's estate makes this election, the estate would not be subject to the estate tax, and the carryover basis rules under EGTRRA would apply. The 2010 Tax Relief Act instructs the IRS to determine the time and manner for making the election.

C. Portability.

The 2010 Tax Relief Act provides for "portability" between spouses of the estate tax applicable exclusion amount. Generally, portability would allow a surviving spouse to elect to take advantage of the unused portion of the estate tax applicable exclusion amount of his or her predeceased spouse, thereby providing the surviving spouse with a larger exclusion amount. A "deceased spousal unused exclusion amount" would be available to the surviving spouse only if an election is made on a timely filed estate tax return. Portability would be available to the estates of decedents dying after December 31, 2010. Under the Tax Relief Act of 2010, the portability election will sunset on January 1, 2013.

With the election and careful estate planning, married couples can effectively shield up to $10 million from estate tax by providing that each spouse maximize his or her $5 million applicable exclusion. Because this provision is scheduled to sunset after 2012, the utility of the portability election is limited to situations where both spouses die with the two-year term (that is, 2011-2012).

<u>EXAMPLE</u>: Doug dies in 2011 with a taxable estate of $3 million. An election is made on Doug's estate tax return to permit Doug's wife Alice to use Doug's unused applicable exclusion amount. At the time of Doug's death, Alice had made no taxable gifts. Alice's applicable exclusion amount would be her $5 million basic exclusion plus $2 million of the deceased spousal unused exclusion amount for a total exclusion amount of $7 million.

If the surviving spouse is predeceased by more than one spouse, the deceased spousal unused exclusion amount available for use by the surviving spouse would be limited to the lesser of $5 million or the unused exclusion of the last deceased spouse. NOTE however, a surviving spouse is NOT allowed to use the unused GST tax exemption of a deceased spouse.

D. State Death Tax Credit/Deduction.

EGTRRA repealed the state death tax credit for decedents dying after 2004 and replaced the credit with a deduction. Under EGTRRA's sunset provisions, the credit, as it existed before 2002, is revived for decedents dying after 2010. The 2010 Tax Relief Act extends the deduction through 2012.

The 2010 Tax Relief Act also extends EGTRRA's provisions affecting qualified conservation easements, qualified family-owned business interests (QFOBIs), and the installment payment of estate tax for closely-held businesses for purposes of the estate tax.

E. Gift Taxes.

As discussed above, for gifts made in 2010, the 2010 Tax Relief Act provides that gift tax is computed using a rate schedule having a top tax rate of 35% and an applicable exclusion amount of $1 million. For gifts made after 2010, the gift tax is reunified with the estate tax with a top gift tax rate of 35% and an applicable exclusion amount of $5 million. In other words, in 2009 a taxpayer could transfer only $1 million during life free of gift tax, while they could transfer $3.5 million at death free of estate tax (less any lifetime transfers). The Act reunifies the estate and gift tax systems, allowing full use of the $5 million exemption ($10 million per couple) amount during life without the imposition of gift tax. Thus, for the next two years, reunification gives an unprecedented opportunity for lifetime wealth transfer.

<u>PLANNING OPPORTUNITY</u>: Reunification at these increased exemption amount levels will provide significant lifetime wealth transfer planning opportunities for your clients to reduce their taxable estate, shift wealth to future generations and, where needed, acquire a life insurance death benefit outside their estates with minimal or no

transfer tax cost. With the gift tax exemption at $5 million, you can make large gifts of cash or assets outright or subject to valuation adjustments in trust. This freezes the value of the asset gifted and all post-transfer appreciation and income are removed from your estates, reducing your estate tax liability. You can further leverage these gifts with other techniques such as installment sales to grantor trusts.

<u>“CLAW BACK” AWARENESS</u>**:** Of course, nothing is ever that straight forward or direct when it comes to tax law and this 2010 Tax Relief Act is no different. What has many professionals concerned is the issue of a “claw back.” The term relates to having a 2011 or 2012 gift, under current law, result in estate tax for decedents dying after January 1, 2013 if the federal estate tax exemption at the time of their death is reduced to a level below the amount of the gift tax exemption used in 2011 or 2012. The concern stems from the wording used in the current Form 706.

Confusion arises because (1) since the 1976 Tax Reform Act the concept of “adjusted taxable gifts” has been used to compute the amount of the Federal estate tax due on the taxable estate; and (2) the rates of tax have never increased since the unified system has been in place.

In essence, in the unified system, the amount of post-1976 taxable gifts is added to the taxable estate, the estate tax is computed on the total amount, and the gift tax previously paid is then backed out of computation. If the tax rates used to compute both the estate tax and gift tax previously paid are the same, there should be no impact (up or down) on the computation.

Section 2001(g), added to the Internal Revenue Code as the result of the recently exacted 2010 Tax Act, makes clear that, in computing the gift tax that was previously paid (or deemed to be paid), the rates of tax in effect at the time of the decedents death are to be used in lieu of the rates of tax in effect at the date of the gift. If the rates of tax in effect at the date of the decedent's death are used for this purpose, there should be no additional tax due as a result of including prior taxable gifts in the computation.

Unfortunately, Section 2001(g) is scheduled to sunset after 2012 along with the 2010 Tax Act. This is resulting in commentators opining that without 2001(g), the rates of tax on the date of the gift must again be used to compute the gift tax deemed to be previously paid, based on the calculations required on the worksheets to From 706 that have not been updated since 2009. Using the rates of tax in effect on the date of the gift, as required on From 706, would result in a higher overall tax if the rates increase between the date of the gift and the date of the death.

Of course, just as many practitioners and commentators have also stated that such a result (i.e. a claw back) is far from clear and many believe that this result would not be reached even if the sunset of section 2001(g) is taken into account

In stating as such, the belief is that Congress clearly did not intend that gifts made during 2011 and 2012 would be subject to an additional estate tax in 2013 and thereafter. Furthermore, they argue that it is likely that some type of administrative or legislative relief will be forthcoming assuming that an unintended "glitch" does exist. The relief may be as simple as revising the Form 706.

But what if the claw-back does occur? If the claw-back happens, the donor's estate still is likely to have benefited from the gifts made in 2011 and 2012. The claw-back would be at the amount of the taxable gift, not the current value of the property given away. Therefore, the appreciation on the property given will not be taxed. If the gift had not been made, the amount of the gift plus appreciation would be subject to tax.

EXAMPLE**:** Donor makes a $5 million gift in 2011, files the required gift tax return and pays no gift tax. Donor dies in 2015. At the time of Donor's death, the property given in 2011 has appreciated in value to $8 million. If the amount of the estate tax exemption for persons dying in 2015 is $1 million, then the gift may be clawed back into the estate at the $5 million amount, meaning that estate tax would be due on the $4 million that is in excess of the 2015 tax-free amount. The $3 million of appreciation is not taxed. If Donor had not made the gift, the full $8 million would be included in Donor's estate.

F. Life Insurance Funding**.**

With the gift tax exemption at $5 million, you can make large gifts to fund life insurance policies owned by irrevocable life insurance trusts (ILITs) without incurring gift tax or using complicated premium leveraging arrangements such as private split-dollar, private financing or commercial premium financing. In addition, this will provide you additional flexibility with annual exclusion planning by decreasing your reliance on annual exclusion gifts to fund ILITs.

G. Multigenerational Wealth Transfer.

With higher gift tax and GST exemption amounts, now is the time to fund multigenerational or dynasty trusts and maximize wealth transfer to future generations. You can further leverage this funding with other techniques such as installment sales to grantor trusts.

H. Qualified Plan Exit Strategy.

With the gift tax exemption at $5 million, you can make large gifts in trust that could facilitate the trust's purchase of life insurance from a qualified plan.

I. GST Tax.

As for generation-skipping transfers, the 2010 Tax Relief Act allows individuals to make aggregate transfers of up to $5 million to "skip persons" outright or in trust tax-free. ("Skip-persons" include family members two or more generations younger than the transferor as well as non-family members more than 37 ½ years younger than the transferor.) Any such transfers made in excess of this $5 million exemption amount will be subject to the 35% GST tax. For generation-skipping transfers in 2010, the Act retroactively imposes a 0% percent tax and a $5 million exemption amount. The $5 million GST exemption amount available through 2012 may be used to exempt gifts to trusts that are expected to benefit multiple generations, so that generation-skipping transfers from the trusts in subsequent years are also exempt from GST.

II. INCOME? WHAT INCOME?

The 2010 Tax Relief Act didn't focus solely on estate and gift tax issues. A number of effects were had on the income tax rates as well. The 2010 Tax Relief Act provides an extension, through 2012, of all the Bush income tax cuts, including the 15% maximum rate for capital gains and qualified dividends. The provision extends the 10%, 15%, 25%, 28%, 33% and 35% individual income tax rates for the next two years, with the rate structure indexed for inflation. By extending low income tax rates into 2011 and 2012, the 2010 Tax Relief Act benefits individuals who complete Roth IRA conversions within the next two years.

At the end of 2012, the Act expires. Beginning in 2013, ordinary income, as well as short-term capital gains and qualified dividends, are scheduled to be taxed at a maximum 39.6% rate; the maximum long-term capital gains rate would be 20%.

But perhaps the most significant impact on income tax rates facing taxpayers now didn't come from the 2010 Tax Relief Act itself, but from the Patient Protection and Affordable Care Act, followed shortly thereafter by the Health Care and Education Reconciliation Act (collectively referred to herein as the "Act"). The Act unquestionably imposes significant changes in the provisions of health care coverage in the U.S. by requiring individuals to maintain a certain level of health insurance coverage and requiring employers to offer qualifying coverage to their employees. Taxes, penalties, and tax credits are used as compliance incentives to implement these changes. The Act, however, goes beyond health care issues and introduces some quite burdensome recordkeeping and reporting requirements on business taxpayers. It also has a direct impact on the income tax rates and additional income taxes related to Medicare payroll tax and a new, additional Medicare tax on unearned income.

A. Increased Medicare Payroll Tax.

Under the Act, the Medicare portion of the payroll tax (applicable generally to wage and self-employment income) will increase from 1.45% to 2.35% for individuals earning more than $200,000 per year and married couples earning more than $250,000 per year. Self-employed individuals meeting the same income thresholds will see an increase to 3.8%. This change will become effective January 1, 2012.

The imposition of this additional tax on payroll income may make Subchapter S corporations and limited partnerships (in certain circumstances) more effective tax vehicles than limited liability companies, due to the fact that amounts of trade or business profit allocated to S corporation shareholders, and in most circumstances, similar allocations made to limited partners of a limited partnership, do not attract the Medicare portion of the FICA tax. There has, however, been discussion in Congress that would diminish planning opportunities with S corporations. Those provisions would treat all of the trade or business income of an S corporation as self-employment income in certain circumstances.

B. Medicare Tax on Unearned Income.

The Act also imposes a 3.8% Medicare tax on unearned income of certain taxpayers. For individuals, the tax will be imposed on the lesser of (a) net investment income or (b) the excess of "modified adjusted gross income" ("MAGI") over the threshold amount of $200,000 for taxpayers filing individually and $250,000 for married taxpayers filing jointly, or $125,000 if filing a separate return. The provision is contained in new Sec. 1411, Unearned Income Medicare Contribution. Congress added the provision as a means of raising revenue to pay for health care reform. It was intended to target wealthier taxpayers.

MAGI is defined as: adjusted gross income increased by the excess of (1) the amount excluded from gross income under section 911(a)(1), over (2) the amount of any deductions (taken into account in computing adjusted gross income) or exclusions disallowed under section 911(d)(6) with respect to the amounts described paragraph (1).

For most individuals, MAGI will be their adjusted gross income unless they are U.S. citizens or residents living abroad and have foreign earned income. The tax is equal to 3.8% of the lesser of net investment income or the amount by which MAGI exceeds the threshold. Net investment income includes interest, dividends, annuities, royalties, and rents, other than such income that is derived in the ordinary course of a trade or business, less allocable deductions. It also includes income from a passive activity or a trade or business of trading in financial instruments or commodities. It does NOT include distributions from qualified plans included in Secs. 401(a), 403(a), 403(b), 408, 408A or 457(b). These sections refer to qualified pension, profit-sharing and stock bonus plans; qualified annuity plans; annuities purchased by Sec. 501(c)(3) organizations or public schools; individual retirement accounts; Roth individual retirement accounts; and eligible deferred compensation plans, respectively Net investment income also does not include tax-exempt interest.

Net gain attributable to the disposition of property other than property held in an active trade or business is subject to this tax. Gains from trading in financial instruments or commodities are also included. The taxable gain on the sale of a personal residence in excess of the Sec. 121 exclusion would be included. So if you happen to sell a personal residence for more than the $250,000 in gain if you are single or $500,000 if married, that amount would be subject to this new 3.8% tax.

Estates and trusts are subject to this tax on the lesser of undistributed net investment income or the excess of adjusted gross income in excess of the highest tax bracket in Sec. 1(e) for the tax year. The tax does not apply to nonresident aliens or a trust in which all of the unexpired interests are devoted to charitable purposes under Sec. 170. "The tax also does not apply to a trust that is exempt from tax under section 501 or a charitable remainder trust exempt from tax under section 664."

Although Medicare tax assessed on self-employment income is deductible, the Medicare tax on net investment income is not deductible when computing any tax imposed by subtitle A of the Code (i.e. income taxes). The tax is subject to the individual estimated tax provisions.

PLANNING OPPORTUNITY: Supposed wealthy taxpayers have approximately a year and a half to develop methods and strategies for avoiding or reducing the impact of this new tax on investments. A good portion of the implementation of plans to limit this tax may take place in the last quarter of the tax year ending on December 31, 2012. This would be a good time for taxpayers to analyze their investment portfolios and harvest any year-end gains, thereby limiting the 3.8% tax on top of the income or capital gain tax assessed on the gains. Given that the wash sale rules do not apply to gains, selling a security at year end and repurchasing it may make sense if the investment is still a good portfolio choice.

Investors and financial planners have had an increased interest in dividend-paying securities since the implementation of the qualified dividend tax rate that came into effect under the Jobs and Growth Tax Relief Reconciliation Act of 2003. Investors may want to pass on capturing dividends and look to investments providing long-term capital gain. Of course, this is a deferral tactic, but potentially an investor may be close to retirement or a career change, at which time there may be a decrease in income. This deferral could end up as a permanent tax savings if the taxpayer's MAGI falls below the taxable threshold.

Taxpayers will have more reason to look at tax-exempt investments/bonds. The analysis of these investments in comparison to taxable interest investments would have to factor in the new

Medicare rate. Typically, a taxpayer could gross up the interest rate on a tax-exempt bond with the inverse of their tax rate. So a 4% tax-exempt bond grossed up at the inverse of a 35% tax rate would provide for a taxable rate of interest of 6.15% (4% divided by 65%). The gross-up number of 65% would need to be reduced by 3.8% in factoring the total rate of tax, including income tax and the Medicare tax. Therefore, the grossed-up taxable rate to use in comparing a 4% tax-exempt rate to a taxable rate would be 6.53% (4% divided by 61.2%).

Income from nonqualified annuities will be subject to this new investment tax. The opportunity to convert the annuity or its income into an investment that would be excluded from the tax is limited. A long-term investor looking for tax deferral may want to consider post-tax IRA investments versus annuities on a go-forward basis because income from an IRA is not subject to this tax. Maximizing investments into any qualified plan as an alternative to other investments will provide for future savings since the income withdrawn from a qualified plan will not be subject to the Medicare tax.

Investors may also look to other insurance products to avoid the new tax. The inside buildup of life insurance cash surrender value is not subject to the new Medicare tax, nor are life insurance proceeds that are excluded from income tax.

Rents are subject to the Medicare tax unless the rent is derived in the ordinary course of a trade or business. Investors in real estate would have more reason to look at the active real estate investors' rules to determine if they could avoid this tax via the active classification. Active real estate investors need to spend more than one-half of their time specifically in the real property trades or businesses (out of their total trades or businesses). In addition, the materially participating taxpayer needs to perform more than 750 hours of services during the tax year in real property trades or businesses. Real estate investors need to consider the possibility of making an election to treat all interests in rental real estate as one activity, thereby aggregating all real property interests into one trade or business.

In the case of a trade or business, the tax applies if the trade or business is a passive activity. Active business ownership within a sole proprietorship, limited liability company (LLC), partnership, or S corporation would not lend itself to this tax. A passive investor in a trade or business housed within one of these flow through entities is not subject to self-employment tax under Sec. 1401 because the investor is not active in the business. Therefore, if a passive investor attempts to construct an argument that she is not passive to avoid the Medicare tax, she will end up being subject to self-employment tax. This is the case of an investment housed within an LLC or a partnership. Under present rules, investors in a trade or business housed within an S corporation can avoid the investor's Medicare tax on their follow through income if they can argue that they were actually active and not passive investors and still not be subject to self-employment tax. Even so, there are implications of no compensation or unreasonably low compensation while claiming to be an active participant for S corporation employee owners. Sec.1411 includes a special rule whereby it excludes from the definition of net investment income any item taken into account in determining self-employment income under Sec. 1401. Thus, a taxpayer should never pay both self-employment tax and the new Medicare tax on the same stream of income.

An owner of a pass-through active trade or business may find that a portion of the flow through income is actually subject to the Medicare tax. Any income, gain, or loss attributable to an investment of working capital will be treated as not derived in the ordinary course of a trade or business. Interest, dividend, and royalty income earned in the normal course of a trade or business would not be subject to this tax, but die cash-producing investment income would be subject to this tax.

Upon the disposition of an interest in a partnership or an S corporation, only the gain attributable to the disposition of nonactive assets would be subject to the Medicare tax. An owners of an interest in a business may find that it has both an active trade or business and a passive activity housed within the operating entity. The determination of the portion of the gain subject to this tax would be based on an allocation of the fair market values of all the assets (active and passive) immediately before the disposition of the interest.

A working interest in an oil and gas property that a taxpayer holds through an entity that does not limit the taxpayer's liability, or one held directly, is not considered a passive activity. Therefore, arguably royalties from this type of investment would not be subject to the tax. This may be an area where the IRS needs to provide clarification. Oil and gas production payments, royalties, or other income arrangements would be subject to the Medicare tax if the investment was not a working interest.

For the most part, a wealthy taxpayer with investments that produce income is going to be subject to this tax. The new law does not take effect until tax years beginning after December 31, 2012. The provides a somewhat lengthy window of opportunity for a taxpayer to plan potential minimization strategies - including the potential of voting for different politicians who may be able to defeat or alter this tax bill before it takes effect.

C. Individual Alternative Minimum Tax Relief

The alternative minimum tax is a special tax system with a minimum 26% tax rate, originally designed to ensure that the ultra-affluent “paid their share.” The 2010 Tax Relief Act provides a two-year extension of alternative minimum tax (“AMT”) relief—indexing the AMT exemption for inflation for 2010 and 2011. It also allows individuals to offset regular tax liability and AMT by nonrefundable personal credits for 2010 and 2011.

AMT EXEMPTION	2010	2011
Unmarried Individuals	$47,450	$48,450
Married/Surviving Spouses - Joint Filing	$72,450	$74,450
Married Spouses - Separate Filing	$36,225	$37,225

III. POLITICS AS USUAL - UNUSUAL PLANNING FOR CLIENTS

Perhaps never has a more truthful statement been written. With what seems to be the norm with "politics as usual" these days, politicians appear to be much more concerned with getting re-elected than with passing good tax policy. The result? More of this kicking the can down the road. Politicians have put more focus on setting up their re-election campaigns so that hot tax issues such as the uncertainty of the estate and gift tax, the income tax rates and the hidden tax effects buried inside other laws such as the Health Care Act become campaign platform issues than they have focused on actually figuring out what is best for the masses. And in doing so, the taxpayer is continuously faced with expiring laws and sun setting provisions that make planning a nightmare.

Unfortunately, in the middle of all the political games are real people having real problems and real deaths every day. But while politicians concentrate on campaign strategies, taxpayers often choose to do nothing when it comes to planning because they can't get past the uncertainty or the fear that they will incur costs upon costs to redo their plan once the tax laws get settled.

This author is here to tell you and the taxpayers that the tax laws are irrelevant. Not irrelevant from a planning standpoint because clearly it is prudent for us to advise our clients how to best position their income, estate and gifts to take advantage of tax planning. But certainly irrelevant from the standpoint of choosing between the need to plan or not. Given that mankind has still yet to be able to pinpoint his own death, one never knows when that day will come - certainly not the politicians. Furthermore, given that it is the estate tax law in place at the time of your death that takes effect as opposed to the tax law in place when you put your plan together, it is irrelevant whether the law in place today is set to expire, sunset or change down the road. It has been said that the only certainty in life is change. I feel the same for tax laws. Would it really make a difference in the planning we do if instead of having the tax laws expire a year or two or five years from now that they were simply set in place giving the appearance that they were permanent? After all, what is permanent about laws, especially tax laws? The lawmakers can still elect to change them down the road and when they do, we will plan accordingly. They can change the laws tomorrow or 2 years from now or 10 years from now. The difference however, in the eyes of the taxpayer, is that they feel certainty. So with certainty, they feel comfortable and thus the desire to plan.

IV. CONCLUSION

So let's sum it up. While the politicians continue to kick the can around and play politics with taxpayers, it is our duty as the trusted advisors to get clients to understand that they still need to plan. We still have traditional estate planning and business succession planning issues that need to be addressed and with the guarantee of change no matter how it is presented, we have a responsibility to plan today for tomorrow. If tomorrow comes and the laws change, we will plan for the next day and hence move forward: one day at a time.

<u>MICHIGAN SUPREME COURT DECISION
IN KLOOSTER V. CITY OF CHARLEVOIX CLARIFIES
JOINT TENANCY UNCAPPING RULES</u>

By: Danielle M. Spehar, Esq.

I. <u>GENERAL PROPERTY TAX ACT (MCL 211.1 et seq.) ("GPTA")</u>

A. An Act to provide for the assessment of rights and interest in property and the levy and collection of taxes on property.

B. 1994 Passage of Proposal A.

1. To limit annual increases in property tax assessments as long as it remained owned by the same party.

2. 1995 Amendments to GPTA.

a. Fixed cap on assessment increases at the <u>lesser</u> of 5% of the assessed value of the property for the previous year or the increase in the rate of inflation from the previous year. (MCL 211.27a(2)).

b. After certain "transfer[s] of ownership" occur, the "taxable value" becomes uncapped and subject to reassessment based on actual property value (MCL 211.27a(3)).

C. Definition of "transfer of ownership." (MCL 211.27a(6)).

1. "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."

2. MCL 211.27a(6)(a)–(j) provides a non-exhaustive list of examples of transfers of ownership, including the following:

    a. Conveyance by deed.

    b. Conveyance by land contract.

    c. Conveyance to or distributions from trusts.

3. MCL 211.27a(7) provides 17 specific transfers and conveyances which are excluded from the definition of "transfer of ownership."

D. The joint-tenancy exception (MCL 211.27a(7)(h)) provides that a transfer of ownership does not include the following:

1. [a] transfer creating or terminating a joint tenancy between 2 or more persons if at least 1 of the persons was an original owner of the property before the joint tenancy was initially created and, if the property is held as a joint tenancy at the time of conveyance, at least 1 of the persons was a joint tenant when the joint tenancy was initially created and that person has remained a joint tenant since the joint tenancy was initially created. A joint owner at the time of the last transfer of ownership of the property is an original owner of the property. For purposes of this subdivision, a person is an original owner of property owned by that person's spouse.

2. Establishes the requirements for excluding three types of conveyances from a "transfer of ownership."

    a. The termination of a joint tenancy.

    b. The creation of a joint tenancy where property was not previously held in a joint tenancy.

c. The creation of a successive joint tenancy.

3. Definitions.

a. "Original owner": A sole owner at the time of the last uncapping event; a joint owner at the time of the last uncapping event; or, the spouse of either a sole or joint owner of the property at the time of the last uncapping event.

b. "Joint tenancy": A form of concurrent ownership where such co-tenant owns an undivided share of property and the surviving co-tenant has the right to the whole estate.

c. "Initial joint tenant": A person whose interest in the property was obtained because he or she was one of the joint tenants who became a co-owner as a result of the "initial" joint tenancy **and** who has continuously held an interest in the property as a co-owner in joint tenancy since the creation of the initial joint tenancy.

II. KLOOSTER V. CITY OF CHARLEVOIX

A. The facts.

1. In 1959, James and Dona Klooster acquire title to the property as tenants by the entirety.

2. August 11, 2004, Dona quit claimed her interest in the property to James, leaving James as the sole owner.

3. August 11, 2004, James quit claimed the property to himself and his son, Nathan Klooster, as joint tenants with rights of survivorship.

4. January 11, 2005, James died, leaving Nathan as the sole property owner by operation of law.

5. September 10, 2005, Nathan quit claimed the property to himself and his brother, Charles Klooster, as joint tenants with rights of survivorship.

6. 2006, the assessor for the City of Charlevoix issued a notice of assessment, taxable valuation, and property classification, indicating that, because of a transfer of ownership, the property's taxable value had been reassessed using the true cash value of the property.

B. History of the case.

1. Nathan appealed to the city's board of review and lost.

2. Nathan appealed to the Tax Tribunal.

    a. Tax Tribunal affirmed the reassessment.

    b. Ruled that the transfer of ownership to Nathan by virtue of his dad's death was a conveyance for purpose of the GPTA.

    c. Ruled that the joint-tenancy exception didn't apply because Nathan was not an original owner or an already existing joint tenant before August 2004.

3. Nathan appealed to the Court of Appeals which reversed the Tax Tribunal, determining that a "conveyance" requires a transfer of title by a written instrument, and thus James' death and the resulting transfer by operation of law did not constitute a transfer of ownership under the GPTA that would uncap the property. *Klooster v. Charlevoix*, 286 Mich App 435 (2009).

4. City of Charlevoix applied for leave to appeal to The Michigan Supreme Court.

III. <u>THE ANALYSIS – AS DETERMINED BY THE KLOOSTER COURT AND INTERPRETED BY THE STATE TAX COMMISSION</u>

A. Identify the “Conveyance at Issue” which may or may not uncap the property for reassessment purposes.

B. Determine if the conveyance is the creation of a joint tenancy.

1. An “initial” joint tenancy is created when a property held by a sole owner, a husband and wife holding as tenants by the entirety, or by tenants in common is conveyed to two or more persons as joint tenants.

2. If the person creating the joint tenancy held title to the interest being conveyed either as a sole owner, as husband and wife, tenants by the entirety, or as tenants in common, then the creation of a joint tenancy is not a transfer of ownership, if, at least one of the persons conveying the interest **<u>and</u>** one of the persons receiving the interest was an original owner.

3. If the conveyance meets these requirements, the conveyance is not a “transfer of ownership.”

C. Determine if the conveyance terminates a joint tenancy.

1. A joint tenancy terminates when there is no successive joint tenancy.

2. The termination of a joint tenancy **<u>is</u>** a transfer of ownership if the resulting owner is not an initial joint tenant.

3. The termination **<u>is not</u>** a transfer of ownership if both of the following are true:

   a. At least one of the joint tenants in the joint tenancy being terminated was an original owner before the joint tenancy was initially created; **<u>and</u>**

   b. At least one of the joint tenants in the joint tenancy being terminated was an initial joint tenant and has remained a joint tenant in successive joint tenancies.

D. Determine if the conveyance at issue is the creation of a successive joint tenancy.

1. Occurs when the conveyance is from one joint tenancy directly into another joint tenancy.

2. A successive joint tenancy may, or may not, be a transfer of ownership.

3. Creation of a successive joint tenancy is **<u>not</u>** a transfer of ownership if both of the following are true:

   a. At least one of the individual’s in the successive joint tenancy was an original owner; **<u>and</u>**

   b. At least one of the joint tenants in the previous joint tenancy was an initial joint tenant and has remained a joint tenant in successive joint tenancies.

E. Conclusion.

1. If a joint tenancy is created by an "original owner" and if that "original owner" or their spouse are also co-tenants in the joint tenancy, then the taxable value does not uncap.

2. If a "successive" joint tenancy is created and an "original owner" or their spouse continue as co-tenants in the "successive" joint tenancy, then the taxable value does not uncap.

3. If a joint tenancy is terminated by the death of an "original owner" or by the "original owner" making a conveyance, resulting in the ownership again being a sole ownership, and if that sole owner is an "initial joint tenant," then the taxable value does not uncap.

4. If a joint tenancy is terminated by conveyance and the sole owner after the termination is an "initial joint tenant," then the taxable value does not uncap.

CURRENT PARTNERSHIP TAX ISSUES

By: Mark R. Hauser, Esq.

In this Outline, when we use the word *Partnership* we mean a general or limited partnership, limited liability company or other enterprise that checks the box to be taxed as a partnership.

Structure of a typical real estate investment.

The General Partner, Managing Member or other sponsor finds an investment property, signs a purchase agreement, conducts due diligence, finds a mortgage financing source, guarantees the loan, or at least the nonrecourse carve outs to the loan, and then seeks to find passive investors who put up most or all of the required equity in exchange for an agreed upon Preferred Return and a return of their capital (and sometimes a subordination of some or all of his property management fee in support of the investor's priority) before the sponsor receives his Promotional Interest on the deal, here called the *Carried Interest.* At times the sponsor acts as a cash investor along with his investment group. In most, he may rely on OPM.

In addition, profits and losses are allocated between the cash investors and the sponsor in a manner which satisfies the substantive economic effect rules of Section 704(b) and the Regulations promulgated pursuant thereto. If the sponsor's promote interest is 20%, he may be allocated 20% of the profits and losses from the venture. Because he is usually a real estate professional, the losses to him are not passive losses subject to the passive loss rules but can be used to offset his ordinary business income.

The so called "Carried Interest legislation" is lurking behind the scenes. If adopted, this would be a serious tax law change for commercial real estate, the largest modification since the 1986 Tax Reform Act. Not only would they tax all income received by the sponsor in connection with his carried interest as ordinary income, but they may also severely limit the losses available to be taken in connection therewith.

I. TREATMENT OF PARTNERSHIP INTERESTS ISSUED FOR SERVICES

A. The Internal Revenue Code does not specifically address how the receipt of a profits interest in a partnership in exchange for services is treated for U.S. federal income tax purposes. However, it is possible under current law to structure the issuance of a profits interest so as to make it non taxable.

1. Section 721 generally provides that no gain or loss will be recognized on the contribution to a partnership in exchange for an interest therein, but does not explicitly address the contribution of services.

2. Section 83 provides rules re: the tax consequences of a grant of property in connection with the performance of services. An employee who receives property in exchange for services must include in income the fair market value of the property received at the first time that the property received is either transferrable or not subject to a substantial risk of forfeiture. However, Section 83 does not address whether a profits interest in a partnership is property for this purpose. Section 83(b) however, allows a taxpayer to include as income in the year received the fair market value of property received for services rendered.

3. In 1990, in Campbell v. Commissioner, T.C. Memo 1990-1991, 59 T.C.M.(CCH) 236 (1990), reversed, 943 F 2d 815 (8^{th} Cir. 1991), the Tax Court held that where a taxpayer received *special limited partnership* interests in three partnerships in exchange for providing services, entitling him to a share of the profits after the limited partners had received a preferred return, the receipt of such interests was a taxable event under Section 83. However, the Eighth Circuit reversed, holding that if the

taxpayer had received a capital interest, it would be taxable but the profits interest received by this taxpayer was without fair market value at the time received and therefore not includable in income for the year received.

4. In Rev Proc. 93-27, 1193 C.B. 343, the IRS responded to the decision in *Campbell* by creating a safe harbor, stating that *if a person receives a profits interest for the provision of services for the benefit of a partnership in a partner capacity or in anticipation of being a partner, the IRS will not treat the receipt of such an interest as a taxable event* unless 1 of the following applies:

   (a) the profits interest relates to a substantially certain and predictable stream of income from partnership assets;

   (b) the partner disposes of the of the profits interest within 2 years; or

   (c) the profits interest is in a publically traded partnership.

   This was later clarified by Rev Proc. 2001-43, 2001 C.B. 191 to address the treatment of on vested profits interest.

5. In 2005, the IRS issued proposed regulations which basically looked to the liquidation value of the profits interest at the time it was issued for purposes of an election under Section 83(b). See 70 Fed. Ref. 29675 (May 24m, 2005). If, as is typically the case, the liquidation value is zero, no income would result. The IRS also issued Notice 2005-43, 2005-1 C.B. 1221 which specified how a taxpayer could make a liquidation value election, resulting in a zero value.

B. Under current law, once a service partner receives a profits interest in a partnership, income allocated to that partner retains the same character as the income earned by the partnership. Therefore, if a partnership recognizes capital gain in a transaction, the portion of the income allocated to the service partner is taxed at capital gains rates.

C. In 2007, a discussion began in academic circles as to whether it was proper for sponsors providing services to private equity funds who received a carried interest in such funds to be taxed at capital gains rates on what was said to be essentially income from the rendering of services. See V. Fleisher, *Two and Twenty; Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U.L. REV. 1 (2008).

D. Later in 2007, a Bill was introduced in the House of Representatives by Rep. Sander Levin purporting to change the treatment of carried interests in the investment management context. H.R. 2834, 110^{th} Cong. (2007). However, the Bill was drafted very broadly and applied beyond the investment management context. Later in 2007, the then chair of the House Ways and Means Committee introduced a tax reform bill which used a carried interest proposal similar to that used in the Levin Bill. H.R. 39700, 110^{th} Cong. (2007). That Bill passed the House but not the Senate.

E. In 2008 the House again passed temporary AMT Relief legislation that had the carried interest provision modeled after previous Bills but with certain technical modifications. This provision was not included in the Senate version of the AMT Relief legislation and did not become law. In April, 2009, Rep. Levin introduced an “updated” version of the carried interest legislation, which was included in a Bill which passed the House in 2010. The Senate dealt with several versions which sought to make a few aspects of the carried interest legislation less onerous but continued to apply very broadly-beyond the private equity fund issue. Senator Baucus took up the carried interest cause, which failed to pass as part of the so called Job Creations and Tax Cuts Act of 2010, S. 3793, 111th Cong. (2010).

F. In February, 2011, the administration released its 2012 Budget proposal which included a carried interest provision-which was said to be a measure which would increase annual government revenues by 14.8 billion. However, unlike prior budget proposals which would have applied to carried interests held in all partnerships irrespective of the underlying business carried on by the Partnership, the provision in the 2012 Budget was specifically limited to interests in "investment partnerships." See the Joint Comm. on Tax'n report reprinted in 2011 Tax Notes Today 31-21 (Feb. 15, 2011). Unfortunately, investment partnerships would most likely include real estate partnerships.

II. MANNER IN WHICH RULES WOULD WORK IF ENACTED

A. The Baucus Bill. Since there is no pending Bill at the time of the preparation of this Outline, the contents of the next Bill to be proposed or what may be enacted is speculative. However, we will briefly review the latest iteration, the so called *Baucus Bill* sponsored by Senator Max Baucus (D. Montana), the most evolved version of the legislation as well as the possible spin put on the Baucus Bill by President Obama's proposed 2012 Budget.

1. Section 83 would be amended to provide that the fair market value of the interest would be treated as its liquidation value and the recipient would be treated as having made an 83(b) election unless the taxpayer affirmatively elects not to have 83)b) apply. This is the least troublesome feature of the Bill.

2. <u>ISPI's</u> The operative rules discussed below would apply to *ISPI's (*Investment Services Partnership Interests). ISPI's generally are defined as

> Any interest in a partnership which is held (directly or indirectly) by any person if it was reasonably expected (at the time that such person acquired such interest) that such person (or any person related to such person) would provide (directly or, to the extent provided by the Secretary, indirectly) a substantial quantity of any of the following services with respect to assets held (directly or indirectly) by the partnership:
>
> a. Advising as to the advisability of investing in, purchasing, or selling any specified asset.
>
> b. Managing, acquiring, or disposing of any **specified asset**.
>
> c. Arranging financing with respect to acquiring specified assets.
>
> d. Any activity in support of any service described above.

Specified assets means securities, real estate held for rental or investment, interests in partnerships; commodities; or options or derivative contracts with respect to such securities, real estate, partnership interests, or commodities. For this purpose, securities include stock in corporations.

Thus, ISPI's are pretty much all inclusive of investment activities and are certainly not limited to persons providing services to private equity funds.

3. A persons holding an ISPI will have net income allocable to such interest or gain resulting from the sale of that interest

treated as ordinary income, subject to self employment tax, and deferring losses with respect to such interests.

4. Although the operative rules are very complex with blended rate rules, the bottom line is that losses allocated to an ISPI holder would be treated as ordinary (or would be subject to a blended rate in the case of individuals) to the extent of the aggregate positive net income with respect to such interest. However, losses in excess of such income would be deferred until either (a) the partnership allocates future income to the partner or (b) the ISPI is sold or redeemed (in which case the loss would be a capital loss).

5. Further, the rules relating to ISPI's would be applied separately with respect to each ISPI. Thus taxable income from one ISPI cannot be offset by taxable loss from another ISPI due to the loss deferral aspect of the Baucus Bill.

6. The Baucus Bill also had special rules for REIT's

B. The 2012 Budget would treat as an ISPI only partnership interests in *Investment Partnerships*. For these purposes, an "investment partnership" would be defined as follows:

A partnership ... if the majority of its assets are investment-type assets (certain securities, real estate, interests in partnerships, commodities, cash or cash equivalents, or derivative contracts with respect to those assets), but only if over half of the partnership's contributed capital is from partners in whose hands the interests constitute property held for the production of income.

While the purpose of this limitation is not stated, it appears to be aimed at both real estate partnerships and Wall Street vehicles such as hedge funds, private equity funds, ,and venture capital funds. Although the concept of holding a partnership interest "for the production of income" is not clearly defined in the budget proposal or the tax law generally, the requirement that over half of the partnership's contributed capital must derive from partners holding their interests in this manner would seemed to be aimed at partnerships with a predominantly passive investor base.

III. IMPACT

A. While the proposal is being promoted as affecting only hedge fund Managers, it is squarely aimed at real estate partnership as a reported 46% of all US partnerships are in real estate and the vast majority that we see use a carried interest structure. The Real Estate Roundtable points out that:

1. There are over 2.5 million tax partnerships managing $13.6 trillion in assets and generating income of roughly $450 billion;

2. Real estate accounted for 45% or 1,125,000 of these partnerships, and roughly $1 trillion in equity investment plus another $350 billion in debt financed investment.

3. The holder of the carried interest is at risk of losing more than his cash investment as he is the ultimate guarantor of the transaction as well as any required environmental remediation. Because the carried interest is subordinated to the cash investors priority return and return of investment dollars, the funds generated may be sufficient to only handle the obligations to the cash investors resulting in a carried interest without value. Thus, it is argued that from a policy point of view, the deal sponsor should be entitled to capital gain and his pro rata share of losses.

B. The proposals have been retroactive so that partnerships which have been in existence for decades may lose capital gains treatment on the carried interest, which arguably would lead to an effective devaluation of all affected properties.

C. As its opponents point out, the enactment of carried interest legislation would dramatically boost the cost of capital, discouraging the risk taking required to have our economy grow.

The author wishes to acknowledge the excellent Article by James B. Sowell and Carol Kulish Harvey of KPMG found in KPMG's *What's News in Tax* dated March 14, 2011 on which the author relied for the background history and analysis of the various carried interest proposals.

<u>PROPOSED AMERICAN JOBS ACT OF 2011</u>

On September 12, 2011, President Obama submitted to Congress the proposed American Jobs Act. The proposed Act, which did not pass Congress, added a few changes to the proposals set forth in the foregoing outline.

Specific Changes/Highlights

- The proposed legislation would only be effective for taxable years ending after December 31, 2012;

- **The proposed legislation does not defer partnership losses as did prior versions;**

- Continues the 2012 Budget definition of an ISPI so that it only applies where the interest is in a partnership that is an "investment partnership;

- The proposed legislation also applies only where a person holds a partnership interest in connection with the conduct of a "**trade or business**" that "primarily involves" the performance of services with respect to specified assets. Prior versions required only that the partner provide "a substantial quantity" of such services, and there was no requirement that the activity constitute a trade or business;

- Recognizing that persons holding an investment services partnership interest may also invest capital in the partnership, the Act would continue current law treatment of income relating to a "qualified capital interest" if:

a. items are made by the partnership to such qualified capital interest in the same manner as locations are made to other qualified capital interests held by partners who do not provide investment services and who are not related to the partner holding the qualified capital interest, and

b. he allocations made to such other interests are significant compared to the allocations made to the qualified capital interest held by the person owning the carried interest.

A "qualified capital interest" includes the portion of a partner's interest in a partnership attributable to

a. the fair market value of any money or other property contributed to the partnership in exchange for such interest (determined without regard to Code section 752(a)),

b. any amounts which have been included in gross income under Code section 83 with respect to the transfer of such interest, and

c. the excess (if any) of

i. items of income and gain taken into account with respect to such interest, over

ii. any items of deduction and loss so taken into account

- An ISPI is not treated as a qualified capital interest to the extent it was purchased with the loans or advances made directly or indirectly from or guaranteed by another partner.

- Amounts treated as ordinary income under the proposed Code section 710 are treated as self employment income subject to Social Security and Medicare taxes.

I AM SO CONFUSED –
409A AND DEFERRED COMPENSATION ISSUES FOR DUMMIES

By: Gary M. Remer and William E. Sigler

I. WHY BE CONCERNED ABOUT SECTION 409A?

A. Noncompliance will result in all current and prior deferred compensation being included in income.

B. A 20% additional tax applies to amounts includable as a result of a violation of Section 409A.

C. An additional 1% penalty is added to the underpayment rate. The underpayment rate is applied to the amounts deferred as of the date of deferral or the date there is no substantial risk of forfeiture, whichever is later.

II. WHAT IS SECTION 409A?

A. Section 409A was added to the Internal Revenue Code by the American Jobs Creation Act of 2004.

B. Section 409A applies to all arrangements in which there is a deferral of compensation. Section 409A generally states that if certain requirements regarding the timing of deferred compensation are not met, then all deferred amounts are immediately included in income unless subject to a substantial risk of forfeiture. In addition to regular income tax, Section 409A imposes an additional 20% tax, plus interest on the deferred compensation.

C. Final regulations were issued by the Treasury on April 10, 2007.

III. WHEN IS SECTION 409A EFFECTIVE?

A. Section 409A is effective for amounts deferred in taxable years beginning after December 31, 2004.

B. Deferred amounts that were "earned and vested" as of December 31, 2004, and the earnings on those amounts, are not subject to Section 409A and are considered "grandfathered amounts." Amounts are earned and vested if they are not subject to a substantial risk of forfeiture under Section 83 or a requirement to perform further services.

C. Grandfathered amounts become subject to Section 409A if the plan under which the deferral is made is materially modified after October 3, 2004.

D. A modification is material if a benefit or right existing as of October 3, 2004 is materially enhanced or a new material benefit or right is added, and the material enhancement or addition affects amounts earned and vested before January 1, 2005.

1. Amending a plan to comply with Section 409A is not a material modification.

2. Changing investment vehicles under an account balance plan is not a material modification.

E. The final regulations are generally effective for taxable years beginning on or after January 1, 2008.

IV. WHAT WAS REQUIRED TO BE DONE?

A. Under Notice 2007-78, plans must be amended on or before December 31, 2008 to comply with Section 409A. However, plans must be operated in compliance with the final regulations for taxable years beginning on or after January 1, 2008.

B. For taxable years beginning prior to January 1, 2008, plans must be operated in good faith compliance with Section 409A. Complying with any applicable IRS Notice, the proposed regulations, or the final regulations is deemed to be good faith compliance.

C. Transitional Rules:

1. Payment elections under existing plans may be changed on or before December 31, 2007, without violating the subsequent election or anti-acceleration rules, except that an election made in 2007 cannot defer a payment that would otherwise have been made in 2007 to a later year or accelerate a payment into 2007 that would have otherwise been made in a later year.

2. Elections as to the time and form of payments under a nonqualified deferred compensation arrangement that is linked to payments under a qualified plan are permitted to remain in effect until December 31, 2007, if the determination of the time and form of payment is made pursuant to the terms of the arrangement that governs payment elections, as in effect on October 3, 2004.

3. A discounted stock right may be amended on or before December 31, 2007, to provide for fixed payment terms. A stock right will not be treated as payable in a year solely because the stock right is exercisable during that year if the stock right is reasonably expected to be exercised in a later year.

4. A discounted stock right may be amended to increase the exercise price to the original fair market value until December 31, 2007.

V. WHAT KINDS OF PLANS OR ARRANGEMENTS ARE NOT SUBJECT TO SECTION 409A?

A. Any "qualified employer plan" is not subject to Section 409A, including a qualified retirement plan under Section 401(a), an annuity arrangement under Sections 403(a) or (b), a SEP under Section 408(k), a SIMPLE plan under Section 408(p), a trust under Section 501(c)(18), a Section 415(m) plan, or any Section 457(b) plan.

B. Vacation or sick leave plans, compensatory time arrangements, disability pay plans, death benefit plans, Archer MSAs, HSAs, or any other medical reimbursement arrangement, including arrangements satisfying Sections 105 and 106 so long as benefits or reimbursements are not includable in income, are not subject to Section 409A.

C. Certain foreign plans are not subject to Section 409A (e.g., plans subject to a treaty, mandated social security systems, tax equalization plans, etc.).

VI. WHAT KINDS OF PLANS OR ARRANGEMENTS ARE SUBJECT TO SECTION 409A?

A. Section 409A applies to any plan or arrangement providing for the deferral of compensation.

B. The definition of deferred compensation is interpreted very broadly and includes arrangements that are not traditionally thought of as deferred compensation.

C. Examples:

1. Nonqualified deferred compensation plans, such as excess plans and 401(k) mirror plans.

2. Nonqualified defined benefit deferral compensation plans, such as SERPs.

3. Section 457(f) plans.

4. Equity compensation awards with provisions for additional deferrals of compensation.

5. Severance agreements.

6. Post-retirement compensation reimbursement arrangements.

7. Certain split dollar plans that include a deferral of compensation.

8. Discounted stock options.

9. Stock appreciation rights.

VII. <u>WHAT IS "DEFERRED COMPENSATION"?</u>

A. Deferred compensation is defined as any "legally binding right" to compensation that has not been actually or constructively received and that is payable in a later year.

1. This definition is applied without regard to whether the amounts are determinable or whether they are subject to a contingency or a substantial risk of forfeiture.

2. An employee does not have a legally binding right to compensation if it can be unilaterally reduced or eliminated after the services have been performed. However, an

employer's right to unilaterally reduce or eliminate a right to compensation after the services have been performed will not be respected if the employee has control over, or is related to, the employer.

B. Short-term deferrals of compensation are exempted from Section 409A.

1. The payment is exempt from Section 409A if the plan does not provide for a deferred payment and the employee receives the payment before the last day of the "short-term deferral period."

2. The "short-term deferral period" ends two and one-half (2 1/2) months following the later of the calendar year or the employer's fiscal year in which the employee's right to receive the payment is no longer subject to a substantial risk of forfeiture. For example, if an employee acquires a vested right to receive compensation in calendar year 2010, and the employer's fiscal year is the calendar year, then the short-term deferral period ends March 15, 2011.

3. The definition of a "substantial risk of forfeiture" under Section 409A is not the same as under Section 83. Under Section 409A, a "substantial risk of forfeiture" exists if entitlement to the amount is conditioned on (i) the performance of substantial future services by any person, or (ii) the occurrence of a condition related to a purpose of the compensation, and the possibility of forfeiture is substantial.

a. A condition related to the purpose of the compensation must relate to the employee's performance for the employer or the employer's business activities or organizational goals (e.g., attainment of earnings or equity value or the completion of an IPO).

b. Refraining from providing services (e.g., a covenant not to compete) is not a substantial risk of forfeiture.

c. The requirement that the employee sign a release in order to receive a benefit is not a substantial risk of forfeiture.

4. Whether the possibility of forfeiture is substantial depends on the surrounding circumstances. In the case of rights to compensation granted by an employer to a significant stockholder, the determination is based partly on the probability as to whether the employer will enforce the forfeiture restriction.

5. An amount will not be considered to be subject to a substantial risk of forfeiture after the date or time that the employee could otherwise have elected to receive the compensation, unless the present value of the amount subject to the forfeiture condition is materially greater than the present value of the amount that the employee could have elected to receive.

6. A plan will not qualify for the short-term deferral exception if any payment under the plan will be made or completed on or after any date, or upon the occurrence of any event, that will or may occur later than the last day of the short-term deferral period, such as a separation from service, death, disability, change in control event, specified time or schedule of payments, or unforeseeable emergency, regardless of whether an amount under the plan is actually paid during the short-term deferral period.

7. A delay in payment beyond the short-term deferral period is permitted if:

    a. It is administratively impractical to make the payment within the short-term deferral period, provided that the impracticality was unforeseeable;

    b. Making the payment would jeopardize the employer's ability to continue as a going concern; or

    c. The employer reasonably anticipates that it will not be permitted to deduct the payment because of the $1 million limitation on compensation under Section 162(m), provided that the employer can show that a reasonable person would not have anticipated that Section 162(m) would have applied at the time the legally binding right to the payment arose.

B. Section 409A does not apply to certain separation pay arrangements.

1. Section 409A does not apply to collectively bargained separation pay arrangements paid on involuntary separation or pursuant to a window program.

2. Non-collectively bargained involuntary or window separation pay arrangements are not subject to Section 409A if:

    a. The total payments to the employee do not exceed the lesser of two times the annual compensation for the year prior to the termination, or two times the Section 401(a)(17) limit ($490,000 for 2011); and

    b. All payments will be made by December 31 of the second year following the year in which the employee terminates employment.

3. Even if separation payments exceed these limits, the amounts up to the limit can be treated as subject to the separation pay exception.

4. Whether a separation is "involuntary" is based on the facts. The characterization made by the parties will be presumed to be correct, but it can be rebutted in certain cases.

5. The regulations permit certain voluntary terminations for "good reason" to be treated as an involuntary separation if there is a material negative change in the employment relationship and the employer has an opportunity to remedy the condition.

6. The regulations also provide a safe harbor definition of "good reason" if the following conditions are met:

    a. The employee separates from service within two years of the initial event giving rise to the separation;

    b. The amount, time and form of payment is identical to a non-good reason termination; and

    c. One or more of the following apply:

        i. There is a material diminution in the employee's base salary:

        ii. There is a material diminution in the employee's authority, duties or responsibilities;

        iii. There is a material diminution in the authority, duties or responsibilities of the person to whom the employee reports;

iv. There is a material diminution in the budget over which the employee has authority; or

v. There is a material change in the geographical location at which the employee must perform services.

C. Certain reimbursement arrangements are not subject to Section 409A.

1. Post-termination reimbursement arrangements are not subject to Section 409A if they are not includable in gross income, are deductible by the employer under Sections 162 or 167, or are reasonable out-placement or moving expenses. The reimbursements must be incurred no later than December 31 of the second calendar year following the calendar year in which the separation occurs and must be paid no later than the third calendar year.

2. Medical reimbursements that are permitted during the COBRA period are not subject to Section 409A.

D. Employer indemnification plans, bona fide legal settlements, and educational benefits are not subject to Section 409A.

E. Restricted stock awards are not subject to Section 409A.

F. Qualified stock options under Sections 422 and 423 are not subject to Section 409A.

G. An option to purchase “service recipient stock” (“SRS”), i.e., a non-qualified stock option, or a stock appreciation right (“SAR”) granted at “fair market value” is not subject to Section 409A.

1. An SRS can be only the common stock of a company (under Section 305), but the stock may not have:

a. Any distribution preferences other than distributions of SRS and liquidation preferences; or

b. Any mandatory repurchase obligation (other than a right of first refusal) or a put-call right that is not a lapse restriction under Section 83, unless the right or obligation is at fair market value.

2. SRS includes the stock of the employer and any corporation that commonly controls the employer. In other words, SRS includes the common stock of any organization "up the employer's chain" but not "down the employer's chain." Common control is 50%, but it may be 20% if there are legitimate business criteria.

3. For a publicly traded corporation, fair market value is any reasonable and consistently applied trading price method.

4. For a privately-held company, fair market value is determined by the "reasonable application of a reasonable valuation method." Whether a valuation method is reasonable is based on the facts and circumstances and all available information.

5. Factors to be considered under a reasonable valuation method include:

a. Value of tangible and intangible assets;

b. Present value of anticipated future cash-flows;

c. Market value of stock or equity interests in similar corporations and other entities engaged in similar trades or businesses;

d. Recent arms length transaction; and

e. Other relevant factors such as control premiums or marketability discounts and whether the valuation is used for other purposes.

6. The following valuation methods will be presumed to be reasonable:

   a. An independent appraisal that meets the requirements for valuing stock held by employee stock ownership plans and was issued no more than twelve months before the date of the grant of the stock right;

   b. A formula-based valuation that would constitute a non-lapse restriction for purposes of Section 83 and will by its terms be used so long as the stock is not publicly traded, provided that it is used both for compensatory transactions and in connection with transfers to the issuer or a 10% shareholder, though its use need not be required in a sale of all or substantially all of the outstanding stock; or

   c. For illiquid stock of start-up companies (generally, those that have been in business for less than 10 years, have no publicly traded class of securities, and do not reasonably anticipate a change in control within 90 days or a public offering within the next 180), a reasonable, good-faith valuation evidenced by a written report issued by someone who is qualified, but not necessarily independent.

7. Any “modification” of a stock option is treated as the grant of a new option. Consequently, if a modification occurs and the

exercised price is not adjusted to the then fair market value (if higher), the option will be subject to Section 409A.

a. A modification is any change that reduces the exercise price, adds a deferral feature, or extends or renews the option.

b. Any change to the option that increases its value is considered to be a modification.

c. An extension of the option is considered to be a modification, unless the right to exercise the option is not extended beyond the earlier of the original expiration date or ten years from the grant date.

d. A modification does not include any of the following:

   i. Acceleration of vesting;

   ii. Adding a stock exercise or withholding feature;

   iii. Making adjustments to reflect certain changes in the capitalization of the corporation; or

   iv. The grantor's exercise of discretion to permit the transfer of a stock option.

H. The grant of a partnership interest is treated under the same principles that govern the grant of stock. The grant of a profits interest in a partnership that is not includable in income does not appear to be subject to Section 409A.

I. Arrangements between accrual basis taxpayers are not subject to Section 409A.

J. Arrangements with service providers, other than an employer director, who are actively engaged in the trade or business of providing substantial services to two or more unrelated service recipients are not subject to Section 409A.

VIII. <u>WHAT ARE THE REQUIREMENTS FOR ELECTIONS UNDER SECTION 409A?</u>

A. Initial elections.

1. Elections as to the amount, time of distribution and form of payment must be made before the beginning of the calendar year in which the services are performed. An election must be irrevocable. An "evergreen" election may remain in effect for future years until timely changed or revoked, provided that the election becomes irrevocable with respect to salary earned during any future calendar year by December 31 of the preceding calendar year.

2. A plan under which the employee does not elect the time or form of payment must provide for the time and form of payment generally no later than the date that the employee first has a legally binding right to payment.

3. In the first year in which an individual becomes eligible to participate in a plan, the election must be made within thirty days after becoming eligible. Only compensation not yet earned may be deferred, and only a pro rata portion of any bonus type compensation earned over a performance period may be deferred.

4. For performance-based compensation, the election must be made no later than six months before the end of the period over which performance is measured.

a. Performance-based compensation is an amount that is contingent on satisfying pre-established company or individual goals over a performance period of not less than twelve months that are not substantially certain to be met at the time of the election.

b. The criteria must be established within ninety days after the performance period begins. If the criteria are based on increases in the value of the employer's stock, then only increases after the award date may be taken into account.

5. Under an involuntary separation pay plan, the employee can make an election regarding the form and timing of the payment up to the date the employee has a legally binding right to the payment. For a window separation pay plan, the employee can make this election up to the time the election to participate in the window program becomes irrevocable.

6. Certain elections to receive bonuses based on the employer's fiscal year must be made before the beginning of the relevant fiscal year.

B. Subsequent elections.

1. A participant may make a subsequent election only if permitted under the plan and the election meets the following conditions:

a. Any change in the timing or form of distribution must not take effect until at least twelve months after the election is made.

b. Except for payments on account of death, disability or unforeseeable emergency, the distribution must be deferred for at least five years from the original payment date, or five years from the first payment date in the case of a life annuity or installment payments treated as a single payment.

c. An election to defer a series of fixed installment payments must be made at least twelve months before the first scheduled payment.

2. Multiple payments, such as installment or annuity payments, that are separately identified may be treated as separate payments and are eligible for separate subsequent elections.

a. Installment payments are treated as one payment, unless the plan treats each payment separately. If the installment payments are treated as one payment, a change from installment payments to a lump-sum payment would require the employee to delay the payment for five years from the original start date of the first installment payment. If the installment payments are separate payments, any change from installment payments to a lump sum payment would require the payment to be made five years after the last installment payment was scheduled to be made.

b. Life annuities are treated as one payment, but a participant may select among actuarial equivalent annuities if the election is made before the annuity payments begin.

IX. <u>WHAT ARE THE REQUIREMENTS FOR DISTRIBUTIONS UNDER SECTION 409A?</u>

A. A plan must provide that amounts subject to Section 409A may not be distributed earlier than one or more of the following events:

1. Separation from service.

a. There is no separation from service if the participant is on military leave, sick leave, or another bona fide leave of absence if the period does not exceed six months or, if longer, the participant's right to reemployment is provided by contract or statute.

b. Payments to "specified employees" of publicly traded companies must be delayed for at least six months following separation from service.

2. Death.

3. Disability.

a. The determination of disability must meet either of the two following definitions:

i. The participant is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to last for at least twelve months; or

ii. The participant is, by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for at least twelve months, receiving income replacement benefits for a period of at least three months under an employer sponsored disability plan.

b. A participant may also be deemed to be disabled if determined to be totally disabled by the Social Security Administration.

4. A time or a fixed schedule specified under the plan.

5. Unforeseeable emergency.

a. Unforeseeable emergency is limited to a severe financial hardship resulting from an illness or accident of the participant, spouse or dependent, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising from events beyond the participant's control.

b. Examples include imminent foreclosure of the participant's primary residence, medical expenses, or funeral expenses.

c. The amount payable is limited to the amount reasonably necessary to satisfy the emergency, including any taxes.

6. Change in control.

a. The change in control of the corporation must be objectively determinable and must involve no discretionary authority.

b. Each change in control distribution event under the plan must qualify as a change in control event.

c. A change in control means:

i. A change in the ownership of the corporation where any one person (or more than one person acting as a group) acquires more than 50 percent of the value or voting power of the stock of a corporation.

ii. A change in the effective control of the corporation, which means either:

(A) Any one person (or more than one person acting as a group) acquires (during a twelve month period) 30% or more of the voting power of the stock of a corporation, or

(B) A majority of the board members are replaced during any 12 month period by directors whose appointment or election was not endorsed by a majority of the board prior to the date of appointment or election.

iii. A change in ownership of a substantial portion of the assets of a corporation where any one person (or more than one person acting as a group) acquires (during a twelve month period) more than 40% of the total gross market value of all of the assets of the corporation.

X. <u>WHAT ARE THE RESTRICTIONS ON ACCELERATING PAYMENTS UNDER SECTION 409A?</u>

A. The payment of deferred compensation subject to Section 409A may not be accelerated, except as follows:

1. Payments necessary to comply with a domestic relations order;

2. Payments necessary to comply with certain conflict of interest rules;

3. Payments intended to pay employment taxes;

4. Certain cash-outs of small amounts related to the termination of a participant's interest in the plan (where the amount does not exceed the Tax Code Section 402(g)(1)(B) limit, which is $16,500 for 2011);

5. Payments intended to pay taxes on account of the failure to meet the requirements of Section 409A;

6. Cancellation of deferrals following an unforeseeable emergency or 401(k) plan hardship distribution;

7. In the case of a 457(f) plan, payments intended to pay taxes upon a vesting event;

8. Plan terminations and liquidations (as more fully discussed below);

9. Certain distributions to avoid a nonallocation year for ESOPs under Section 409(p);

10. Distributions to pay state, local, or foreign tax obligations arising from participation in the plan;

11. Cancellation of deferral elections due to disability (with the cancellation occurring by the later of the end of the calendar year in which the disability is incurred, or the 15th day of the third month following the date the disability is incurred, and where “disability” refers to a medically determinable physical or mental impairment resulting in the employee’s inability to perform the duties of his or her position or any substantially similar position, where that disability can be expected to result in death or can be expected to last for a continuous period of not less than six months);

12. Offsets to satisfy debts of an employee to an employer, where the amount of the reduction in any calendar year does not exceed $5,000; and

13. Payments as part of a settlement between the employee and employer of an arms length bona fide dispute as to the employee’s right to the deferred amount.

B. An employee is not permitted to receive a distribution of assets upon the termination of a non-qualified deferred compensation plan, except in the following circumstances:

1. A plan may be terminated during 30 days before or twelve months after a change in control.

2. A plan may be terminated upon a corporate dissolution or with the approval of a bankruptcy court if certain conditions are met.

3. A plan may be terminated if:

   a. The employer terminates all similar plans,

   b. Distributions are made no sooner than twelve months and no later than 24 months after termination, and

c. The employer does not adopt any new plan of the same type for three years.

C. The aggregation of all account and non-account balance plans does not apply in this context.

D. There is no acceleration permitted for ceasing to be a member of the top-hat group.

XI. WHAT ARE THE RESTRICTIONS ON FUNDING UNDER SECTION 409A?

A. The final regulations do not provide any guidance concerning the funding restrictions set forth in Section 409A. Therefore, the restrictions provided under Notice 2005-1 and Notice 2006-33 continue to apply.

B. Any assets set aside in a trust under a deferred compensation arrangement will be includable in the individual's income if the assets are located or transferred outside of the U.S. This provision does not apply to assets located in a foreign jurisdiction if substantially all of the services to which the deferred compensation relates are performed in that jurisdiction.

C. Any amounts subject to a deferred compensation plan that become restricted in connection with a change in the employer's financial health will be includable in the participant's income whether or not the assets are available to satisfy the claims of the employer's general creditors. This effectively eliminates immediate funding in either a secular or rabbi trust if the employer's financial condition deteriorates.

XII. WHAT IS THE SIGNIFICANCE OF "PLAN AGGREGATION" UNDER SECTION 409A?

A. The proposed regulations introduced a "plan aggregation" concept and divided plans into four separate categories:

1. Account balance.

2. Non-account balance.

3. Certain separation pay arrangements.

4. Other plans.

B. All plans of the same type in which an employee participates are treated as one plan. If any one of those plans violates Section 409A, adverse tax consequences apply to all amounts deferred under all plans of the same type.

C. The final regulations add three new categories of plans for this purpose:

1. Split-dollar life insurance arrangements.

2. Reimbursement plans.

3. Stock rights.

XIII. WHAT IS THE WRITTEN PLAN REQUIREMENT?

A. The regulations establish a requirement that the material terms of a deferred compensation arrangement that is subject to Section 409A be set forth in writing. The written plan requirement may be satisfied in one or more documents.

B. Those material terms include such things as the following:

1. The amount (or the method or formula for determining the amount) of deferred compensation to be provided under the plan.

2. The time and form of payment.

3. If employees are permitted to make initial deferral elections, then the plan must set forth in writing, on or before the date the employee's election is required to be irrevocable, the conditions under which the election may be made.

4. If a plan permits subsequent deferral elections, then the plan must set forth in writing, on or before the date such an election is required to be irrevocable, the conditions under which those elections may be made.

5. A plan is generally not required to set forth in writing the conditions under which payment may be accelerated.

6. A "savings clause" is not adequate to comply with Section 409A.

C. Although generally a plan will not be considered to be established until its material terms are set forth in writing, a plan will be deemed to be established as of the date a participant has a legally binding right to a deferral of compensation, so long as the plan is actually established by (i) the end of the year in which the legally binding right arises, or (ii) with respect to an amount not payable in the year immediately following the year in which the legally binding right arises (i.e., the subsequent year), the 15th day of the third month of the subsequent year. In the case of an amendment that increases the amount deferred under a plan, the plan is not considered to be established with respect to the additional amount until the plan is appropriately amended.

D. Although the final regulations are applicable for taxable years beginning on or after January 1, 2008, Notice 2007-78 provided limited transition relief, until December 31, 2008, with respect to the plan document requirements.

1. After December 31, 2007, taxpayers may not generally change the time and form of payment, and no change in the time and form of payment after December 31, 2007 may result in an amount that was deferred as of December 31, 2007 qualifying for an exclusion from the definition of deferred compensation under the final regulations.

XIV. CORRECTION GUIDANCE?

A. IRS Notice 2010-06 – On January 5, 2010, the IRS issued this Notice offering opportunities for companies to correct non-compliant deferred compensation documents and avoid certain penalties that would otherwise apply under Section 409A. The documentary failures that may be corrected under Notice 2010-6 cover a broad spectrum of Section 409A pitfalls, including:

1. Plan terms (such as "separation from service," "change in control," and "disability") that do not meet the definition and all requirements of Section 409A;

2. Payment periods of longer than 90 days following a permissible payment event;

3. Payment periods following a permissible payment event that are dependent upon the employee completing certain employment related actions (such as executing a non-competition agreement or a release of claims);

4. Impermissible payment event (such as initial purchase offering that does not constitute a change in control event under Section 409A);

5. Alternative payment schedules that depend on which type of permissible payment event occurs;

6. Company or employee discretion regarding payment schedules following a permissible event (including subsequent deferral election);

7. Impermissible company discretion to accelerate payment event;

8. Impermissible reimbursement of in kind benefit provision; and

9. Failure to provide for the required 6 month delay in payment to specified employees.

B. Notice 2010-06 pertains to the correction of documentary violations of Section 409A: that is, to deferred compensation arrangements that are drafted in violation of Section 409A, whether or not such violations have resulted in any impermissible payments.

C. It is important to note that deferred compensation arrangements drafted in violation of Section 409A are subject to acceleration of income recognition and the taxes and penalties under Section 409A, even if no payments have been made with respect to such arrangements.

D. Although Notice 2010-06 did provide guidance, its examples also gave employers cause for concern. For example:

1. The phrase "termination of employment" may violate Section 409A if it leads to payments in situations not permitted under Section 409A (for example, where an employee reduces their hours or is rehired as an independent contractor providing significant service after termination of employment).

2. Severance payments contingent on a release of claims or the end of a rescission period may violate Section 409A if the compensation to be paid is subject to Section 409A.

V. NOTICE 2010-80 REDUCES THE BURDEN.

A. Notice 2010-80 modifies both procedures and principally affects the document correction procedures of Notice 2010-06.

1. Many severance agreements, and some deferred compensation plans, require the employee to sign a release of claims or other agreement (such as a non-compete) in order to receive a payment.

2. Although many severance agreements are exempt from Section 409A, if the agreement is subject to 409A and does not specify time period during which the release must be signed, the IRS considers this a Section 409A violation because the employee can determine which year the payment is made based on when he or she signs the release.

3. Notice 2010-06 provided that in order to correct this, the agreement had to be amended to provide that the payment had to be made on a specified date, generally either 60 or 90 days after termination, and could not be paid any earlier.

4. Notice 2010-80 allows payments to be made within a specified period, such as 90 days after termination, provided that if the payment period overlaps 2 years, the payment must always be made in the later year.

5. Under an extended transitional period, an agreement can be formally amended at any time until December 31, 2012, to comply with the timing rules. If the employee terminates prior to that date, the payment must actually be made during a permitted payment period.

B. One of the most unpopular features of the correction procedures is the requirement that both the employer and the employee must attach statements to their respective tax returns, notifying the IRS that they have relied on the correction procedures.

C. Notice 2010-80 provides that the employee is not required to attach the statement to his or her tax return for (1) any document correction under Notice 2010-06 that is completed in 2010; (2) any correction of the release timing rules that is completed by December 31, 2012, under the new transitional relief under the current notice; <u>or</u> (3) certain other technical corrections that are permitted under Notice 2010-06 to be completed by December 31, 2011.

D. The employer is still required to file the attachment to its tax return.

ROUNDUP OF RECENT TAX DEVELOPMENTS

By: William E. Sigler

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I. FEDERAL

A. Small Business Jobs Act of 2010 ("SBA"). SBA was signed into law in September 27, 2010, but changes were made to some of its provisions by Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010 ("TRA"), which was signed into law on December 17, 2010.

1. Section 179 First-Year Depreciation Deduction. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), signed into law December 17, increased the additional first-year depreciation deduction from 50 percent to 100 percent of the adjusted basis of qualified property acquired and placed in service after September 8, 2010, and before January 1, 2012. The IRS has issued Rev. Proc. 2011-26, which explains the eligibility requirements for qualified property to be eligible for the 100% additional first-year depreciation deduction. There was an inconsistency between the statutory language and the JCT's technical explanation. The new Revenue Procedure addresses the inconsistency by using a component analysis, in which a component is a part used in the manufacture, construction or production of the property. A component may be the same as the actual property subject to the 100% additional first-year depreciation deduction. The Revenue Procedure states that if a component of the property was acquired or self-constructed after September 8, 2010, but manufacture, construction or production of the larger self-constructed property began before that time, the taxpayer may elect the 100% additional first-year depreciation deduction for all eligible components, i.e., those that are qualified property acquired or self-constructed after September 8, 2010, and before January 1, 2012. The new guidance also allows taxpayers with qualified property placed in service in the tax year that includes September 9, 2010, to either elect out of bonus depreciation entirely for the whole year, default into bonus for the whole year (either 50 percent or 100 percent depending on when and what qualifies), or elect to claim 50 percent for the whole year. The following summarizes the differences in the rules between bonus depreciation under Section 168(k), originally created by the Job and Growth Tax Relief Reconciliation Act of 2003, and the Section 179 additional first-year depreciation deduction:

a. Bonus Depreciation at a Glance

- The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 provides 100 percent depreciation bonus for capital investments placed in service after September 8, 2010 through December 31, 2011. For equipment placed in service after December 31, 2011 and through December 31, 2012, the bill provides for 50 percent depreciation bonus.

- However, The Small Business Jobs Act of 2010, which contained 50 percent depreciation bonus, still applies to purchases made between January 1, 2010 through September 7, 2010.

- Depreciation bonus helps businesses that cut their tax bill buy new equipment.
- Applies, among other things, to purchases of tangible personal property (including construction, mining, forestry, and agricultural equipment) with a MACRS recovery period of 20 years or less
- Applies to new equipment only
- Allowed for both regular and alternative minimum tax purposes
- Discretionary - Taxpayer need not claim the depreciation bonus

b. Section 179 additional first-year depreciation at a Glance

- The Small Business Jobs Act increased Sec. 179 expensing levels to $500,000 for 2010 and 2011
- The phase-out threshold amount is $2 million
- The new tax cut extension law also extends Sec. 179 expensing for taxable years beginning in 2012, at $125,000 and $500,000 respectively, indexed for inflation.
- New and used equipment is eligible for expensing
- Can be combined with bonus depreciation

2. <u>Start-up Cost Deduction Rule Liberalized for 2010</u>. For tax years beginning in 2010, SBA increases the maximum deduction that can be claimed for start-up costs in the year when a new business commences operations from $5,000 to $10,000. However, the $10,000 deduction allowance is phased out once cumulative start-up costs exceed $60,000. Start-up costs that cannot be deducted in the year when the business commences under the $10,000 allowance can be amortized over 180 months, starting with the month when business commences.

3. <u>Qualified Small Business Corporation Stock</u>. Prior to SBA, sellers of "qualified small business corporation" shares could potentially exclude

50% or 75% of the resulting gain, depending on when the shares were purchased. However, the portion of the gain that was included in income was taxed at a maximum federal rate of 28%, and part of the gain was included in income for alternative minimum tax purposes. In order to encourage new investments in qualified small business corporation stock, SBA increases the gain exclusion percentage to 100% for qualifying sales of qualified small business corporation stock that is issued between September 28, 2010 and December 31, 2010. In addition, the excluded gains from the sale of those shares will not generate alternative minimum tax adjustments. As under pre-SBA law, shares must still be held for over five years to qualify for this tax break. Thus, it applies to sales that will occur in 2015 and beyond. In addition, TRA extends the 100% exclusion for one more year to stock acquired before January 1, 2012.

4. Break for S Corporation Built-in Gains Recognized in 2011. When a C Corporation converts to S Corporation status, the corporate-level built-in gains tax generally applies when built-in gain assets, including receivables and inventories, are turned into cash or sold within the recognition period. The recognition period is normally the ten year period that begins on the conversion date. For tax years beginning in 2011, the SBA exempts gains from the built-in gains tax if the fifth year of the recognition period has gone by before the start of the 2011 tax year.

5. Eligible Small Businesses Get Special Treatment for 2010 General Business Credits. Previously, most general business credits could be used to offset regular income taxes, but not alternative minimum tax. General business credits generated in the current tax year that could not be used in that year could be carried back one year or forward 20 years. SBA creates an exception that allows general business credits that arise in tax years beginning in 2010 to offset alternative minimum tax for 2010. Also, unused general business credits from 2010 can be carried back five years or forward 25 years. These exceptions are available to eligible small businesses with average annual gross receipts for the preceding three tax years of $50 million or less.

6. Health Insurance Premiums Can Be Deducted in Calculating 2010 Self-Employment Taxes. Until now, a self-employed individual's federal income tax deduction for health insurance premiums could not be deducted as an expense when calculating his or her self-employment tax liability. For 2010, the health insurance premium deduction is allowed as an expense on Schedule SE.

7. Qualified Plan Distributions Can Be Rolled Over Into a Plan's Designated Roth Account. Some qualified retirement plans, typically Section 401(k) plans, allow participants to make salary-reduction contributions to designated Roth accounts. These accounts are similar to Roth IRAs, but they are operated by the retirement plan, rather than the individual. SBA provides that a plan that maintains Roth accounts can, but is not required to, allow a plan participant to rollover a distribution from the "regular" part of the plan into his or her designated Roth

account. This change is effective for distributions made after September 27, 2010. The tax impact of rolling over a distribution into a designated Roth account is the same as rolling over the distribution into a Roth IRA, and thereby effecting a Roth conversion with respect to the distributed amount. In both cases, the taxable portion of the distribution must be included in gross income. There is a special rule for 2010 Roth conversions that allows the gross income triggered by the conversion to be spread 50/50 between 2011 and 2012, unless the taxpayer elects to recognize all of the income in 2010. Apparently, the special rule is only available for retirement plan distributions made after September 27, 2010 that are then rolled over into a designated Roth account.

8. Partial Annuitization Allowed for Annuity, Endowment and Life Insurance Contract. When an annuity, endowment or life insurance contract is annuitized, each resulting annuity payment consists partly of a tax-free recovery of basis and partly of a taxable distribution of accumulated earnings. Effective for amounts received after 2010, SBA allows annuity, endowment and life insurance contracts to be partially annuitized. In effect, the annuitized portion is treated as a separate contract. Each annuity payment received from the portion treated as a separate contract will then consist partly of a tax-free recovery of basis and partly of a taxable distribution of accumulated earnings. The portion of the contract that is not annuitized is also treated as a separate contract, and that portion will continue to earn income on a tax-deferred basis.

9. Harsher Penalties for Failure to Comply with Form 1099 Reporting Rules. Beginning in 2011, the IRS can assess much harsher penalties for failing to file Form 1099 information returns with the IRS, and failing to send copies to payees. In many cases, the penalties will be doubled. The new rules, which are quite complicated, will apply to Forms 1099 and payee statements due in 2011 and beyond.

B. Limited Partner Exclusion from the Self-Employment Tax. *Renkemeyer, Campbell & Weaver, LLP, et al. v. Commr.*, 136 TC No. 7, the Tax Court rejected the taxpayer's argument that the limited partner exclusion in Section 1402(a)(13) applied to the taxpayer's self-employment income. The Tax Court found that the exclusion was intended only for individuals who merely invest in, but do not actively participate in, partnership business operations, not for individuals who perform services in their capacity as a partner. In this case, the taxpayer performed legal services for his firm in his capacity as a partner and his distributive share was attributable to that income, i.e., it was not merely a return on investment. This has been an unsettled area for many years. The IRS previously proposed regulations extending the limited partner exception to entities beyond limited partnerships, but indicated that persons in these other entities would not be classified as "limited partners" for self-employment tax purposes if they participate in the entity's trade or business for more than 500 hours a year or if they are able to contract on behalf of the entity or have personal liability for the entity's debts. The proposed regulations were controversial, and in 1997 Congress issued a one year moratorium on the issuance of final regulations. As a consequence, the IRS took no further action. However, it indicated that it would not challenge positions taken by taxpayers who rely on the proposed regulations. Over the years taxpayers have taken a wide variety of other positions with respect to who qualifies as a limited partner. Many of these positions would not pass muster under a test that looks solely at whether the earnings of the member in the limited liability company, or the partner in a limited liability partnership, are “basically of an investment nature.” Even some non-managing members of certain limited liability companies and, for that matter, persons who are bona fide limited partners in limited partnerships under state law, could be exposed to self-employment tax under this test. Thus, the case has renewed the uncertainty over the law in this area.

C. Partnership Withholding on Outbound Payments. In partially redacted emailed advice, the IRS has indicated that a domestic partnership must abide by the statutory withholding requirements on qualifying payments to non-resident aliens and foreign corporations regardless of whether the recipient holds a partnership interest in the payor. CCA-119202-10 (Released 3/25/2011).

D. Discharge of Indebtedness Income of Grantor Trusts and Disregarded Entities. The IRS has issued proposed regulations (REG-154159-09) on the exclusion from gross income under Section 108(a) for discharge of indebtedness income of a grantor trust or an entity that is disregarded as an entity separate from its owner. Income from the discharge of indebtedness is generally included in gross income under Section 61(a)(12), but it may be excluded under Section 108 in some instances, such as where the discharge occurs in a bankruptcy case or to the extent the taxpayer is insolvent. The activities of a disregarded entity are treated in the same manner as those of a sole proprietorship, branch, or division of the owner so that all assets, liabilities, and items of income, deduction, and credit of a disregarded entity are treated as assets, liabilities and items of income, deduction, and credit of the owner of the disregarded entity. Similarly, a grantor trust is any part of a trust that is treated as being owned by the grantor or another person so that its items of income, deduction, and credit attributable to the trust are includable in computing the taxable income and credits of the owner. The proposed regulations specify that the term “taxpayer” refers to the owner of the grantor trust or disregarded entity. Therefore, the trusts or entities themselves will not be considered owners for purposes of applying Section 108. The proposed regulations are partially a response to the position taken by some taxpayers who believe the insolvency exception should be available to the extent the grantor trust or disregarded entity is insolvent, even if its owner is not. Likewise, some taxpayers have argued that the bankruptcy exception should apply to the extent the grantor trust or disregarded entity is under the jurisdiction of a bankruptcy court, even if its owner is not. The IRS rejected both of these positions in the proposed regulations.

E. Rollback of IRS Form 1099 Reporting Requirements. The Health Care Reform Bill passed last year contained a provision that would start in 2012 requiring businesses that make a payment to a vendor for goods or services of over

$600 annually to report that amount to the IRS on a Form 1099. This much-criticized requirement has been repealed by the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011. Repeal of the requirement means that the law reverts to the rules that were in effect prior to passage of the Health Care Reform Bill. Thus, businesses must continue to issue Form 1099s for payments of $600 or more to service providers. Likewise, the exception for reporting payments made to corporations remains in effect. The new law also repeals a provision in the 2010 Small Business Jobs Act that after December 31, 2011 would have required landlords to issue Form 1099s for payments of rental property expenses if those payments exceed $600 annually, even if the rental operations of those landlords did not arise to the level of a trade or business. This means that landlords do not need to identify specific rental property expenses for reporting unless they are otherwise required to be reported under the tax laws. For example, landlords whose rental operations amount to a trade or business must continue to issue Form 1099s if their payments to service providers are over $600 annually.

F. Payment of Creditors Was Willful Failure to Remit Employment Taxes. The Eleventh Circuit affirmed a district court's grant of summary judgment to the government, finding that an individual's choice to pay other creditors before remitting employment taxes to the government satisfied the willfulness requirement of section 6672. *Terri Lynn Brown v. United States* (No. 11-10833).

G. Regulations on Elections to Deduct Start-Up Expenses Finalized. The Treasury has issued final regulations (T.D. 9542) permitting taxpayers to deduct up to $5,000 of start-up and organizational expenses in a business's first tax year, while permitting any remaining expenses to be amortized over 15 years. Prior to the American Jobs Creation Act of 2004, start-up expenses, other than section 197 intangibles, could be amortized over a period of at least five years. Section 197 intangibles could be amortized over 15 years. Taxpayers wishing to amortize their expenses had to affirmatively elect to do so by attaching to their return a statement describing the business, the period of amortization, and what expenses were incurred. The 2004 Act changed that provision by increasing the amortization period from five years to 15 years for all start-up costs. In addition, taxpayers were allowed to deduct up to $5,000 of the expenses up-front. That deduction is reduced dollar-for-dollar by any start-up expenses above $50,000. These changes were contained in Section 195(b). Similar changes were made to Section 248(a), covering the amortization of organizational costs, and Section 709(b) for partnerships. Under the 2008 temporary regulations, taxpayers were deemed to have elected that deduction and amortization treatment unless they clearly elected to capitalize those expenses. The final regulations were amended to clarify that taxpayers wishing to forego the deemed amortization election must affirmatively make the election to capitalize on a timely filed federal income tax return. But, the regulations do not establish detailed requirements for the election. Reference to "affirmative" is a clear indication that more is needed than just capitalization. The regulations also specify that a business (and therefore the deduction and amortization period) begins not at the time of its incorporation, but rather "when it starts the business operations for which it was organized." Acquisition of operating assets may constitute the beginning of business.

H. Employer-Provided Cell Phones. The IRS has released guidance (Notice 2011-72) allowing employers and employees to exclude the value of employer-provided cell phones from employee income without burdensome substantiation requirements.

I. New Voluntary Worker Classification Settlement Program. According to a September 21, 2011 news release, the IRS announced a new program that will enable many employers to resolve past worker classification issues by making a minimal payment covering past payroll tax obligations. Under the program, dubbed "Voluntary Classification Settlement Program ("VCSP"), eligible employers can obtain relief from federal payroll taxes that they may have owed in the past if they prospectively treat workers as employees. To be eligible, an employer must (i) consistently have treated the workers in the past as non-employees; (ii) have filed all required Forms 1099 for the workers for the previous three years; and (iii) not currently be under audit by the IRS, the Department of Labor or a state agency concerning the classification of these workers. Interested employers can apply for the program by filing Form 8952 at least 60 days before they want to begin treating the workers as employees.

J. Failure to Disclosed Listed and Reportable Transactions. The IRS has issued final regulations (T.D. 9550) on the penalty for failing to disclose listed and nonlisted reportable transactions. Prior to the Small Business Jobs Act of 2010, the statute required a fixed monetary penalty that did not take into account the size of the tax benefit associated with the reportable transaction. The Act modified the Section 6707A penalty for failing to report a listed transaction, effective for penalties assessed after December 31, 2006, to equal 75% of the tax benefit of the unreported transaction, with a minimum penalty of $5,000 for individuals and $10,000 for other taxpayers, and a maximum penalty of $100,000 for individuals and $200,000 for other taxpayers. The penalty for failing to disclose nonlisted reportable transactions is $10,000 for individuals and $50,000 for other taxpayers.

K. President Signs Bill Barring Tax Strategy Patents. The President signed a patent reform bill (H.R.1249) into law barring the approval of new tax strategy patents. It does not apply to return preparation software or financial management software that does not limit the use of a tax strategy.

L. Treatment of Expenses in Bankruptcy Reorganization. The IRS has issued a private letter ruling addressing the treatment of expenses incurred in a bankruptcy reorganization. PLR 2011-38-022.

M. Nonaccrual Experience Method. The IRS has released guidance that provides a safe harbor method for taxpayers who use the nonaccrual experience ("NAE") method to account for amounts to be received for the performance of services. Rev. Proc. 2011-46. The NAE method is found in Section 448(d)(5) and is generally available to accrual method taxpayers who perform services in the areas of health, law, engineering, architecture, accounting, actuarial science, performing arts or consulting, or who have under $5 million in gross receipts in prior years. Treas. Reg. Sec. 1.448-2(f)(1)-(5) provides methods for computing the amount of uncollectible payments for services. The new revenue procedure provides a book safe harbor method, which allows taxpayers to determine their uncollectible amounts by multiplying the year-end allowance for doubtful accounts in their applicable financial statements attributable to current-year NAE accounts receivable by 95%.

N. Section 199 Guidance on When Service Income Can Be Attributed to Property that is Rented. The IRS has issued guidance on the availability of the Section 199 domestic production activities deduction ("DPAD") when a taxpayer provides access to taxpayer property in connection with the provision of a service. Rev. Rul. 2011-24. The Section 199 deduction is generally available for income related to qualified property that is manufactured, produced, grown, or extracted by the taxpayer in whole or significant part in the United States. The net income from the rental of qualified property is eligible for the deduction, but income attributable to the provision of services is not. The ruling provides three examples for determining when income for providing telecommunications services is considered income from property that is rented and when it is considered income only for the provision of services. Although the revenue ruling deals with telecommunications services, the IRS has informally indicated that they consider it applicable to any service.

O. 2012 Inflation Adjustments for Certain Tax Benefits.

1. The value of each personal and dependent exemption, available to most taxpayers, is $3,800, up $100 from 2011.

2. The new standard deduction is $11,900 for married couples filing a joint return, up $300, $5,950 for singles and married individuals filing separately, up $150, and $8,700 for heads of household, up $200. Nearly two out of three taxpayers take the standard deduction, rather than itemizing deductions, such as mortgage interest, charitable contributions and state and local taxes.

3. Tax-bracket thresholds increase for each filing status. For a married couple filing a joint return, for example, the taxable-income threshold separating the 15-percent bracket from the 25-percent bracket is $70,700, up from $69,000 in 2011.

P. 2012 Inflation Adjustments for Credits, Deductions and Related Phase Outs.

1. For tax year 2012, the maximum earned income tax credit (EITC) for low- and moderate- income workers and working families rises to $5,891, up from $5,751 in 2011. The maximum income limit for the EITC rises to $50,270, up from $49,078 in 2011.The credit varies by family size, filing status and other factors, with the maximum credit going to joint filers with three or more qualifying children.

2. The foreign earned income deduction rises to $95,100, an increase of $2,200 from the maximum deduction for tax year 2011.

3. The modified adjusted gross income threshold at which the lifetime learning credit begins to phase out is $104,000 for joint filers, up from $102,000, and $52,000 for singles and heads of household, up from $51,000.

4. For 2012, annual deductible amounts for Medical Savings Accounts (MSAs) increased from the tax year 2011 amounts; please see the table below.

5. The $2,500 maximum deduction for interest paid on student loans begins to phase out for a married taxpayers filing a joint returns at $125,000 and phases out completely at $155,000, an increase of $5,000 from the phase out limits for tax year 2011. For single taxpayers, the phase out ranges remain at the 2011 levels.

II. MICHIGAN

A. Repeal of the Michigan Business Tax. The Governor proposed eliminating the Michigan Business Tax and replacing it with a six percent (6%) corporate income tax. He also proposed significant changes to the individual income tax. These proposals have passed the Michigan House and Senate and were signed into law on May 25, 2011. The following are some of the details of the law:

1. Corporate Income Tax ("CIT")

- 6% of the CIT tax base after allocation or apportionment.
- Honors existing commitments for tax credits made to businesses through signed agreements under the old tax structure.
- Businesses subject to the CIT are limited to C corporations and limited liability companies that have chosen to be taxed

as C corporations for federal tax purposes. Unlike the MBT, partnerships (including limited liability companies taxed as partnerships), S corporations, trusts, and individuals are not subject to the CIT.

- Nexus standards from the MBT are retained. That is, an out-of-state taxpayer will be subject to the CIT tax if that taxpayer has a physical presence in Michigan or actively solicits sales in this state and has Michigan sales of $350,000 or more, subject to federal restrictions.

- The CIT tax base is federal taxable income subject to certain adjustments before allocation or apportionment.

- The CIT tax base is apportioned by a sales factor, which is Michigan sales over sales everywhere. The sale of tangible personal property is sourced by destination. Receipts from services are sourced where the benefits are received.

- The Small Business Alternative Credit is retained from the MBT. All other credits are eliminated for CIT purposes.

- Taxpayers with a CIT liability of $100 or less need not file a CIT return or pay the tax.

- A unitary business group is required to file a combined return.

- Insurance companies are subject to a tax equal to 1.25% of gross direct premiums written on property or risk located or residing in Michigan.

- Financial institutions are subject to a franchise tax equal to 0.29% of the financial institution's net capital. Net capital means equity capital as computed in accordance with GAAP less the average daily book value of U.S. and Michigan obligations. Net capital is based on a 5-year average.

2. <u>Individual Income Tax</u>

- Rate fixed at 4.35% through January 1, 2013, at which time it is lowered to 4.25%, where it would remain.

- Public and private pensions, senior dividends and interest, and political contributions are no longer subtracted from

AGI. Thus, these items will now be taxable, except as noted in Subparagraph 3 below.

- The standard personal exemption allowance is fixed at the 2011 level of $3,700 through 2012. The exemption is phased out at a certain level of income. All special exemptions are repealed except for the exemption for disabled persons. Special provisions for military personnel and veterans are retained.

- Under current law, the Homestead Property Tax Credit equals some percentage of the property taxes that exceed 3.5% of household income. The applicable percentage varies, with most taxpayers receiving 60%, while seniors and disabled individuals receive 100%. The bill would eliminate the difference in rates between seniors and most taxpayers. The phase-out range for the Homestead Property Tax Credit is lowered to $41,000 to $50,000 from the current range of $73,650 to $82,650. The Homestead Property Tax Credit would not be available if the taxable value of the homestead exceeds $135,000 (for a new home, this equates to a purchase price of $270,000).

- The Michigan earned income tax credit would be reduced to 6% of the Federal earned income tax credit after December 31, 2011. Currently, it is 20%.

- Many other credits are repealed going forward including:

  - Historic preservation credit
  - City income tax credit
  - Credit for gifts to public art, radio, colleges, universities, archives, museums, and libraries
  - Community foundations, food banks and homeless shelters credit
  - College tuition and fees credit
  - Automobile donation credit
  - Family/Individual development accounts credit

3. Changes to the Pension Tax Proposal**.** The Governor's original pension tax proposal was changed as follows in discussions with Republican leaders:

- People born before 1946 would continue paying taxes at the same rates they do today, which means their public pensions and social security are tax-exempt and their private pensions are exempted up to $45,120 per person. They will not see any changes.

- People born from 1946 and through 1952 would be exempt from paying taxes on all "retirement income," including all pensions and retirement accounts, up to $20,000 for a single filer and $40,000 for a married couple. Once this group turns 67, their total income would be exempt up to $20,000 for single filers and $40,000 for married couples, which means that seniors who do not have a pension would be treated like seniors with pensions. The exemption would not be available when household resources exceed $20,000/single or $40,000/joint. Social Security income would be exempt, but there would be no senior citizen exemption for interest, dividends and capital gains.

Everyone born after 1952 would have their pensions and retirement account income (but not Social Security income) taxed at the normal individual income tax rate. However, once they turn 67, they would get a "senior income exemption" of $20,000 for single filers and $40,000 for joint filers, regardless of where the income comes from. There would be no special exemption for Social Security income and no personal exemption available. In addition, the senior income exemption would cease to be available when household resources exceed $20,000/single or $40,000/joint. In lieu of the senior income exemption, a taxpayer could elect instead to exempt social security income and claim a personal exemption.

4. Technical Corrections. As of the date of preparation of this outline, many bills have been introduced in the House and Senate that would make technical corrections to the new law. These may be summarized as follows:

a. Senate Bills by Section No.

Income Tax Act Section No.	Bill No.	Reasons for Amendment
115	SB 664	Correct effective date.
251	SB 681	Correct citation reference to withholding sections added by CIT.
508(4)	SB 661	Clarify definition of "total household resources" under IIT as to add back for any net business loss.
510	SB 662	Remove reference to net operating loss in definition of "income" to remove conflict in definitions.
522	SB 663	Correct for conflict as to homestead property tax credit. For senior citizens with income over $21,000, 2011 PA 38 provided a homestead property tax credit refund percentage of less than 100%, but language in 522(1)(C) still provided for 100%.
603	SB 665	Eliminate special tax base for mutual and electric cooperatives.
605	SB 666	Clarifies definition of corporation to correct for a circular definition.
607(3)	SB 653	Clarifies that foreign operating entity limited to US corp
607(4)	SB 676	Revises "gross receipts" definition. Prior section was carried over from MBT, where gross receipts was subject to tax. Gross receipts is not part of tax base in CIT; now only used for purposes of determining filing threshold and small business credit eligibility. Revised definition is that used under SBT.
607(7)	SB 653	Clarifies definition of member. Relates to flow through entity.
609(1)	SB 667	Clarifies definition of person. Flow through entity already defined, so replaces list with already defined term.
609(5)	SB 667	Clarifies definition of shareholder to apply both to corporation (stock owner) and to other that files as corporation for federal purposes (i.e. LLC).
611(4)	SB 657	Clarifies what tax year is for a person joining or departing a unitary business group prior to person's federal tax year.
611(7)	SB 657	Clarifies that US person does not include foreign disregarded entities.
621	SB 669	2011 PA 38 provided for Treasury to define "actively solicits" for purposes of nexus. Treasury already defined term when required to under MBT (in RAB 2007-6). No need to have Treasury define again. Codifies definition issued by Treasury in RAB.
623	SB 668	CIT is a tax on or measured by net income. Current reference might infer otherwise. Removes redundant phrasing regarding length of business loss.

Income Tax Act Section No.	Bill No.	Reasons for Amendment
623(2)(E)	SB 668	Consistent reference to "State Treasurer."
625(2) and (4)	SB 675	Clarifies apportionment provisions regarding sales of tangible personal property, intangible property and sales of services for foreign person. Sales of tangible personal property where title passes outside of US are not included in apportionment. Sales of services and intangible personal property are included in apportionment.
651	SB 652	Correct reference to office of thrift supervision
653	SB 650	Corrects potential flaw in nexus provision. Current reference to section 621, which defines nexus for "taxpayer", could be read to exclude nexus for financial institution, since "taxpayer" under section 611 excludes financial institution for chapter 11. Clarifies nexus for financial institution.
661	SB 674	Clarifies use of apportionment factor of flow through for corporate owner with interest in flow through.
663	SB 673	Clarifies legislative intent that the tax base is to be apportioned using 100% sales factor, except where taxpayer petitions or where Department otherwise provides alternative method under section 667.
665	SB 656	Clarifies for apportionment purposes only that rental receipts relating to prewritten computer software are sourced to where the hardware that accesses software resides. Grammar correction re SIC codes.
667(1)	SB 671	Consistent reference to "State Treasurer."
669	SB 651	Codifies rules on where benefit of services is received. Rules were previously issued by the Department under the MBT (RAB 2010-5). Provides greater clarity on how services are to be sourced.
671	SB 655	Clarifies that a unitary group taxpayer is disqualified from small business tax credit if any disqualification conditions met by any member. Also, closes existing loophole where an owner's compensation/business income could be dispersed amongst several UBG members to avoid disqualification thresholds. Change would require summing all amounts paid or allocable to determine disqualification threshold. Excludes from definition of "compensation" for purposes of small business credit amounts paid to independent contractor realtors and brokers.
673	SB 659	Provides for recapture (add back to taxpayer's tax liability) of an amount of tax credit previously granted under SBT or MBT where taxpayer failed to satisfy or breached conditions for credit or where taxpayer sold or disposed of assets for which credit was provided prior to the end of the asset's intended life. Recapture provisions contained previously under SBT

Income Tax Act Section No.	Bill No.	Reasons for Amendment
		and MBT.
681	SB 660	Clarifies reference to "tax base" rather than "corporate income tax base" so as to apply to corporate income, insurance company and financial institution taxpayers. Provides for quarterly returns for each type of taxpayer. Clarifies that taxpayer with tax year less than 4 months is not required to file estimated return or remit estimated payments. Similarly provided for under MBT.
683	SB 672	Clarifies that a fiscal year taxpayer with a short period tax year due to transition from MBT to CIT must use same method (actual or annualized) for each short tax period.
685	SB 654	Clarifies that taxpayer can remit final payment by annual due date even though taxpayer filed annual return prior to due date. (1) To determine whether gross receipts filing threshold met, receipts of flow through entities owned by taxpayer are imputed to owner/member based on owner's proportionate share of distributive income to total distributive income of flow-through. (1) Adjusts gross receipts thresholds to incorporate less than full year circumstances. (2) Consistent reference to "State Treasurer." (3)
699	SB 678	Adds section to clarify treatment of federally disregarded entities. A US person disregarded for federal income tax purposes will be treated as disregarded for CIT purposes. A non-US person disregarded for federal income tax purposes will not be treated as disregarded, but rather as separate entity, for CIT purposes.
701	SB 680	Removes "trust" as flow-through entity for withholding purposes. Defines "partnership" and "publicly traded partnership" for withholding purposes.
703	SB 670	Clarifies withholding rate and calculation for personal pension and annuity payments. (1) Allows for withholding by flow-throughs to be based on reasonable estimates of distributive shares of taxable income. (3) Clarifies withholding rate relating to distributive share income amounts to non-resident members of flow-through. Quarterly

Income Tax Act Section No.	Bill No.	Reasons for Amendment
		withholding with each period to equal ¼ of total withholding calculated based on reasonable estimates of distributive share accruing during the tax year of flow-through entity. (3) Clarifies what business income is to be withheld for flow-through entities (partnerships and S corps). (4) Clarifies when withholding amounts accrue to State of Michigan. (5) Removes "publicly traded partnerships" from withholding requirement. (10) Reference to "no form" filing option removed as this filing option was repealed earlier. (14 – 15)
705	SB 677	Current language did not name pension distributors as withholders, so revision adds them as withholders.
711	SB 679	Clarifies withholding requirements. Requires a flow-through entity that withholds tax to file with Department an annual reconciliation return within 2 months following end of flow-through's federal tax year. Provides authority to Department to require flow through entities to file annual informational return – to assist in determining proper withholding.
Michigan Business Tax Section Number	**Bill No.**	**Reasons for Amendment**
107	SB 658	Correct citations to Ren Zone Act's definition of "qualified collaborative agreement" and to NASCAR capital expenditure credit requirements subsection.
117	SB 658	Clarifies that for fiscal year taxpayers electing to file MBT, for the first year there are 2 short period MBT tax years, and a separate return is required for each short period tax year.
431(7)	SB 658	Allow a taxpayer claiming a MEGA credit for health care benefits to report the aggregate costs of the eligible benefits to MEGA.
500	SB 658	Clarifies that unitary group taxpayer seeking to claim certificated credit must include all entities (including flow-through entities) in group. (1)

Income Tax Act Section No.	Bill No.	Reasons for Amendment
		Clarifies that taxpayer claiming a multiphase brownfield credit must continue to file return and pay MBT each year until credit complete or carry forward used up. (2) Section 623(2)(c) of CIT adds back federal NOL deducted in arriving at federal taxable income. Section 623(4) provides deduction for any available business loss incurred after 2011. Together, they allow a deduction only for NOLs after 2011. The amendment clarifies that a flow-through entity electing to pay the MBT, when calculating its CIT pro forma alternative tax liability amount, shall not deduct a business loss for any year after 2011 that the taxpayer did not elect to pay MBT. (4)(b)(i) Clarifies that for a taxpayer under MBT that is a partnership or S corp, business income includes income and expense attributable to the business activity of the partnership or S corp separately reported to its members. (4)(b)(iii)
503	SB 658	Clarifies that for a fiscal year taxpayer with 2 short period tax years, the taxpayer must use same method (actual or annualized) for each short period tax year.
512	SB 658	Adds section to clarify treatment of federally disregarded entities. A US person disregarded for federal income tax purposes will be treated as disregarded for purposes under the MBT. A non-US person disregarded for federal income tax purposes will not be treated as disregarded, but rather as separate entity, for MBT Act purposes.

b. Senate Bills by Bill No.

Income Tax Act Section No.	Bill No.	Reasons for Amendment
653	SB 650	Corrects potential flaw in nexus provision. Current reference to section 621, which defines nexus for "taxpayer", could be read to exclude nexus for financial institution, since "taxpayer" under section 611 excludes financial institution for chapter 11. Clarifies nexus for financial institution.
669	SB 651	Codifies rules on where benefit of services is received. Rules were previously issued by the Department under the MBT (RAB 2010-5). Provides greater clarity on how services are to be sourced.
651	SB 652	Correct reference to office of thrift supervision
607(3)	SB 653	Clarifies that foreign operating entity limited to US corp
607(7)	SB 653	Clarifies definition of member. Relates to flow through entity.
685	SB 654	Clarifies that taxpayer can remit final payment by annual due date even though taxpayer filed annual return prior to due date. (1) To determine whether gross receipts filing threshold met, receipts of flow through entities owned by taxpayer are imputed to owner/member based on owner's proportionate share of distributive income to total distributive income of flow-through. (1) Adjusts gross receipts thresholds to incorporate less than full year circumstances. (2) Consistent reference to "State Treasurer." (3)
671	SB 655	Clarifies that a unitary group taxpayer is disqualified from small business tax credit if any disqualification conditions met by any member. Also, closes existing loophole where an owner's compensation/business income could be dispersed amongst several UBG members to avoid disqualification thresholds. Change would require summing all amounts paid or allocable to determine disqualification threshold. Excludes from definition of "compensation" for purposes of small business credit amounts paid to independent contractor realtors and brokers.
665	SB 656	Clarifies for apportionment purposes only that rental receipts relating to prewritten computer software are sourced to where the hardware that accesses software resides. Grammar correction re SIC codes.
611(4)	SB 657	Clarifies what tax year is for a person joining or departing a unitary business group prior to person's federal tax year.

Income Tax Act Section No.	Bill No.	Reasons for Amendment
611(7)	SB 657	Clarifies that US person does not include foreign disregarded entities.
	SB 658	MBT - SEE HIGHLIGHTED SECTION BELOW
673	SB 659	Provides for recapture (add back to taxpayer's tax liability) of an amount of tax credit previously granted under SBT or MBT where taxpayer failed to satisfy or breached conditions for credit or where taxpayer sold or disposed of assets for which credit was provided prior to the end of the asset's intended life. Recapture provisions contained previously under SBT and MBT.
681	SB 660	Clarifies reference to "tax base" rather than "corporate income tax base" so as to apply to corporate income, insurance company and financial institution taxpayers. Provides for quarterly returns for each type of taxpayer. Clarifies that taxpayer with tax year less than 4 months is not required to file estimated return or remit estimated payments. Similarly provided for under MBT.
508(4)	SB 661	Clarify definition of "total household resources" under IIT as to add back for any net business loss.
510	SB 662	Remove reference to net operating loss in definition of "income" to remove conflict in definitions.
522	SB 663	Correct for conflict as to homestead property tax credit. For senior citizens with income over $21,000, 2011 PA 38 provided a homestead property tax credit refund percentage of less than 100%, but language in 522(1)(C) still provided for 100%.
115	SB 664	Correct effective date.
603	SB 665	Eliminate special tax base for mutual and electric cooperatives.
605	SB 666	Clarifies definition of corporation to correct for a circular definition.
609(1)	SB 667	Clarifies definition of person. Flow through entity already defined, so replaces list with already defined term.
609(5)	SB 667	Clarifies definition of shareholder to apply both to corporation (stock owner) and to other that files as corporation for federal purposes (i.e. LLC).
623	SB 668	CIT is a tax on or measured by net income. Current reference might infer otherwise. Removes redundant phrasing regarding length of business loss.
623(2)(E)	SB 668	Consistent reference to "State Treasurer."
621	SB 669	2011 PA 38 provided for Treasury to define "actively solicits" for purposes of nexus. Treasury already defined term when required to under MBT (in RAB 2007-6). No need to have

Income Tax Act Section No.	Bill No.	Reasons for Amendment
		Treasury define again. Codifies definition issued by Treasury in RAB.
703	SB 670	Clarifies withholding rate and calculation for personal pension and annuity payments. (1) Allows for withholding by flow-throughs to be based on reasonable estimates of distributive shares of taxable income. (3) Clarifies withholding rate relating to distributive share income amounts to non-resident members of flow-through. Quarterly withholding with each period to equal ¼ of total withholding calculated based on reasonable estimates of distributive share accruing during the tax year of flow-through entity. (3) Clarifies what business income is to be withheld for flow-through entities (partnerships and S corps). (4) Clarifies when withholding amounts accrue to State of Michigan. (5) Removes "publicly traded partnerships" from withholding requirement. (10) Reference to "no form" filing option removed as this filing option was repealed earlier. (14 – 15)
667(1)	SB 671	Consistent reference to "State Treasurer."
683	SB 672	Clarifies that a fiscal year taxpayer with a short period tax year due to transition from MBT to CIT must use same method (actual or annualized) for each short tax period.
663	SB 673	Clarifies legislative intent that the tax base is to be apportioned using 100% sales factor, except where taxpayer petitions or where Department otherwise provides alternative method under section 667.
661	SB 674	Clarifies use of apportionment factor of flow through for corporate owner with interest in flow through.
625(2) and (4)	SB 675	Clarifies apportionment provisions regarding sales of tangible personal property, intangible property and sales of services for foreign person. Sales of tangible personal property where title passes outside of US are not included in apportionment. Sales of services and intangible personal property are included in apportionment.
607(4)	SB 676	Revises "gross receipts" definition. Prior section was carried over from MBT, where gross receipts was subject to tax. Gross receipts is not part of tax base in CIT; now only used for purposes of determining filing threshold and small

Income Tax Act Section No.	Bill No.	Reasons for Amendment
		business credit eligibility. Revised definition is that used under SBT.
705	SB 677	Current language did not name pension distributors as withholders, so revision adds them as withholders.
699	SB 678	Adds section to clarify treatment of federally disregarded entities. A US person disregarded for federal income tax purposes will be treated as disregarded for CIT purposes. A non-US person disregarded for federal income tax purposes will not be treated as disregarded, but rather as separate entity, for CIT purposes.
711	SB 679	Clarifies withholding requirements. Requires a flow-through entity that withholds tax to file with Department an annual reconciliation return within 2 months following end of flow-through's federal tax year. Provides authority to Department to require flow through entities to file annual informational return – to assist in determining proper withholding.
701	SB 680	Removes "trust" as flow-through entity for withholding purposes. Defines "partnership" and "publicly traded partnership" for withholding purposes.
251	SB 681	Correct citation reference to withholding sections added by CIT.
Michigan Business Tax Section Number	**Bill No.**	**Reasons for Amendment**
107	SB 658	Correct citations to Ren Zone Act's definition of "qualified collaborative agreement" and to NASCAR capital expenditure credit requirements subsection.
117	SB 658	Clarifies that for fiscal year taxpayers electing to file MBT, for the first year there are 2 short period MBT tax years, and a separate return is required for each short period tax year.
431(7)	SB 658	Allow a taxpayer claiming a MEGA credit for health care benefits to report the aggregate costs of the eligible benefits to MEGA.
500	SB 658	Clarifies that unitary group taxpayer seeking to claim certificated credit must include all entities (including flow-through entities) in group. (1) Clarifies that taxpayer claiming a multiphase brownfield credit must continue to file return and pay MBT each year until credit complete or carry forward used up. (2)

Income Tax Act Section No.	Bill No.	Reasons for Amendment
		Section 623(2)(c) of CIT adds back federal NOL deducted in arriving at federal taxable income. Section 623(4) provides deduction for any available business loss incurred after 2011. Together, they allow a deduction only for NOLs after 2011. The amendment clarifies that a flow-through entity electing to pay the MBT, when calculating its CIT pro forma alternative tax liability amount, shall not deduct a business loss for any year after 2011 that the taxpayer did not elect to pay MBT. (4)(b)(i) Clarifies that for a taxpayer under MBT that is a partnership or S corp, business income includes income and expense attributable to the business activity of the partnership or S corp separately reported to its members. (4)(b)(iii)
503	SB 658	Clarifies that for a fiscal year taxpayer with 2 short period tax years, the taxpayer must use same method (actual or annualized) for each short period tax year.

c. House Bills.

Income Tax Act Section No.	Bill No.	Reasons for Amendment
669	HB 4937	Codifies rules on where benefit of services is received. Rules were previously issued by the Department under the MBT (RAB 2010-5). Provides greater clarity on how services are to be sourced.
607(4)	HB 4938	Revises "gross receipts" definition. Prior section was carried over from MBT, where gross receipts was subject to tax. Gross receipts is not part of tax base in CIT; now only used for purposes of determining filing threshold and small business credit eligibility. Revised definition is that used under SBT.
607(7)	HB 4938	Clarifies definition of member. Relates to flow through entity.
683	HB 4939	Clarifies that a fiscal year taxpayer with a short period tax year due to transition from MBT to CIT must use same method (actual or annualized) for each short tax period.
701	HB 4940	Removes "trust" as flow-through entity for withholding purposes. Defines "partnership" and "publicly traded partnership" for withholding purposes.
685	HB 4941	Clarifies that taxpayer can remit final payment by annual due date even though taxpayer filed annual return prior to due date. To determine whether gross receipts filing threshold met, receipts of flow through entities owned by taxpayer are imputed to owner/member based on owner's proportionate share of distributive income to total distributive income of flow-through. Adjusts gross receipts thresholds to incorporate less than full year circumstances. Consistent reference to "State Treasurer."
663	HB 4942	Clarifies legislative intent that the tax base is to be apportioned using 100% sales factor, except where taxpayer petitions or where Department otherwise provides alternative method under section 667.
667(1)	HB 4943	Consistent reference to "State Treasurer."
653	FIB 4944	Corrects potential flaw in nexus provision. Current reference to section 621, which defines nexus for "taxpayer", could be read to exclude nexus for financial institution, since

Income Tax Act Section No.	Bill No.	Reasons for Amendment
		"taxpayer" under section 611 excludes financial institution for chapter 11. Clarifies nexus for financial institution.
705	HB 4945	Current language did not name pension distributors as withholders, so revision adds them as withholders.
611(4)	HB 4946	Clarifies what tax year is for a person joining or departing a unitary business group prior to person's federal tax year.
611(7)	HB 4946	Clarifies that US person. does not include foreign disregarded entities.
621	HB 4948	2011 PA 38 provided for Treasury to define "actively solicits" for purposes of nexus. Treasury already defined term when required to under MBT (in RAB 2007-6). No need to have Treasury define again. Codifies definition issued by Treasury in RAB.
623	HB 4949	CIT is a tax on or measured by net income. Current reference might infer otherwise. Removes redundant phrasing regarding length of business loss.
623(2)(E)	HB 4949	Consistent reference to "State Treasurer."
671	HB 4950	Clarifies that a unitary group taxpayer is disqualified from small business tax credit if any disqualification conditions met by any member. Also, closes existing loophole where an owner's compensation/business income could be dispersed amongst several UBG members to avoid disqualification thresholds. Change would require summing all amounts paid or allocable to determine disqualification threshold. Excludes from definition of "compensation" for purposes of small business credit amounts paid to independent contractor reactors and brokers.
651	HB 4951	Correct reference to office of thrift supervision.
510	HB 4952	Remove reference to net operating loss in definition of "income" to remove conflict in definitions.
603	HB 4953	Eliminate special tax base for mutual and electric cooperatives.
251	HB 4954	Correct citation reference to withholding sections added by CIT.
625(2) and (4)	HB 4955	Clarifies apportionment provisions regarding sales of tangible personal property, intangible property and sales of services for foreign person. Sales of tangible personal property where title passes outside of US are not included in apportionment. Sales of services and intangible personal property are included in

Income Tax Act Section No.	Bill No.	Reasons for Amendment
		apportionment.
609(1)	HB 4956	Clarifies definition of person. Flow through entity already defined, so replaces list with already defined term.
609(5)	HB 4956	Clarifies definition of shareholder to apply both to corporation (stock owner) and to other that files as corporation for federal purposes (i.e. LLC).
508(4)	HB 4957	Clarify definition of "total household resources" under IIT as to add back for any net business loss.
115	FIB 4958	Correct effective date.
703	HB 4959	Clarifies withholding rate and calculation for personal pension and annuity payments. Allows for withholding by flow-throughs to be based on reasonable estimates of distributive shares of taxable income. Clarifies withholding rate relating to distributive share income amounts to non-resident members of flow-through. Withholding for each period is to equal 1/4 of total withholding calculated based on reasonable estimates of distributive share accruing during the tax year of flow-through entity. Clarifies what business income is to be withheld for flow-through entities (partnerships and S corps). Clarifies when withholding amounts accrue to State of Michigan. Removes "publicly traded partnerships" from withholding requirement. Reference to "no form" filing option removed as this filing option was repealed earlier.
681	HB 4960	Clarifies reference to "tax base" rather than "corporate income tax base" so as to apply to corporate income, insurance company and financial institution taxpayers. Clarifies that taxpayer with tax year less than 4 months is not required to file estimated return or remit estimated payments. Similarly provided for under MBT.
699	FIB 4961	Adds section to clarify treatment of federally disregarded entities. A US person disregarded for federal income tax purposes will be treated as disregarded for CIT purposes. A

Income Tax Act Section No.	Bill No.	Reasons for Amendment
		non-US person disregarded for federal income tax purposes will not be treated as disregarded, but rather as separate entity, for CIT purposes.
665	HB 4962	Clarifies for apportionment purposes only that rental receipts relating to prewritten computer software are sourced to where the hardware that accesses software resides. Grammar correction re SIC codes.
661	HB 4963	Clarifies use of apportionment factor of flow through for corporate owner with interest in flow through.
605	HB 4964	Clarifies definition of corporation to correct for a circular definition.
711	HB 4965	Clarifies withholding requirements. Requires a flow-through entity that withholds tax to file with Department an annual reconciliation return within 2 months following end of flow-through's federal tax year. Provides authority to Department to require flow through entities to file annual informational return — to assist in determining proper withholding.
522	HB 4966	Correct for conflict as to homestead property tax credit. For senior citizens with income over $21,000, 2011 PA 38 provided a homestead property tax credit refund percentage of less than 100%, but language in 522(1)(C) still provided for 100%.
673	HB 4967	Provides for recapture (add back to taxpayer's tax liability) of an amount of tax credit previously granted under SBT or MBT where taxpayer failed to satisfy or breached conditions for credit or where taxpayer sold or disposed of assets for which credit was provided prior to the end of the asset's intended life. Recapture provisions contained previously under SBT and MBT
607(3)	HB 4968	Clarifies that foreign operating entity limited to US corp

Michigan Business Tax Section Number	Bill No.	Reasons for Amendment
107	HB 4947	Correct citations to Ren Zone Act's definition of "qualified collaborative agreement" and to NASCAR capital expenditure credit requirements subsection.

Income Tax Act Section No.	Bill No.	Reasons for Amendment
117	HB 4947	Clarifies that for fiscal year taxpayers electing to file MBT, for the first year there are 2 short period MBT tax years, and a separate return is required for each short period tax year.
431(7)	HB 4947	Allow a taxpayer claiming a MEGA credit for health care benefits to report the aggregate costs of the eligible benefits to MEGA.
500	FIB 4947	Clarifies that unitary group taxpayer seeking to claim certificated credit must include all entities (including flow-through entities) in group. Clarifies that taxpayer claiming a multiphase brownfield credit must continue to file return and pay MBT each year until credit complete or carryforward used up. Section 623(2)(c) of CIT adds back federal NOL deducted in arriving at federal taxable income. Section 623(4) provides deduction for any available business loss incurred after 2011. Together, they allow a deduction only for NOLs after 2011. The amendment clarifies that a flow-through entity electing to pay the MBT, when calculating its CIT pro forma alternative tax liability amount, shall not deduct a business loss for any year after 2011 that the taxpayer did not elect to pay MBT. Clarifies that for a taxpayer under MBT that is a partnership or S corp, business income includes income and expense attributable to the business activity of the partnership or S corp separately reported to its members.
503	HB 4947	Clarifies that for a fiscal year taxpayer with 2 short period tax years, the taxpayer must use same method (actual or annualized) for each short period tax year.
512	HB 4947	Adds section to clarify treatment of federally disregarded entities. A US person disregarded for federal income tax purposes will he treated as disregarded for purposes under the MBT. A non-US person disregarded for federal income tax purposes will not be treated as disregarded, but rather as separate entity, for MBT Act purposes.

B. Reporting Unclaimed Property. A recent change in the Uniform Unclaimed Property Act, Public Act 29 of 1995, has changed the reporting dates and shortened the dormancy periods of most properties, beginning in 2011. The new reporting dates are as follows:

YEAR	ANNUAL REPORTING PERIOD	REPORT DUE DATE TO THE STATE:
2011	July 1, 2010 thru March 31, 2011	July 1, 2011
2012 and beyond	April 1, thru March 31	July 1 of each year

Under Michigan's Uniform Unclaimed Property Act, every business or government entity that has unclaimed property belonging to owners whose last known address is in Michigan must report and remit the property to the Michigan Department of Treasury, regardless of where they are incorporated or headquartered. In addition, every business or government entity that is incorporated in Michigan must report to the Michigan Department of Treasury abandoned property belonging to owners where there is no known address. If an entity has unclaimed property to report, it must mail the electronic media containing the annual unclaimed property report, Michigan Holder Transmittal for Annual Report of Unclaimed Property (Form 2011) and remittent to the Unclaimed Property Division. If an entity does not have unclaimed property to report, it must complete and return the Attestation of Compliance with Unclaimed Property Reporting (Form 4305). The Michigan Department of Treasury is offering holders that have not filed sufficient Unclaimed Property Reports with an opportunity to avoid penalty charges on any property voluntarily remitted. To be eligible, an entity must file Unclaimed Property Reports for the previous four years (2007-2010). Penalties will not apply to property voluntarily remitted. However, interest will be charged from the date the property should have been reported. Failure to comply results in a penalty of 25% of the value of the property that should have been paid or delivered.

C. Court Holds Members Liable For Debts Of LLC. In a decision published May 3, 2011, the Michigan Court of Appeals found a limited liability company to be the alter-ego of its members with the result that the members were found to be liable to a creditor of the limited liability company. *Florence Cement Co. v. Vettriano, Bencivenga & AV Investment Corp.*, (No. 295090 May 3, 2011). The limited liability company was formed to own, develop and sell vacant lots for residential construction. It contracted with the plaintiff to perform concrete and asphalt work. The project was not successful. Nevertheless, the limited liability company was able to pay all of the contractors and subcontractors, except the plaintiff. In holding the members of the limited liability company personally liable, the court found that the members had acquired some of the parcels of property personally, that they had incurred expenses for developmental costs and then simply had the limited liability company reimburse them directly, that payments were made to the members which were viewed by the court as not beneficial to the limited liability company, in that the members treated the monies which they had borrowed or guaranteed for the project as debts of the limited liability company. As a consequence, the court viewed the limited liability company as the alter-ego of the members. In effect, the defendants made no distinction between their own debts and the debts of the limited liability company. They did not treat the limited liability company as a separate entity. While this case is very fact specific, it is an important reminder of the need to observe appropriate formalities in the formation and operation of corporations and limited liability companies.

D. State Tax Commission has Adopted New Rules. The State Tax Commission has adopted new and revised rules (Michigan Administrative Code R209.1 et seq.) that reflect new processes and procedures that are to be put into place due to the combination of the old State Tax Commission and the State Assessor's Board into the new State Tax Commission through Executive Order 2009-51, effective December 28, 2009 (see *State & Local Taxes Weekly,* Vol. 20, No. 45, 11/09/2009). The rulemaking also repeals a number of administrative rules (R211.401 et seq.). The rule changes are effective December 15, 2010. (Michigan Administrative Code R209.1 et seq., effective 12/15/2010.)

E. Conveyances Involving Joint Tenancy. The Michigan Supreme Court has issued a decision holding that the termination of a joint tenancy caused by the death of a cotenant was within the joint-tenancy exception under the transfer of ownership rules. Therefore, the termination of the joint tenancy in this situation did not uncap the property's assessed value. *Klooster v. City of Charlevoix*, 795 N.W.2d 578 (2011).

III. EMPLOYEE BENEFITS

A. Exemption for IRAs Under the Bankruptcy Code. In a matter of first impression, a bankruptcy court in Arizona has held that debtor's inherited IRA was exempted from her bankruptcy estate under 11 USC §522(b)(3)(C) and Arizona law. *In re: Thiem*, 107 AFTR 2d 2011-529 (Bktcy Ct AZ, 1/19/2011)**.** 11 USC §522(d)(12) is identical to 11 USC §522(b)(3)(C) and provides the same exemption for debtors in states that have not opted out of the federal scheme of bankruptcy exemptions. Previously, the Eighth Circuit held that a debtor's inherited IRA was an exempt asset of the debtor's bankruptcy estate under 11 USC §522(d)(12). I*n re: Nessa*, 105 AFTR 2d 2010-1825 (Bktcy Appellate Panel CA 8, 4/9/2010). In contrast, the bankruptcy court in Texas has previously concluded that, unlike a debtor's own traditional IRA, a debtor's inherited IRA is not an exempt asset of the debtor's bankruptcy estate under 11 USC §522((d)(12). *In re: Chilton*, 105 AFTR 2d §2010-1271 (Bktcy Ct TX, 3/5/2010).

B. Determination, Opinion & Advisory Letters for Pre-Approved Retirement Plans - New Submission Procedures and 6-Year Remedial Amendment Cycle

If the Plan is -		Initial Submission Period	Initial Remedial Amendment Cycle Ends (i.e., EGTRRA RAP)	Next Submission Period	Next 6-Year Remedial Amendment Cycle
Defined Contribution	Mass Submitter (Lead and Specimen Plans) and National Sponsor Plans	02/17/2005 to 01/31/2006	04/30/2010	02/01/2011 to 10/31/2011	02/01/2011 to 01/31/2017
	Non-Mass Submitter Plans (including word-for-word identical adopter and minor modifier applications)	02/17/2005 to 01/31/2006	04/30/2010	02/01/2011 to 1/31/2012	02/01/2011 to 01/31/2017
Defined Benefit	Mass Submitter Lead and Specimen Plans and National Sponsor Plans	02/01/2007 to 01/31/2008	04/30/2012	02/01/2013 to 10/31/2013	02/01/2013 to 01/31/2019
	Non-Mass Submitter Plans (including word-for-word identical adopter/minor modifier applications)	02/01/2007 to 01/31/2008	04/30/2012	02/01/2013 to 01/31/2014	02/01/2013 to 01/31/2019

C. New Determination Letter Submission Period for Individually Designed Plans. A new submission period began February 1, 2011 for individually designed plans on Cycle A to apply for determination letters. The submission period ends January 31, 2012.

D. IRS Significantly Increases User Fees. The IRS has significantly increased the cost to plan sponsors for submitting their plans to the IRS for determination letters and other rulings. In some cases, those user fees have more than doubled. For example, the user fee for a base level determination letter application for a single employer plan has increased from $1,000 to $2,500. The user fee increases took effect February 1, 2011. Rev. Proc. 2011-8.

E. IRS Provides Guidance on Funding Relief Rules. The Preservation of Access to Care for Medicare Beneficiaries and Pension Act of 2010 provided funding relief for single and multiple employer defined benefit pension plans. Generally, a defined benefit plan must establish a shortfall amortization base with respect to a plan year for which the value of a plan's assets is less than the amount of the plan's funding target. The period for amortization of a shortfall is seven (7) years. Under the Relief provisions of the Act, a plan sponsor may elect, for certain plan years, to amortize the shortfall amortization base for the plan year under one of two alternative amortization schedules: the "2 plus 7 year" amortization schedule or the "15 year" amortization schedule. Sponsors of defined benefit plans could have elected relief for the 2008, 2009, or 2010 plan years or may elect relief for the 2011 plan year. Notice 2011-3.

F. Opinion Letters on Preapproved Retirement Plans. Rev. Proc. 2011-49 updates the guidance provided in Rev. Proc. 2005-16 on the requirements for requesting opinion and advisory letters regarding the acceptability under Sections 401 and 403(a) of the form of preapproved plans. Preapproved plans include master and prototype plans and volume submitter plans.

G. Failure to Update Inactive Plan Leads to Plan Disqualification. For a second time in recent months, the Tax Court has ruled that a qualified retirement plan, in this case a profit sharing plan, may be disqualified and its tax-exempt status retroactively revoked for defects relating a failure to timely amend the plan document to reflect statutory changes. The court rejected arguments that the plan had discontinued receiving contributions, had become a "repository trust" and, therefore, was a terminated plan that did not need to be amended for changes required by various statutes enacted in 2000 and 2001. The court held that the mere discontinuance of contributions and the barring of new participants were not sufficient to demonstrate that the plan had been terminated. The case serves as a reminder that until a plan is formally terminated and the plan assets are fully liquidated, required amendments still must be made and adopted on a timely basis. *Christy & Swan Profit Sharing Plan v. Commissioner*, Tax Ct. 2011.

H. Asset Sale Exception to Multiemployer withdrawal Liability Upheld. Underfunded multiemployer pension plans assess "withdrawal liability" to a contributing employer if the employer ceases to contribute to the plan either wholly (a "complete withdrawal") or where there is a 70 percent or more reduction in contributions (a "partial withdrawal"). When an employer sells all the assets of a business that had been contributing to a multiemployer plan, the contributing employer will cease its plan contributions, resulting in a withdrawal from the plan. However, a special statutory rule in ERISA Section 4204 allows an employer who has ceased contribution to a multiemployer plan as a result of a sale of assets to avoid the imposition of withdrawal liability if (1) the buyer of the assets has an obligation to contribute to the plan at the same rate the seller had before the sale, and (2) the buyer posts a bond with the plan to cover an amount of up to three plan years' of average contributions. The bond must remain in place for five years after the sale and must be payable to the plan if the buyer withdraws from making plan contributions or fails to make its required plan contributions at any time during those five years. The seller of assets remains secondarily liable for withdrawal liability if the buyer withdraws during these five years and does not pay its assessment of withdrawal liability, if any. The asset sale exception to withdrawal liability is available only where a cessation of plan contributions occurred "solely because" of the asset sale. In one of the rare instances where a court has ruled on the "solely because" rule as applied to the use of the asset sale exception to withdrawal liability, the U.S. Court of Appeals for the Seventh Circuit upheld an arbitrator's ruling that an asset sale qualified for the exception from payment of withdrawal liability even though earlier actions taken by the contributing employer resulted in reduced plan contributions as a result of plant closures and layoffs. The court determined that the statutory exception would not apply where an employer had deliberately set out to withdraw from a plan in stages and attempted to use the asset sale exception only for the last stage. In this case, however, there was no evidence that plant closings and layoffs in the 1990s were part of an integral plan to withdraw from a multiemployer plan with an asset sale in 2004 that was designed to avoid payment of withdrawal liability. *Central States, Southeast and Southwest Areas Pension Fund v. Georgia-Pacific LLC,* 7th Cir. 2011.

I. Importance of Following Proper Plan Amendment Procedures. A recent court decision reminds us how important it can be to follow procedures specified in plan documents when adopting plan amendments. A federal district court in North Carolina recently ruled that an amendment to an employer's retirement plan authorizing the liquidation of company stock from the plan was invalid. Because the plan document specifically identified company stock as an available investment option, a plan amendment was required to authorize the stock's liquidation. The plan's amendment procedures required action (either by a majority vote or by a written instrument signed by a majority of the committee members) by the plan committee to adopt any plan amendment. The committee did not meet to consider the amendment, and only the committee secretary's signature appeared on the amendment eliminating company stock as an investment option, thus rendering the amendment ineffective. It is worth noting that this decision was made in the context of a class action lawsuit to recover plan losses alleged to have resulted from the liquidation of the company stock. *Tatum v. R.J. Reynolds Tobacco Co.*, W.D.N.C. 2011.

J. Deadline Postponed for Amending Cash Balance and Other Hybrid Plans. The deadline for plan amendments to comply with most the Pension Protection Act of 2006 changes for hybrid plans had been scheduled for the end of the first plan year beginning in 2011, as provided in IRS Notice 2010-77. However, Notice 2011-85 extends the amendment deadline. Cash balance and hybrid plans must now be amended by the last day of the plan year before the plan year that the 2010 proposed hybrid plan regulations are finalized and applicable to the plans. With this extension, the IRS has provided a helpful mechanism to automatically further extend the amendment deadline if the 2010 proposed hybrid plan regulations are not finalized in 2012. As with past extensions, the additional extension does not apply to amendments that would eliminate a plan's lump sum "whipsaw" provisions.

K. Pension Plan Limitations for 2012.

1. The elective deferral (contribution) limit for employees who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan is increased from $16,500 to $17,000.

2. The catch-up contribution limit for those aged 50 and over remains unchanged at $5,500.

3. The deduction for taxpayers making contributions to a traditional IRA is phased out for singles and heads of household who are covered by a workplace retirement plan and have modified adjusted gross incomes (AGI) between $58,000 and $68,000, up from $56,000 and $66,000 in 2011. For married couples filing jointly, in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, the income phase-out range is $92,000 to $112,000, up from $90,000 to $110,000. For an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered, the deduction is phased out if the couple's income is between $173,000 and $183,000, up from $169,000 and $179,000.

4. The AGI phase-out range for taxpayers making contributions to a Roth IRA is $173,000 to $183,000 for married couples filing jointly, up from $169,000 to $179,000 in 2011. For singles and heads of household, the income phase-out range is $110,000 to $125,000, up from $107,000 to $122,000. For a married individual filing a separate return who is covered by a retirement plan at work, the phase-out range remains $0 to $10,000.

5. The AGI limit for the saver's credit (also known as the retirement savings contributions credit) for low-and moderate-income workers is $57,500 for married couples filing jointly, up from $56,500 in 2011; $43,125 for

heads of household, up from $42,375; and $28,750 for married individuals filing separately and for singles, up from $28,250.

6. Effective January 1, 2012, the limitation on the annual benefit under a defined benefit plan under section 415(b)(1)(A) is increased from $195,000 to $200,000.

7. The limitation for defined contribution plans under Section 415(c)(1)(A) is increased in 2012 from $49,000 to $50,000.

8. The limitation under Section 402(g)(1) on the exclusion for elective deferrals described in Section 402(g)(3) is increased from $16,500 to $17,000.

9. The annual compensation limit under Sections 401(a)(17), 404(l), 408(k)(3)(C), and 408(k)(6)(D)(ii) is increased from $245,000 to $250,000.

10. The dollar limitation under Section 416(i)(1)(A)(i) concerning the definition of key employee in a top-heavy plan is increased from $160,000 to $165,000.

11. The dollar amount under Section 409(o)(1)(C)(ii) for determining the maximum account balance in an employee stock ownership plan subject to a 5 year distribution period is increased from $985,000 to $1,015,000, while the dollar amount used to determine the lengthening of the 5 year distribution period is increased from $195,000 to $200,000.

12. The limitation used in the definition of highly compensated employee under Section 414(q)(1)(B) is increased from $110,000 to $115,000.

13. The dollar limitation under Section 414(v)(2)(B)(i) for catch-up contributions to an applicable employer plan other than a plan described in Section 401(k)(11) or Section 408(p) for individuals aged 50 or over remains unchanged at $5,500. The dollar limitation under Section 414(v)(2)(B)(ii) for catch-up contributions to an applicable employer plan described in Section 401(k)(11) or Section 408(p) for individuals aged 50 or over remains unchanged at $2,500.

14. The annual compensation limitation under Section 401(a)(17) for eligible participants in certain governmental plans that, under the plan as in effect on July 1, 1993, allowed cost of living adjustments to the compensation limitation under the plan under Section 401(a)(17) to be taken into account, is increased from $360,000 to $375,000.

15. The compensation amount under Section 408(k)(2)(C) regarding simplified employee pensions (SEPs) remains unchanged at $550.

16. The limitation under Section 408(p)(2)(E) regarding SIMPLE retirement accounts remains unchanged at $11,500.

17. The limitation on deferrals under Section 457(e)(15) concerning deferred compensation plans of state and local governments and tax-exempt organizations is increased from $16,500 to $17,000.

18. The compensation amounts under Section 1.61 21(f)(5)(i) of the Income Tax Regulations concerning the definition of "control employee" for fringe benefit valuation purposes is increased from $95,000 to $100,000. The compensation amount under Section 1.61 21(f)(5)(iii) is increased from $195,000 to $205,000.

19. The applicable dollar amount under Section 219(g)(3)(B)(i) for determining the deductible amount of an IRA contribution for taxpayers who are active participants filing a joint return or as a qualifying widow(er) is increased from $90,000 to $92,000. The applicable dollar amount under Section 219(g)(3)(B)(ii) for all other taxpayers (other than married taxpayers filing separate returns) is increased from $56,000 to $58,000. The applicable dollar amount under Section 219(g)(7)(A) for a taxpayer who is not an active participant but whose spouse is an active participant is increased from $169,000 to $173,000.

20. The adjusted gross income limitation under Section 408A(c)(3)(C)(ii)(I) for determining the maximum Roth IRA contribution for married taxpayers filing a joint return or for taxpayers filing as a qualifying widow(er) is increased from $169,000 to $173,000. The adjusted gross income limitation under Section 408A(c)(3)(C)(ii)(II) for all other taxpayers (other than married taxpayers filing separate returns) is increased from $107,000 to $110,000.

21. The dollar amount under Section 430(c)(7)(D)(i)(II) used to determine excess employee compensation with respect to a single-employer defined benefit pension plan for which the special election under section 430(c)(2)(D) has been made is increased from $1,014,000 to $1,039,000.

IV. HEALTH CARE

A. New Michigan Law Increases Employer's Health Care Costs. The Michigan legislature has passed a new law imposing a 1 percent assessment on all paid claims under fully-insured and self-funded employer group health plans beginning in 2012. This tax replaces the 6 percent use tax on Medicaid HMOs and plans providing Medicaid mental health services. "Paid claims" means reimbursements by the plan for medical, prescription drug and dental claims with dates of service on or after January 1, 2012. Reimbursements under medical FSAs, HSAs and HRAs are not included. The assessment is to be paid by insurers and third party administrators on a quarterly basis. The new law sunsets on January 1, 2014.

B. New Guidance Regarding Debit Card Use for OTC Expenses. Under the Affordable Care Act, expenses incurred for a medicine or a drug would be treated as a reimbursement for a medical expense only if the medicine or drug is a prescribed medicine or drug, or is insulin. IRS Notice 2010-59 provides that, except with respect to "90 percent pharmacies," health FSA and HRA debit cards may not be used to purchase over-the-counter medicines or drugs after January 15, 2011. In Notice 2011-5, the IRS modified Notice 2010-59 with respect to the use of debit cards for the purchase of over-the-counter medicines or drugs. The new guidance provides that after January 15, 2011, health FSA and HRA debit cards may continue to be used to purchase over-the-counter medicines or drugs if certain requirements are met. For example, the over-the-counter medicine or drug must be dispensed by the pharmacist in accordance with applicable law and regulations pertaining to the practice of pharmacy, and an Rx number must be assigned.

C. Grandfathered Plan Regulations Permit Insurance Contract Changes. Under the Affordable Care Act, group health plans are required to comply with certain new insurance market reform requirements. Grandfathered plans are not subject to these requirements. Under the initial regulations, if a plan sponsor changed insurance carriers, changed from one group insurance contract to another with the same insurer, or converted from self-funded to insured status, the grandfathered status of the plan would be lost. In November 2010, the initial regulation was amended to provide that a benefit option under a group health plan will not lose its grandfathered status if a plan sponsor enters into a new insurance policy, as long as the plan does not make any other changes that would cause a loss of grandfathered status, such as a reduction in benefits or a change in copays, employer contributions, deductibles, out-of-pocket maximums, or co-insurance.

D. Insured Plan Non-Discrimination Rules Delayed. The Affordable Care Act imposes non-discrimination rules on insured non-grandfathered group health plans. The new rules were to apply to plan years beginning on or after September 23, 2010. Notice 2011-1 was subsequently issued stating that compliance with the new rules is not required until after regulations or other administrative guidance has been issued.

E. Self-Employment Health Insurance Deductions. Individuals who have self-employment income can take a deduction for health insurance expenses for themselves, their spouse and their dependents. Generally, this applies to self-employed individuals reporting income on Schedule F (for farmers) or Schedule C (for other self-employed persons), general partners in a partnership and actively participating members in an LLC treated as a partnership who have self-employment income, and employees of an S corporation who own two percent (2%) or more of the S corporation's stock. Before claiming this tax deduction, a taxpayer must calculate the taxpayer's allowable health insurance deduction. Next, the taxpayer must determine his self-employment income, and subtract the fifty percent (50%) deduction for self-employment taxes, and also subtract any retirement contributions made to a SEP-IRA, simple-IRA, or KEOGH plan. The remainder is the maximum allowable deduction for health insurance expenses. If a loss is being reported from a self-employed activity, then the taxpayer is not eligible to deduct health insurance costs since this particular deduction is limited to self-employment income. However, a claim for health insurance expenses can still be made on Schedule A as an itemized medical deduction. A deduction cannot be taken for any insurance costs for any month in which the taxpayer is eligible to participate in a group health insurance plan through the taxpayer or the taxpayer's spouse's employer. For 2010, self-employed persons will be able to deduct their health insurance premiums as a business expense that reduced their self-employment tax. For 2011 and later years, the health insurance deduction can only be deducted against the income tax, unless Congress decides to extend the special rule for 2010.

F. Reporting Requirements for Employer-Sponsored Healthcare Coverage. Notice 2011-28 provides interim guidance to employers on information reporting on each employee's annual form W-2 of the cost of the health insurance coverage they sponsor for employees. Interim guidance was issued pursuant to the Affordable Care Act, which requires employers to report the cost of employer-provided health care coverage on Form W-2. Last fall, Notice 2010-69 made this requirement optional for all employers for the 2011 Forms W-2 (generally furnished to employees in January 2012). In the new Interim Guidance, the IRS provides further relief for smaller employers (those filing fewer than 250 Forms W-2) making the requirement optional for them, at least for 2012 (i.e., for 2012 Forms W-2 that generally would be furnished to employees in January 2013), and continuing this optional treatment for smaller employers until further guidance is issued.

G. Proposed Regulations on Health Insurance Premium Tax Credit. The IRS has issued proposed regulations (REG-131491-10) on the health insurance premium tax credit enacted into the law as part of the Patient Protection and Affordable Care Act of 2010. The credit is intended to help people who enroll in qualified health plans through state-based health insurance exchanges. The credit is generally available to individuals and families with incomes between 100 percent and 400 percent of the federal poverty level who may not be claimed as a dependent by another taxpayer and who, if married, file a joint return. The credit is equal to the lesser of the premium amount for the insurance or an amount calculated under a formula based on a "benchmark plan." When finalized, the regulations would apply for taxable years ending after December 31, 2013.

H. Healthcare Reform Changes Becoming Effective in 2012.

4. <u>Summary of Benefits and Coverage</u>. Insurers and plan sponsors of self-insured health plans will have to provide to all participants and applicants a Summary of Benefits and Coverage (SBC), which is based on a format set by HHS, using uniform definitions.

5. <u>Advanced Notice of Mid-Year Changes (Notice of Material Modifications)</u>. Plans will be required to provide 60-days advance notice of changes that will affect the content of the SBC.

- ➢ Not discriminate in favor of highly compensated individuals for insured health plans (effective date and related sanctions are delayed, pending additional guidance).

- ➢ Cover emergency services without pre-authorization and treat them as in-network.

- ➢ Allow designation of gynecologist, obstetrician or pediatrician as primary care provider.

- ➢ Cover immunizations and preventive care without cost-sharing.

6. <u>Medical Loss Ratio (Insured Plans Only)</u>. A rebate must now be provided to enrollees if more than 15% of premium revenue is extended on non-claim costs (for large groups) or 20% (for small groups and individual markets). States may adopt a higher percentage.

7. <u>Health Savings Account, Flexible Spending Account and Health reimbursement Arrangement Changes</u>.

- ➢ The definition of qualified medical expense for Health Savings Accounts (HSAs), FSAs and Health Reimbursement Arrangements was amended to exclude over-the-counter medicine except for insulin, unless obtain with a prescription.

- ➢ An increase in additional tax to 20% will now be charged on distributions from HSAs that are not used for qualified medical expenses.

8. <u>Phasing Out of the Medicare Part D Coverage Gap</u>. A $250 rebate will be provided for all Medicare Part D enrollees who enter the lapse in coverage that occurs once an individual reaches the coverage limit under Medicare Part D Prescription Drug Coverage (known as the “donut hole”). The donut hole will be completely closed by 2020.

9. Quality of Care Reporting. Plans and insurers will have to submit annual reports to HHS, which are designed to measure the quality of care. Regulations are required by March 23, 2012.

10. Comparative Effectiveness Research Fees.

- Insurers will contribute $1 multiplied by the number of lives covered under each health insurance policy (including self-insured health plans) for plan years or policy years ending after September 30, 2012.

- This amount increases to $2 per participant in 2013, and is indexed thereafter.

- The fee will be phased out by 2019.

11. Administrative Simplification. Beginning in 2012 and extending through 2016:

- HHS will adopt uniform standards and operating rules for the electronic transactions that occur between providers and health plans that are governed under the Health Insurance Portability and Accountability Act of 1996.

I. Constitutionality of Healthcare Reform. Earlier this year, the Sixth Circuit Court of Appeals upheld the constitutionality of the individual mandate provisions of the Patient Protection and Affordable Care Act ("PPACA"). *Thomas More Law Ctr. v. Obama*, 2011 WL 2556039 (6th Cir. 2011). On August 12, 2011, the Eleventh Circuit Court of Appeals subsequently held the PPACA unconstitutional in *State of Florida v. United States Department of Health and Human Services*, D.C. Docket No. 3:10-cv-91-RV/EMT. Now that two different courts of appeals have reached opposite decisions regarding the constitutionality of the PPACA it will be up to the U.S. Supreme Court to resolve the conflict. A decision is expected in 2012.

V. ESTATE PLANNING

A. Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010 ("TRA")

1. Background. In 2001, the Economic Growth and Tax Relief Reconciliation Act ("EGTRRA") was signed into law. EGTRRA phased in a repeal of the estate and generation-skipping transfer ("GST") taxes. Prior to full repeal in 2010, the tax rates were reduced as follows: in 2002, the 55% and 53% tax rates and the 5% surtax on estates and gifts in excess of $10 million were repealed; in

2003, the maximum rate was 49%; and, each year thereafter, the maximum rates were reduced by 1% per year from 2004 through 2006, so that in 2007 the highest rate was 45% where it remained until 2010.

In addition, EGTRRA increased the estate tax exclusion to $1 million in 2002 and 2003, $1.5 million in 2004 and 2005, $2 million in 2006 through 2008, and $3.5 million in 2009. However, the lifetime gift exclusion remained at $1 million. After repeal of the estate tax in 2010, beneficiaries would inherit assets with the decedent's basis (not to exceed fair market value), except that up to $3 million of basis could be added to assets left to a surviving spouse, and $1.3 million of basis could be added to assets left to any beneficiaries, including a surviving spouse.

Over the years since 2001, numerous pieces of legislation have been introduced to change the outcome of EGTRRA. Starting in 2009, when repeal was one year away, a host of bills were introduced dealing with the estate tax. In the closing days of 2009, the House approved H.R. 4853, which would have kept the 2009 estate, gift and GST tax rules in effect. However, H.R. 4853 did not pass, and repeal of the estate tax became effective in 2010. Due to the budget rules under which it was enacted, EGTRRA included a provision providing for it to "sunset" at the end of 2010. Thus, if Congress did not act before the end of 2010, then the estate and GST tax would have been reinstated in 2011 at their 2001 rate levels.

On December 6, 2010, an amendment was proposed to a Senate amendment to H.R. 4853 which would have retroactively reinstated the estate tax to January of 2010, but allowed decedents' estates to elect out of the estate tax in favor of the carryover basis regime created by EGTRRA for 2010. It would also have created an estate tax exclusion of $3.5 million and a top estate and gift tax rate of 45%. On Friday, December 10, 2010, the President and Republican leadership negotiated a compromise plan that took the form of the "Senate Amendment to the House Amendment to the Senate Amendment to H.R. 4853." That "Senate Amendment" is effectively what became the Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010 ("TRA").

2. <u>Overview</u>. In general, TRA does the following:

- It creates an estate tax regime for decedents whose death occurs after December 31, 2009, but still allows estates for decedents who die during 2010 to elect to apply the carryover basis rules that otherwise would have applied under EGTRRA for 2010.

- It establishes a top estate tax rate of 35% with an exclusion amount of $5 million, which sunset on December 31, 2012.

- It makes the estate and gift tax exclusion "portable" between spouses after December 31, 2010.

- It extends the estate death tax deduction created by EGTRRA through 2012.

- It provides that the gift tax for 2010 is calculated using a rate schedule with a top rate of 35% and a maximum exclusion of $1 million. After 2010, the top gift tax rate will remain at 35%, but the maximum exclusion will increase to $5 million.

- It provides a GST tax exemption of $5 million for transfers made during 2010. But oddly, the GST tax rate for 2010 is zero percent. Basically, this allows various GST tax elections to be made, notwithstanding that there is no GST tax *per se* in 2010. After 2010, the GST tax rate will be 35%, i.e., equal to the highest estate and gift tax rate.

The following table summarizes the laws in effect during the period from 2009 through 2013:

	2009	2010	2011	2012	2013
Estate Tax					
Exclusion	3,500,000	5,000,000	5,000,000	5,000,000	1,000,000
Top Rate	45%	35%	35%	35%	55%
Portability	No	No	Yes	Yes	No
C/O Basis	No	Optional	No	No	No
Gift Tax					
Exclusion	1,000,000	1,000,000	5,000,000	5,000,000	1,000,000
Top Rate	45%	35%	35%	35%	55%
Portability	No	No	Yes	Yes	No
GST Tax					
Exclusion	3,500,000	5,000,000	5,000,000	5,000,000	1,000,000*
Top Rate	45%	-0-%	35%	35%	55%
Portability	No	No	No	No	No

**indexed from 1997*

Note: The 55% top rate in 2013 can be further increased by a surtax. The surtax consists of a 5% additional tax on estates and taxable gifts between $10,000,000 and $17,184,000 to eliminate the effect of the marginal tax rates, effectively creating a flat 55% tax rate.

3. New Terminology. TRA introduces some new terminology that is important in understanding the new rules. The "Applicable Credit Amount" means the tax on the amount of the "Applicable Exclusion Amount." The "Applicable Exclusion Amount" is the amount of an estate or gift that is exempt from tax under TRA. It is the sum of the "Basic Exclusion Amount" and the "Deceased Spousal Unused Exclusion Amount." In 2011, the Basic Exclusion Amount is $5 million. For

2012, it is indexed for inflation, rounded to the nearest multiple of $10,000. Finally, the "Deceased Spousal Unused Exclusion Amount" is a definition that is used in determining the amount of a deceased spouse's Basic Exclusion Amount that can be used later on by the surviving spouse. It is most easily understood by means of an example:

> Jim and Betty are married. Jim has $3.5 million in his personal name. Betty has $6 million in her name. They have no joint assets. Jim dies in 2011, never having made any taxable gifts during his lifetime. Jim leaves all of his assets to Betty. The amount of Jim's unused exclusion amount that Betty can use when she dies, i.e., the Deceased Spousal Unused Exclusion Amount, is the lesser of (i) $5 million (i.e., the Basic Exclusion Amount with regard to Betty), or (ii) $1.5 million. Thus, in this case the Deceased Spousal Unused Exclusion Amount will be $1.5 million. This means that if Betty dies in 2011 after Jim, then her Applicable Exclusion Amount is the sum of her Basic Exclusion Amount of $5 million, plus the $1.5 million Deceased Spousal Unused Exclusion Amount from Jim, for a total of $6.5 million.

4. <u>Gift Tax under the TRA</u>. TRA did not retroactively increase the gift tax exemption for 2010. Thus, it remains at $1 million. However, beginning in 2011 the gift tax exemption is increased from $1 million to $5 million. The top marginal gift tax rate is 35% for 2010, 2011 and 2012.

The gift tax is determined by computing a tentative tax on the sum of the current year's taxable gifts and all of the prior years' taxable gifts, and subtracting from this amount the tentative tax on the prior years' taxable gifts. For this purpose, the rates of tax in effect for the year of the new gift are used instead of the rates of tax in effect at the time of the prior years' taxable gifts. This is a change from the method previously used to calculate the gift tax. It is more favorable to the taxpayer and preserves more of the applicable credit amount for future use.

All taxpayers, regardless of whether they made taxable gifts in their lifetimes, may give at least $4 million, and some taxpayers may give up to $10 million with the new portability provision, with no gift tax liability in 2011. Thus, a taxpayer who previously used his or her entire $1 million gift tax exclusion will nevertheless be able to transfer an additional $4 million in 2011 with no gift tax liability.

5. <u>Estate Tax under the TRA</u>. As noted above, EGTRRA repealed the estate tax, but only for 2010. TRA retroactively reinstates the estate tax for persons dying after December 31, 2009, but with certain modifications. The Applicable Exclusion Amount is $5 million, instead of the $3.5 million that was in effect in 2009, which was the last year prior to EGTRRA's repeal of the estate tax. Beginning in 2012, the Applicable Exclusion Amount is indexed for inflation, with adjustments rounded to the nearest $10,000 amount. The maximum estate tax rate

is 35%. Moreover, there are only two estate tax brackets. The tax is essentially $155,800 on the first $500,000, plus 35% on the excess over $500,000.

As 2010 went on, the idea of making the estate tax retroactive began to seem more and more unfair. Eventually, there was talk about making the estate tax retroactive, but giving executors the alternative of choosing to apply EGTRRA's carryover basis rules for 2010. TRA provided this structure, with a bonus that the estate tax now has a $5 million portable exclusion.

Thus, TRA grants executors for decedents dying in 2010 the option to elect out of the retroactive estate tax system and to use the carryover basis system under EGTRRA. EGTRRA gives executors the authority to allocate $1.3 million in increased basis to estate assets, as well as an additional $3 million in increased basis to assets transferred in a qualifying manner to a surviving spouse. The 2010 carryover basis election must be made in the manner specified by the Secretary of the Treasury. At present, no guidance has been issued by the Secretary of the Treasury with respect to how this election is made.

The estate tax is calculated on the total amount of the taxable estate, plus prior taxable gifts. This total is then reduced by the tax on the prior taxable gifts. The purpose of this structure is to prevent taxpayers from getting the benefit of two runs through the lower rate brackets by making both lifetime gifts and testamentary transfers at death. The tax rates in effect for the year of death are used instead of the rates of tax in effect at the time of the prior taxable gifts. This is a change from prior law. It is more favorable to the taxpayer and preserves more applicable credit amount for use against the estate tax.

The new rules also allow a decedent's estate or a donor to take advantage of the Applicable Exclusion Amount of the decedent's or donor's previously deceased spouse. This "portability" concept is intended to prevent families from incurring gift and estate tax that could have been avoided through planning prior to the death of the predeceased spouse.

Under the new portability provision, a decedent or donor not only has the benefit of his or her own Basic Exclusion Amount, but also the Deceased Spouse's Unused Exclusion Amount of the decedent's or donor's previously deceased spouse. However, this new provision is only available with respect to gifts made or decedents dying on or after January 1, 2011, and only with respect to previously deceased spouses who die on or after January 1, 2011. In addition, it expires after December 31, 2012, along with the rest of the TRA.

For estate tax purposes, TRA limits a decedent's use of the Deceased Spousal Unused Exclusion Amount to the last deceased spouse of the decedent. In other words, if a surviving spouse who subsequently dies had more than one previously deceased spouse, then the survivor's estate may only use the last deceased spouse's Deceased Spousal Unused Exclusion Amount. For gift tax purposes, the TRA does not make it clear how the Deceased Spousal Unused Exclusion Amount is used. For example, does the Deceased Spousal Unused Exclusion Amount get used first before the surviving spouse must use his or her Basic Exclusion Amount? An example in the legislative history appears to allow that, but no corresponding provision was incorporated into TRA.

In order to get the benefit of the Deceased Spousal Unused Exclusion Amount, the executor for the deceased spouse must do each of the following:

- File an estate tax return on a timely filed basis, including extensions (a late filed return will not suffice);

- On that return compute the Deceased Spousal Unused Exclusion Amount; and

- Make an irrevocable election that the Deceased Spousal Unused Exclusion Amount may be taken into account by the surviving spouse.

The statute of limitations does not bar the reexamination of the deceased spouse's estate tax return for purposes of determining the Deceased Spousal Unused Exclusion Amount available to the surviving spouse when the surviving spouse subsequently dies.

A number of implications arise from these new estate tax changes:

- The Deceased Spousal Unused Exclusion Amount is not indexed for inflation, which favors continued use of the traditional marital and family trust arrangements and credit shelter trust planning to keep the appreciation on assets out of the estate of the surviving spouse.

- One benefit of relying upon the Deceased Spousal Unused Exclusion Amount is to take advantage of the available basis step-up on assets received by the surviving spouse. This is an advantage compared to the traditional credit shelter trust planning.

- Under the sunset provisions of TRA, portability will disappear after 2012. For decedents dying in 2011 and 2012, credit shelter planning is a more certain device to lock in the benefit of the new $5 million Applicable Exclusion Amount.

- Portability does not apply to the GST tax. Thus, the inability to preserve the first spouse's unused GST exemption favors the use of credit shelter trust planning.

- The portability concept encourages the filing of a federal estate tax return for all married decedents dying on or after January 1, 2011, in order to preserve the availability of the Deceased Spousal Unused Exclusion Amount.

Fiduciaries of estates of decedents who died between January 1, 2010 and December 16, 2010, which is the day prior to the date of enactment of the TRA, may delay filing an estate tax return and paying the estate tax until nine months after December 17, 2010.

6. GST Tax Under the TRA. TRA retroactively restates the GST tax in 2010 with a $5 million exemption. However, to mitigate the potentially inequitable consequences of a retroactive reinstatement of the GST tax, TRA permits an executor to elect out of the estate tax regime for 2010. For executors who decide not to make that election, the GST tax for 2010 is zero. This somewhat odd arrangement is intended to eliminate some of the uncertainty under the EGTRRA sunset with respect to the allocation of GST exemption in 2010 when EGTRRA has eliminated the GST tax, and other measures that may have been taken, such as deemed allocations of the GST tax exemption, late allocations of the GST tax exemption, and "qualified severances" of trusts. All of these actions will be respected, notwithstanding that they were taken at a time when there was otherwise no GST tax.

Beginning in 2011, there will be a GST tax with a $5 million exemption and a maximum rate of 35%. In 2012, the GST exemption will be indexed in increments of $10,000. Portability does not apply to the GST tax. But, all of the GST tax provisions, along with the rest of TRA, sunset after 2012.

For those making generation-skipping transfers in 2010 prior to the enactment of TRA, TRA extends the filing deadline for GST tax reporting until nine months after the date of enactment. For direct skips occurring at death, taxable distributions and terminations, TRA extends the filing deadline that applies to Form 706. Less clear is the reporting of *inter vivos* direct skips which are reported on Form 709. Even with a zero percent applicable rate, *inter vivos* direct skips are presumably reportable in 2010, given their potential impact on the GST tax exemption.

7. Planning Implications under TRA.

a. *Timing of Gifts*. With the gift tax Applicable Exclusion Amount increasing dramatically in 2011 and 2012, it may make sense to make large taxable gifts using the gift tax Applicable Exclusion Amount. There is some uncertainty over what happens if a donor makes a $5 million gift and dies when the estate tax Applicable Exclusion Amount is only $1 million in 2013 or thereafter.

While there are good arguments against a "clawback," the possibility of a clawback cannot be ignored given Congress's unpredictability.

b. *Installment Sales*. The increased gift tax Applicable Exclusion Amount in 2011 might afford clients who were involved in an installment sale with a trust the opportunity to gift additional assets to the trust and perhaps negotiate the cancellation of the existing note guarantees or otherwise unwind some of the complexity of those transactions.

c. *Discounts*. There have been a number of bills introduced into Congress that call for significant restrictions on the use of discounts for closely-held family businesses in estate planning transactions. None of the provisions of these bills made their way into TRA. Thus, for the time being discount planning should remain viable. The use of discount planning combined with the substantial $5 million gift tax Applicable Exclusion Amount could prove to be a way to shift a great deal of wealth to children and grandchildren. However, since there is only a two year time horizon, i.e., 2011 and 2012, during which the $5 million Applicable Exclusion Amount is available, this may be a limited opportunity.

d. *Grantor Retained Annuity Trusts*. There have been a number of proposals introduced into Congress that would require a ten year term for a grantor retained annuity trust ("GRAT"). A GRAT is a trust that allows gifts to be made at a discounted value due to the annuity retained by the donor for the period of time specified in the GRAT instrument. A ten year term would effectively repeal this technique for older clients. TRA does not include any restrictions on GRATs. Thus, GRAT planning should remain viable while interest rates and asset values are low. To some extent, the $5 million gift and estate tax Applicable Exclusion Amount, combined with portability, may lessen some of the interest in GRAT planning. But, this is not necessarily the case. It may be worth considering a GRAT strategy due to the possibility in 2013 of a reduced estate tax Applicable Exclusion Amount and a higher rate. The best candidates may be individuals who have already implemented a GRAT strategy, so that the cost of engaging in additional GRATs is relatively low.

e. *Qualified Personal Residence Trusts*. A qualified personal residence trust ("QPRT") involves placing a residence in trust and having it pass to one or more beneficiaries after a stated period of time. It is another device for discounting the value of the property that is the subject of a gift. The higher $5 million Applicable Exclusion Amount may make it unnecessary to consider QPRTs for modestly sized estates, at least if the $5 million Applicable Exclusion Amount remains. However, some clients have so much value tied up in their homes that the Applicable Exclusion Amount previously in effect was not sufficient to eliminate all of the gift tax on a QPRT transaction. Thus, if TRA is allowed to sunset and the $1 million Applicable Exclusion Amount returns, then it may be insufficient to cover the gift tax on a QPRT transaction after 2012. For those clients, a QPRT may still be worth considering.

f. *Formula Clauses and Bequests*. The increase in the Applicable Exclusion Amounts, combined with portability, make it advisable for all individuals to review any formula clauses in their estate plans that are tied to an estate tax computation. The same is true of any computations that are found in their prenuptial or buyout agreements.

g. *GST Tax*. For 2011 and 2012, clients should consider utilizing the newly increased GST exemption amount of $5 million. If the GST exemption amount is allocated to a trust, then the trust is exempt from further GST tax. Beginning in 2010, it may also be worthwhile making a late allocation of GST exemption to a previously established non-exempt or partially exempt trust, since there is an increase in the GST exemption amount.

h. *Charitable Giving*. The size and scope of the TRA changes may lessen charitable giving in situations where it was motivated by client concerns about reducing the liability for estate tax. For example, clients who have implemented testamentary charitable lead trusts as part of their estate plan in order to reduce the size of their taxable estates should revisit those decisions.

i. *Estates of Individuals Who Died in 2010*. The law permits the executor, personal representative or trustee to elect out of the new estate tax regime and into the carryover basis regime of EGTRRA. For decedents with estates of less than $5 million, it would generally be preferable to be subject to the estate tax regime and have a full step-up in basis. For estates in excess of $5 million, the selection of the tax regime would depend on a variety of factors, such as the estate tax cost versus the income tax cost, the timing of sales of assets, and the ability for future tax planning. For very large estates, it would generally be preferable to elect the carryover basis regime in lieu of the new estate tax. Paying an estate tax of 35% within the later of nine months from TRA's date of enactment or death is generally going to be more costly than paying a capital gains tax at some later point in time. If carryover basis is elected, then under TRA the fiduciary has up to nine months after the date of enactment to file the report for carryover basis. Incidentally, there is a technical issue with respect to whether the date is, in fact, nine months after the date of enactment, or whether it is the time for filing the decedent's final income tax return. It is believed that the time for filing the decedent's final income tax return should be the proper date, but this remains to be clarified.

B. Carryover Basis Election Guidance Released. Rev. Proc. 2011-41 provides guidelines for those estates wishing to take advantage of the safe harbor provisions of Section 1022, which under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) allow executors of estates having decedents who died in 2010 to elect to have the carryover basis rules apply. Notice 2011-66, released simultaneously with Rev. Proc. 2011-41, describes the time and manner in which an executor can make an election under

Section 1022 or choose to allocate a generation-skipping transfer tax exemption to transfers occurring as a result of the decedent's death.

C. IRS Extends Deadline for Forms 706 and 8939. The IRS has released Notice 2011-76 that extends the filing deadline for Forms 706 and 8939 for estates of decedents dying in 2010. The Notice provides that estates of people who died in 2010 will have until early next year to file the required returns and pay any estate taxes that are due. In addition, the IRS is providing penalty relief to certain beneficiaries of these estates on their 2010 federal income tax returns. This relief is designed to give large estates, normally those over $5 million, more time to comply with key tax law changes enacted late last year.

Specifically, the following relief is given:

- Large estates opting out of the estate tax now will have until Tuesday, Jan. 17, 2012, to file Form 8939, which was previously due on Nov. 15, 2011. Because this is a change in the specified due date rather than an extension, no statement or form needs to be filed with the IRS to have this new due date apply.

- 2010 estates that request an extension on Form 4768 will have until March 19, 2012 to file their estate tax returns and pay any estate tax due. Normally, a six-month filing extension is automatically granted to estates filing this form, but extensions of time to pay are granted only for good cause. As a result, most 2010 estates that timely file Form 4768 will have until Monday, March 19, 2012 to file Form 706 or Form 706-NA. For estates of those dying late in 2010 (after Dec. 16, 2010 and before Jan. 1, 2011), the due date is 15 months after the date of death. No late-filing or late-payment penalties will be due, though interest still will be charged on any estate tax paid after the original due date.

- Special penalty relief is provided to many individuals, estates and trusts that already filed a 2010 federal income tax return, or obtained an extension and plan to file by the Oct. 17, 2011 extended due date. Late-payment and negligence penalty relief applies to persons inheriting property from a decedent dying in 2010, who then sells the property in 2010 but improperly reports gain or loss because they did not know whether the estate made the carryover basis election.

D. White House Estate Tax Proposals. With a $5 million applicable exclusion amount per person for 2011 and 2012, an estimated 3,600 estates will owe estate tax. More than 99.8% of 2011 decedents will not be subject to the estate tax. If the exemption had been lowered to $3.5 million (the rate in 2009), 5,500 estates would have been taxable. With an exemption of $1 million (plus indexed increases), Treasury estimates that 40,000 estates would be subject to tax. We do not know what changes Congress will enact into the law for 2013. However, in the meantime, the White House has included the following in its budget proposal:

1. Restoring the 2009 estate, gift and GST tax rules on January 1, 2013. This would include a top estate, gift and GST tax rate of 45%, a $1 million gift tax exclusion, and a $3.5 million estate and GST basic exclusion amount.

2. Making portability of the deceased spousal unused exemption amount permanent.

3. Require consistency in valuation for income and estate tax purposes, so that beneficiaries are required to use estate tax values to determine the adjusted basis of property received from a decedent.

4. Expand Section 2704(b) to ignore in valuing partnerships, LLCs, and other entities a new category of "disregarded restrictions," so as to reduce the use of valuation discounts for family transactions.

5. Require a minimum ten year term for GRATs, require the remainder interest in a GRAT to have a positive value, and prohibit the retained annuity interest from decreasing during the term of the GRAT.

6. Limit the duration of dynasty trusts by providing that the allocation of GST exemption to a transfer protects the transfer from GST tax for no more than ninety (90) years.

E. Qualified Charitable Distributions for 2010 and 2011

1. The qualified charitable distribution provisions were renewed for 2010 and 2011, allowing individuals age 70 1/2 or over to exclude from gross income up to $100,000 that is paid directly from their individual retirement accounts (excluding SEP or SIMPLE IRAs) to a qualified charity. An excluded amount can be used to satisfy any required minimum distributions that the individual must otherwise receive from their IRAs for 2010 and 2011. The deadline for making a 2010 qualified charitable distribution is January 31, 2011. The election to treat a January 2011 qualified charitable distribution as having been made in 2010 is made by including the qualified charitable distribution on the individual's 2010 income tax return.

2. To qualify as a qualified charitable distribution, the IRA trustee must make the distribution directly to the qualified charity. Any distributions, including any required minimum distributions, which the IRA owner actually receives, cannot qualify as a qualified charitable distribution. Likewise, any tax withholdings on behalf of the owner from an IRA distribution cannot qualify as a qualified charitable distribution.

3. IRA owners who have received their 2010 required minimum distributions may not recontribute those distributions to an IRA to have them redistributed directly to a qualified charity as a qualified charitable distribution. However, if an IRA owner received a distribution in excess of his or her 2010 required minimum distribution, the IRA owner can roll the excess to another or the same IRA within 60 days of receiving the distribution and then have the funds paid directly to the qualified charity as a qualified charitable distribution.

F. Indirect Gifts and the Step Transaction Doctrine. In *Linton v. United States*, No. 09-35681 (9th Cir. 2011), the Ninth Circuit reversed the District Court's summary judgment in favor of the government on the issue of indirect gifts and the applicability of the step transaction document. This is another case where a partnership or LLC was formed for estate planning purposes, conveyances were made to the entity, and at or about the same time transfers were made of the ownership interests in the entity to the children and a discount was taken for valuation purposes. The IRS typically rejects the minority interest discount based on the argument that the transfers were of the underlying assets and not interests in the entities. This argument is often based, at least in part, on the step transaction doctrine. The court discussed the three tests, any of which, if satisfied, would require the application of the step transaction doctrine. The Court concluded that the Lintons wanted to give their children LLC interests and at the same time deny them control over the LLC or its assets. Thus, the "end result test," if applied, would produce a win for the taxpayers. Applying the "interdependence test," the court looked at whether the steps taken by the taxpayers were so interdependent that the legal consequences would depend on the completion of the entire series of events, and concluded that creating an LLC is a "reasonable business activity." Thus, it was not necessarily "fruitless" even if done in anticipation of gifting LLC interests to the taxpayers' children. Finally, the court found the "binding commitment test" inapplicable because the test applies only when the series of transactions extend over several years, and in this case the taxpayers' actions occurred within a few weeks. Thus, the court found that the government had not identified any "meaningless or unnecessary steps that should be ignored" under the step transaction doctrine.

G. Section 67 Limitations on Estates and Trusts. Notice 2011-37 provides interim guidance on the treatment under Section 67 of investment advisory costs and other costs subject to the two-percent floor under Section 67(a). The Notice provides that for taxable years beginning before the date that final regulations under Treas. Reg. §1.67-4 are published, non-grantor trusts and estates will not be required to "unbundle" a fiduciary fee into portions consisting of costs that are fully deductible and costs that are subject to the two-percent floor.

H. Ninth Circuit Upholds Validity of Formula Clause. The Ninth Circuit Court of Appeals has upheld a Tax Court decision (T.C. Memo. 2009-280) and ruled in *Estate of Petter v. Commissioner* (Docket No. 10-71854) that a formula clause was effective to determine the amount of property transferred to a grantor's heirs and the amount transferred to charity with respect to the total property interests transferred from the grantor.

I. Two-Percent Floor for Trust and Estate Deductions. The IRS has proposed new regulations (REG-128224-06) concerning when costs incurred by trusts and estates are subject to the two-percent adjusted gross income (AGI) floor for miscellaneous itemized deductions. Section 67(e)(1) provides that the AGI of a trust or an estate is to be computed in the same manner as an individual, with an exception for deductions that are: (1) paid or incurred in connection with the administration of the trust or estate, and (2) which would not have been incurred if the property were not held in such trust or estate. Deductions that meet these tests are allowed to be taken in full and above-the-line to reduce AGI. In *Knight v. Commissioner*, 552 U.S. 181 (2008), the Supreme Court settled a split among the Circuit Courts and put to rest the issue of whether investment advisory fees are fully deductible above-the-line under Section 67(e) or deductible under Section 67(a) only in excess of the two-percent AGI floor by ruling that the second requirement of Section 67(e)(1) had not been met, and the fees are only deductible in excess of the two-percent AGI floor. The new proposed regulations provide that a cost is subject to the two-percent AGI floor if it would be commonly or customarily incurred by a hypothetical individual owning the same property. With regard to tax preparation fees, the costs for all estate and generation-skipping transfer tax returns, fiduciary income tax returns and the decedent's final individual income tax return are not subject to the two-percent AGI floor. Investment advisory fees are generally subject to the two-percent AGI floor. However, incremental costs of investment advice are fully deductible if charged solely because the investment advice is rendered to a trust or estate instead of to an individual that is attributable to an unusual investment objective or the need for a specialized balancing of interests of the various parties (beyond the usual balancing between current beneficiaries and remaindermen). In certain situations, a single fee (such as a fiduciary's commission, attorney's fee or accountant's fee) must be unbundled and treated in accordance with its component parts. Any reasonable method may be used to allocate a bundled fee between costs that are subject to the two-percent AGI floor and those that are not. However, any portion of a bundled fee attributable to payments made from the bundled fee to third parties for expenses subject to the two-percent AGI floor is readily identifiable and must be pulled out of the bundled fee. There is an exception to the unbundling requirement for a bundled fee that is not computed on an hourly basis. In that situation, the portion of the fee that is attributable to investment advice must be pulled out, as well as any payments made from the bundled fee to third parties for expenses subject to the two-percent floor. This portion is then subject to the two-percent AGI floor while the remainder of the fee is fully deductible.

J. Assets Transferred to an FLP are Included in Decedent's Estate. The Tax Court ruled in *Turner v. Commissioner* (T.C. Memo. 2011-209) that the assets of a decedent transferred to a family limited partnership were includable in his estate under Section 2036. The partnership agreement provided for the payment of a reasonable management fee to the general partners, and the court found that the fee paid to the taxpayer was not reasonable given their involvement with the management of the family limited partnership. The partnership agreement could also be amended by the general partners at any time without the consent of the limited partners. Based on these factors, the court found that there was an express agreement that the decedent would continue to enjoy the assets transferred to the family limited partnership. The court also concluded that there was an implied agreement due to various factors. These included the receipt of the management fees for which no services had been performed, the taking of distributions from the partnership at will, comingling of personal and partnership funds, disproportionate distributions from the partnership, and the creation of the partnership being testamentary in nature.

K. Notice Not Required for Crummey Withdrawal Powers. The Tax Court has ruled that the beneficiaries of an irrevocable trust do not have to be given notice of their withdrawal rights in order for gifts to the trust to qualify for the annual gift tax exclusion. *Turner v. Commissioner* (T.C. Memo. 2011-209).

L. Guidance on Portability. Notice 2011-82 provides guidance to executors on how to make the election under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 to allow a surviving spouse to use a predeceased spouse's unused estate tax exemption. Section 2010(c)(5) requires the executor of the predeceased spouse to file an estate tax return and computes the unused estate tax exemption and makes an election on the return that allows the surviving spouse to use the predeceased spouse's unused estate tax exemption. The election is irrevocable. Under the Notice, by timely filing a properly prepared and complete Form 706, an estate will be considered to have made the portability election without the need to make an affirmative statement, check a box or otherwise affirmatively elect. Not timely filing Form 706 will prevent the making of that election. If an executor does not want to make the portability election, but has an obligation to file Form 706, then the executor must follow the instructions for Form 706 that will describe the necessary steps to avoid making the election.

M. Unreported Gifts of Real Property. In late December 2010, the IRS filed an ex-parte petition in the U.S. District Court for the Eastern District of California seeking judicial authorization to serve a John Doe summons on the California State Board of Equalization ("BOE"). The summons sought to identify, from California state records, taxpayers who had made non-spousal transfers of real property to related parties for less than full consideration and then failed to report those transfers on a Form 709, the Federal Gift Tax Return. Papers filed in the BOE John Doe summons action detail the ongoing and creative IRS compliance initiative. The declaration of an experienced attorney in the IRS estate and gift program who is also the first designated federal/state coordinator for the program reveals the following:

- For over 18 months the IRS has been engaged in a compliance initiative involving unfiled gift tax returns in cases of property transfers between related parties (non-spousal) for less than full consideration.

- Many states exempt donative transfers of real property among related parties from state transfer, excise, or stamp taxes, and thus the parties to the transaction usually complete a state filing to claim the pertinent exemption. These forms are, of course, maintained in state records.

- Fifteen states have voluntarily provided the IRS records of those exemption claims to assist it in detecting real property transfers between related parties for less than full consideration. Those states are Connecticut, Florida, Hawaii, Nebraska, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Texas, Virginia, Washington, and Wisconsin.

- The IRS is checking to determine whether a federal gift tax return has been received that reflects a related-party transaction claimed as exempt on state records.

- As of December 2010 the IRS had opened 323 taxpayer examinations, 217 of which were pending in numerous states, including New York and Florida, and at least 50 cases were opened in Ohio alone. Also, as of the end of 2010, the IRS had found 97 instances of unfiled gift tax returns and had made 12 assessments when gifts exceeded the lifetime credit.

- Based on what it considers a representative sampling, the IRS estimates that there is a 60 to 90 percent noncompliance rate when property has been transferred intrafamily for less than full consideration.

N. 2012 Inflation Adjustments.

1. For an estate of any decedent dying during calendar year 2012, the basic exclusion from estate tax amount is $5,120,000, up from $5,000,000 for calendar year 2011. Also, if the executor chooses to use the special use valuation method for qualified real property, the aggregate decrease in the value of the property resulting from the choice cannot exceed $1,040,000, up from $1,020,000 for 2011.

2. The annual exclusion for gifts remains at $13,000.

3. The monthly limit on the value of qualified transportation benefits exclusion for qualified parking provided by an employer to its employees for 2012 rises to $240, up $10 from the limit in 2011. However, the temporary increase in the monthly limit on the value of the qualified transportation benefits exclusion for transportation in a commuter highway vehicle and transit pass provided by an employer to its employees expires and reverts to $125 for 2012.

4. Several tax benefits are unchanged in 2012. For example, the additional standard deduction for blind people and senior citizens remains $1,150 for married individuals and $1,450 for singles and heads of household.

VI. MERGERS & ACQUISITIONS

A. Michigan Enacts New Venture Investment Income Tax Credit. Michigan recently enacted a venture investment income tax credit equal to 25% of a qualified investment made in a qualifying business after December 31, 2010, and before January 1, 2013. To qualify for the credit, the taxpayer must obtain a certification from the Michigan Strategic Fund within 60 days of making the qualified investment in the qualifying business. The amount of the investment cannot exceed $1 million in any one qualified business, and the credit is limited to $250,000 taken in two equal installments over two years beginning with the tax year the certification was issued. The credit is not refundable, but any unused credit may be carried forward for five years.

B. New Export Assistance. The Michigan Economic Development Corporation has announced a new export assistance program for small businesses. Businesses with fewer than 500 employees can qualify for the program, which offers financial assistance for exporting. The funds come from a $1.5 million award to the state from the U.S. Small Business Administration state export pilot program.

C. Personal Goodwill from Dental Practice. The Ninth Circuit Court of Appeals has held that goodwill generated by a dentist during his employment with his solely owned professional service corporation was owned by the corporation and was not a personal asset of the dentist. *Howard, Larry E., et al. v. United States* (Docket No. 10-35768). The court noted that the goodwill of a professional practice may attach to both the professional as well as the practice. Where the success of the practice depends entirely on the personal relationships of the professional, the practice does not generally have its own goodwill. However, ownership of the goodwill may be transferred to the practice if the professional enters into an employment contract or covenant not to compete with the business. In this case, the dentist had entered into an employment agreement and covenant not to compete with his professional corporation. As a result, the goodwill ceased to be a personal asset of the dentist and became an asset of the dentist’s corporation.

VII. REAL ESTATE

A. Section 179 Deductions Can Now be Claimed for Real Property. Until now, real property costs were ineligible for the Section 179 deduction. For tax years beginning in 2010 and 2011, up to $250,000 of qualified improvement costs involving the interiors of leased non-residential buildings, restaurant buildings, or interiors of retail buildings can be immediately deducted under the Section 179 deduction provisions. The $250,000 Section 179 allowance for real estate improvements is part of the overall $500,000 allowance. Generally, excess Section 179 deductions that cannot be deducted in the current tax year can be carried forward indefinitely. This is not true for excess Section 179 deductions relating to qualified real property. Those excess deductions can only be carried over to a tax year that begins in 2011. Thus, there is no carryover available for excess Section 179 deductions from real property placed in service in a tax year that begins in 2011. Instead, the taxpayer must depreciate those amounts under the standard rules for real property.

B. Taxpayers Not A Real Estate Professional. In *Yusufu Yerodin Anyika*, e*t ux v. Commr.*, TC Memo. 2011-69; No. 23437-08. The Tax Court found that a Pennsylvania engineer did not qualify as a real estate professional in that his real estate rental activities were passive activities. The Tax Court upheld the accuracy-related penalties, but declined to uphold penalties for willful delay of tax court proceedings. A taxpayer qualifies as a real estate professional, and is therefore not engaged in a passive activity under Section 496(c)(2), if more than one-half of the personal services performed in trades or businesses by the taxpayer are performed in real property trades or businesses in which the taxpayer materially participates, and the taxpayer performs more than 750 hours of service during the taxable year in real property trades or businesses in which the taxpayer materially participates. Under Treas. Reg. §1.469-5T(f)(4), an individual's hours of participation in an activity may be established by any reasonable means. Contemporaneous daily time reports, logs or similar documents are not required to the extent participation may be established by other reasonable means. However, a "ballpark guesstimate" will not suffice. The taxpayer in this case worked 37.5 hours per week, 48 weeks per year, as an engineer. In his petition, he indicated that he spent 750 hours actively managing rental properties. On Form 4564, the IRS's information document request form, he indicated, under penalties of perjury, that he devoted 800 hours per year to working on rental properties. However, when he learned that he must spend at least 750 hours materially participating in a real estate business and, in addition, must devote more than one-half of his working hours to the real estate business, he claimed that he spent 1,920 hours per year working on rental properties. He stated that he was "speaking from memory with the exact numbers," but he did not otherwise have any records or supporting documentation. The Tax Court ruled in favor of the IRS and assessed a negligence penalty dismissing in the process the taxpayer's claim that he relied on Turbo Tax. On the other hand, the Tax Court declined to assess the penalty under Section 6673(a)(1), which applies when proceedings are instituted or maintained by the taxpayer primarily for delay, noting that "negligent disorganization does not amount to purposeful delay."

C. Change in Accounting for Leases. The current rules on accounting for leases under GAAP requires leases to be categorized as either capital leases or operating leases, each with substantially different impacts on financial statements. Categorization as a capital lease applies where the lessee will utilize the leased property for a minimum of 80% of its useful life or for a period which corresponds to a minimum of 90% of the value of the leased property. In those situations, the lessee is considered to have essentially purchased the leased property and must record the leased property as an asset with an offsetting liability, which is essentially debt. Over time, the asset is amortized to expense and interest is recorded on the lease debt. In contrast, characterization as an operating lease is applicable where the lessee will utilize the property for less than 80% of its useful life or for a period which corresponds to less than 90% of the value of the leased property. In these situations, the lessee is considered to be simply renting the leased property and must record the rental payments to expense as they are incurred. No debt or interest is recorded for operating leases. Concerns have been expressed on the accounting for leases by users of financial statements, particularly in the investment community. As a result, many financial statement users attempt to adjust financial statements containing operating leases by imputing some level of debt, making them more comparable to statements containing capital leases. The Financial Accounting Standards Board has proposed revised rules that would require all lessees to record an asset representing the right to use leased property during the term of the lease along with a corresponding liability. The scope of this accounting change will be significant. In addition to the impact on the lessee's balance sheet, the proposed rules will change the timing and classification of the lease-related expenses on the income statement, meaning that traditional financial metrics such as EBITDA, debt to equity ratio, interest coverage, etc., will change materially. The industry that may be affected most is commercial real estate, in particular, large retailers, banks and other companies that lease multiple locations will see significant changes in their financial statements as they shift their current "off balance sheet" operating leases to assets and liabilities. The requirement to record leases as assets and liabilities means that there will no longer be the same financial reporting advantage to leasing real estate. Consequently, some businesses with adequate resources may opt to purchase, rather than lease. Tenants often desire the shortest lease terms possible. This will be even more true in the future, because longer lease terms will result in larger liabilities on the balance sheet of those tenants. Companies will be required under the new rules to include renewal options as part of the lease obligation, thereby increasing the liability on the balance sheet. Thus, it is likely that lessees will pay closer attention to extension clauses in an effort to minimize the liability required to be added to their balance sheet.

D. Real Estate Developer's Expense Deductions Denied. The Tax Court, upholding an accuracy-related penalty, sustained IRS determinations disallowing expense deductions related to a couple's real estate properties, finding that some expenses weren't substantiated while others were subject to the passive activity loss limitations, and that legal fees were nondeductible capital expenses. *Robert Ortega et ux. v. Commissioner*; T.C. Memo. 2011-179; No. 10106-09.

HAZARDS OF DIRECT PAY PERMITS

By: Brian Nettleingham, Esq.[1]

I. WHAT IS A DIRECT PAY PERMIT?

A. Michigan's Legislature has empowered Treasury to issue a "direct pay permit" to a party requesting it. MCLA § 205.98. Holders of direct pay permits can instruct sellers to refrain from charging sales or use tax, because the permit holder will remit the tax directly to the State.

B. It is important to note, however, that Treasury has the authority to identify items that are not eligible for a direct payment authorization. In the case discussed below, the ineligible items included the following:

1. Materials furnished by construction contractors in the performance of a contract to construct, alter, repair or improve real estate

2. Vehicles purchased, leased or rented for highway use and requiring a license and title

3. Aircraft

4. Watercraft

5. Services subject to use tax including communication services and motel rentals

6. Petty cash purchases made by company employees on behalf of the company

7. Prepayment of sales tax on gasoline

[1] This outline was prepared in large part based on research and writing that was the combined effort of a team that included Brian Nettleingham, Michael Hauser, and Ian Bolton.

8. Tangible personal property consumed by a person performing any service activity for your company

C. There is a sales tax exemption for a person who sells goods to a permit holder. See MCL § 205.54a(1)(n).

II. <u>A POTENTIAL PROBLEM ARISING FROM THE EXCEPTIONS TO PERMITS</u>

A. The direct pay permit holder instructs suppliers not to charge sales or use tax.

1. Assume that the State issued a direct pay permit to the fictional company, ACME. The company instructs its suppliers **<u>not</u>** to charge sales tax because ACME will pay the tax directly to the State. ACME's purchasing personnel inform their suppliers, and the instructions are printed on ACME's purchase orders.

2. Assume that Beta Supplies, Inc. sells a mixture of goods and services to ACME on a monthly basis. Because ACME wants to streamline its purchasing process, it uses Beta as an intermediary for certain types of supplies, including paper goods and cleaning supplies that are used by ACME's employees (not Beta's). BETA also provides supervisory personnel – Beta's employees – to help manage divisions of ACME's workforce.

3. Consistent with ACME's direction, Beta does not collect or remit sales tax on the goods that it sells to ACME.

B. The supplier is audited

1. Treasury audits Beta's sales and use tax records and notes that Beta has not paid sales or use tax on goods that it purchased and resold to ACME.

2. Beta explains that it purchased the goods for resale, so it was not required to pay sales or use tax on its purchases. Further, ACME holds a direct pay permit, so Beta was not required to assess and remit sales tax on the resale.

   a. Michigan's Use Tax Act ("UTA") imposes a tax upon the "privilege of using, storing, or consuming tangible personal property in this state."[2]

   b. The UTA exempts from tax "property purchased for resale."[3] Michigan's General Sales Tax Act ("GSTA") imposes a tax on "sales at retail,"[4] and it defines a "retail sale" as "a sale, lease or rental of tangible personal property for any purpose other than for **resale**, sublease, or subrent" (emphasis supplied).[5]

   c. Michigan Admin. Code R. 205.9 provides, in part:

      > Sales for purposes of resale include sales of tangible personal property not to be consumed or used by the immediate purchaser, but to be resold in the regular course of business by the purchaser; provided that property purchased for resale purposes which is not resold, but is used or consumed by the purchaser, is taxable on the delivered cost to the purchaser who shall remit the tax to the state.

   d. In short, purchases for resale are exempt from sales and use taxes.

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[2] MCL 205.93(1).

[3] MCL 205.94(1)(c)

[4] MCL 205.52(1).

[5] MCL 205.51(1)(b).

e. Sales or use tax may be incurred on any taxable transaction, but not both. Payment of use tax "shall relieve the seller … from the payment of the amount of the tax which he may be required … to collect from the purchaser."[6]

f. Michigan courts have held that "[t]he use tax … complements the sales tax and is designed to cover those transactions not covered by Michigan's General Sales Tax Act."[7]

g. The legislative intent of the statutes was to avoid "pyramiding of sales and use tax," such that "a transfer of property that has already been subjected to Michigan's sales tax is not subject to this state's use tax."[8]

3. Beta assumes that ACME remitted the tax and that Treasury can simply verify that the tax was actually paid. Beta further assumes that if there is a problem, it will be ACME's problem. After all, the State issued ACME a direct pay permit, and Beta believes that Treasury will direct its collections efforts at ACME.

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[6] MCL 205.97. See also RIA's Michigan tax service, at ¶ 21,190, which states: "[t]he sales tax and the use tax are mutually exclusive and neither applies where the other was due and paid," citing MCL 205.94(1)(a) ("The following are exempt … Property sold in this state on which transaction a tax is paid under the general sales tax act … if the tax was due and paid on the retail sale to a consumer").

[7] *WPGP1, Inc. v. Dept. of Treas.*, 240 Mich. App. 414 (2000), citing *Sharper Image Corp. v. Dept. of Treas.*, 216 Mich. App. 698 (1996).

[8] *General Motors Corp. v. Dept. of Treas.*, 466 Mich. 231 (2002).

C. Treasury issues an assessment for unpaid sales/use tax to Beta.

1. Treasury's field auditor looks at several things when reviewing Beta's records, including the following:

   a. Whether goods and services were separately broken out on Beta's invoices

   b. Whether the cost of the goods fluctuated with the volume of the goods supplied monthly

   c. Whether the personnel that Beta supplied to ACME consumed the goods

   d. The contracts between ACME and Beta

2. Treasury concludes:

   a. Beta was a servicer and used the goods in the performance of services, so Exception 8 of the direct pay permit excluded the transaction.

      i. Although Beta supplied materials and services to ACME, Beta's personnel did not actually use the materials.

      ii. Treasury takes the position, however, that because Beta's personnel were in supervisory roles, they could manage the way in which ACME's employees consumed the materials.

   b. Beta did not "sell" goods to ACME as a transaction distinct from its performance of services, and even if there was a "sale" it should be disregarded as incidental to the services.

3. Treasury also takes the position that it is not required to determine whether ACME actually paid the tax under the direct pay permit. Even if the assessment results in a "double payment", Treasury feels confident that ACME's tax attorneys will remedy that problem by filing for a refund.

III. POSSIBLE RESOLUTION THROUGH THE MICHIGAN TAX TRIBUNAL

A. Beta files a petition with The Michigan Tax Tribunal

Beta files a petition with the Michigan Tax Tribunal, disputing the assessment, arguing that the company did not owe use tax on its purchases because it did not use, store or consume the tangible personal property at issue.

Rather, Beta argues that it purchased the products for resale to ACME, and ACME's employees used the products. Therefore, the sales of goods to ACME are covered by ACME's direct pay permit.

B. Acme takes the position that its actual payment of the taxes should not be part of the dispute.

To prove that the tax was actually paid, Beta attempts to subpoena ACME's records showing that tax on purchases of goods from Beta were already paid. ACME quashes the subpoena, arguing that:

1. ACME undergoes its own audit with Treasury, and ACME should not be subject to a second audit through the pending MTT audit.

2. Beta's assessment should rise and fall based on Beta's business practices and records.

In addition, it becomes clear that it is not possible to "trace" purchases to particular tax payments, since ACME remits sales and use tax payments based on a formula that has been previously approved by the State.

C. The State argues that Beta sold services, and any goods were simply incidental to the sale of those services.

1. Treasury takes the position that any goods that Beta supplied were merely incidental to the services, and therefore Beta should have paid sales or use tax when it purchase the goods.

2. Treasury also argues that Beta's supervision of ACME employees constitutes "use" of the goods, so that Exception 8 of the direct pay permit would apply.

3. In response, Beta argues that Treasury's binary classification method (either a "servicer" or a "seller", but not both) fails, because it ignores taxpayers who provide both non-taxable services and taxable goods.[9] Michigan's Supreme Court[10] has offered the following factors to consider when determining whether the sale of goods is merely incidental to the services provided:

a. what the buyer sought as the object of the transaction,

b. what the seller or service provider is in the business of doing,

c. whether the goods were provided as a retail enterprise with a profit-making motive,

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[9] Hellerstein, *State Taxation*, ¶ 13.02[1].

[10] *Catalina Marketing Sales Corp. v. Dept. of Treas.*, 470 Mich. 13, 678 NW2d 619 (2004).

d. whether the tangible goods were available for sale without the service,

e. the extent to which intangible services have contributed to the value of the physical item that is transferred, and

f. any other factors relevant to the particular transaction.

D. The Tribunal agrees with Beta's arguments, but takes an unexpected turn and **<u>still</u>** finds for Treasury – at first.

1. The Tribunal agrees with Beta that:

a. Beta did not owe use tax on its purchases because it did not use, store or consume the tangible personal property at issue.

b. Beta purchased the products for resale to ACME and it was *ACME's* employees who used the products.

c. Beta's sales of goods were distinct from its performance of services, similar to an automobile repair bill, and there Treasury was incorrect in concluding that Beta should be simply labeled as a servicer or that the "incidental to services" test should apply.

2. The Tribunal still finds for Treasury, however, claiming that the direct pay permit did not apply to Beta because it excludes "tangible personal property consumed by **<u>a person</u>** performing any service activity for your company" ("Exclusion 8"), and here:

a. ACME's employees are *persons* who perform services for ACME.

b. ACME's employees consumed the property.

c. The word "person" is broad enough to trigger Exclusion 8 if tangible personal property is consumed by *anyone* performing a service activity for AMCE, even if that person is an ACME employee.

E. The Court reconsiders

After receiving the Tribunal's opinion, Beta files a motion to reconsider, arguing that the Tribunal's interpretation of the direct pay permit would effectively exclude all sales of any tangible personal property from the direct pay permit, since all such property would be consumed by an AMCE employee.

After further reflection, the Tribunal agrees and issues an order in Beta's favor and dismissing the assessments.

IV. <u>POTENTIAL LESSONS LEARNED</u>

A. Sellers should always obtain a copy of the direct pay permit and examine its exceptions.

B. Invoices should itemize services and goods separately.

C. Be aware that it will be difficult to impossible to demonstrate that the buyer has actually self-assessed and remitted the applicable tax if there is a dispute.

D. Consider requesting indemnification for tax liability if treasury issues an assessment despite the direct pay permit.

E. Push back against buyers whose purchasing personnel insist that a direct pay permit applies, even where it is clear that an exception applies.

PROTECT MORE OF YOUR ASSETS FROM THE ESTATE TAX

By: Richard F. Roth, Esq.

I. TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010

A. Estate tax

1. Applicable exclusion amount

2. Indexed for inflation after 2011

B. Tax rate

C. Portability

1. The deceased spousal unused exclusion ("DSUE") amount

II. BACKGROUND – MARITAL DEDUCTION

A. Section 2056

B. Qualified person

C. Qualified manner

D. Unlimited since 1982

E. Terminal interest property

F. Loss of exclusion amount

G. Law made trusts a necessity

H. 60% estate tax bracket

III. CREDITOR PROTECTION WITHOUT NEGATIVE ESTATE TAX IMPLICATIONS

A. Section 303 of the 2010 Act

B. Great for professionals

1. Make yourself creditor proof

2. Give your spouse all of your assets

C. Need for a QTIP trust

IV. IMPACT OF NON-PORTABILITY PROVISION

A. Is a trust needed? Yes or No.

B. No need to equalize estates

V. DIVORCE OR DEATH

A. Safe marriage

B. Post-nuptial agreement

C. Last spouse standing or dying

1. Second marriage

2. Third marriage

3. Death of original surviving spouse

VI. ELECTION TO ALLOW SPOUSE TO USE UNUSED EXCLUSION AMOUNT

A. IRC 2010(c)(5)(a)

B. Decedent’s estate must file election on estate tax return

1. Regardless of size of estate

2. Timely – no election necessary

C. Irrevocable election

D. Cost of preparation of estate tax return

E. Family cooperation

F. Audit of estate tax returns

G. IRS Notice 2011-82 (attached) – guidance on election

H. Line 3, Form 706 (see attached instructions) – no election necessary

I. Not making an election – can spouse use the DSUE from prior deceased spouse?

J. Exclusion is portable, not the credit

1. Credit equivalent for first deceased spouse equals $1,730,800

2. In the second estate, it is worth $1,750,000

VII. <u>ISSUES</u>

A. Should second spouse gift away the unused exclusion amount?

B. Marry to maximize unused exclusion amount?

C. Pay marriage tax?

D. Avoid remarrying

VIII. EXAMPLES FROM THE STAFF OF CONGRESS' JOINT COMMITTEE ON TAXATION

A. Example 1

1. Assume that Husband 1 dies in 2011, having made taxable transfers of $3 million and having no taxable estate.

2. An election is made on Husband 1's estate tax return to permit his widow to use Husband 1's deceased spousal unused exclusion amount.

3. As of Husband 1's death, his widow has made no taxable gifts.

4. Thereafter, her applicable exclusion amount is $7 million (her $5 million basic exclusion amount plus $2 million deceased spousal unused exclusion amount from Husband 1), which she may use for lifetime gifts or for transfers at death.

B. Example 2

1. Assume the same facts as in Example 1, except that the widow subsequently marries Husband 2.

2. Husband 2 also predeceases the woman, having made $4 million in taxable transfers and having no taxable estate.

3. An election is made on Husband 2's estate tax return to permit the widow to use Husband 2's deceased spousal unused exclusion amount.

4. Although the combined amount of unused exclusion of Husband 1 and Husband 2 is $3 million ($2 million for Husband 1 and $1 million from Husband 2), only Husband 2's $1 million unused exclusion is available for the widow to use, because the

deceased spousal unused exclusion amount is limited to the lesser of the basic exclusion amount ($5 million) or the unused exclusion of the last deceased spouse of the surviving spouse (here, Husband 2's $1 million unused exclusion).

5. Thereafter, the widow's applicable exclusion amount is $6 million (her $5 million basic exclusion amount plus $1 million deceased spousal unused exclusion amount from Husband 2), which she may use for lifetime gifts or for transfers at death.

C. Example 3

1. Assume the same facts as in Examples 1 and 2, except that the woman predeceases Husband 2.

2. Following Husband 1's death, the widow's applicable exclusion amount is $7 million (her $5 million basic exclusion amount plus $2 million deceased spousal unused exclusion amount from Husband 1).

3. The widow made no taxable transfers and has a taxable estate of $3 million.

4. An election is made on her estate tax return to permit Husband 2 to use her deceased spousal unused exclusion amount, which is $4 million (her $7 million applicable exclusion amount less her $3 million taxable estate).

5. Example 3 is wrong. In Example 3, the amount of the unused deceased wife's exclusion amount available to the second husband is the excess of the "basic exclusion amount" (which is $5 million) in excess of her taxable estate. In other words, the widow's basic exclusion amount is $5 million less her taxable

estate of $3 million, which leaves Husband 2 with $2 million of his deceased wife's exclusion amount.

IX. CONCLUSION

A. Plan for clients to use it

B. Discuss re-marriage issues

C. Post-nuptial agreement

D. QTIP trust

E. Remember the election

<u>FOR YOUR HEALTH - A REVIEW OF HEALTH CARE RELATED TAXES AND PENALTIES</u>

By: Marc S. Wise, Esq.

Since the enactment of the Patient Protection and Affordable Care Act ("PPACA") in 2010, a renewed emphasis by the Internal Revenue Service on the enforcement of health-care related penalties has commenced. The following outlines the common health care problems that we see, applicable excise taxes and required IRS excise tax reporting.

I. <u>COMMON HEALTH PLAN PROBLEMS</u>

We see a number of common issues arising in our review of employer-sponsored health care programs. The common issues that we see include the following:

A. Eligibility under the health insurance policy differs from what the employer is making available to its employees.

B. No documentation that was signed or ever prepared for Medical Reimbursement Plans or Premium Only Section 125 plans.

C. Coverage of employees of related employers without disclosing and obtaining a rider from the health insurance company.

D. Failure to perform the proper testing for Medical Reimbursement Plans or Section 125 Cafeteria Plans as required under the Internal Revenue Code.

E. Failure to provide accurate information to the health insurance company supporting the initial application or renewal application.

F. Providing health insurance to individuals who are not employed by the employer or who otherwise do not meet the applicable number of hours required for health insurance coverage.

G. Failure to obtain written waivers when an employee declines coverage and providing all eligible employees a notice of special enrollment rights under the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”).

H. Failure to comply with the Medicare Secondary Payer Act when an employer has 20 or more employees.

I. Failure to comply with the Cobra Health Care Continuation Requirements when a group of individual entities, each under 20 employees, are part of a control group which in the aggregate employs 20 or more employees in the prior calendar year.

J. Failure to provide the federally mandated disclosures under ERISA and related federal statutes. This would include the failure to comply with the summary plan description requirements, failure to provide the annual notice relating to the Newborns’ and Mothers’ Health Protection Act and the Woman’s Health and Cancer Rights Act of 1998 and the failure to provide required notice under HIPPA as to the group health care plan’s privacy practices.

K. Failure to convert part-time employees to full-time equivalents in determining whether the 20 or employee threshold is met for the application of COBRA.

L. Failure to timely file a Form 5500 as required under ERISA when one or more health or welfare benefits covers 100 or more employees.

II. IRS FORM 8928-RETURN OF EXCISE TAXES UNDER CHAPTER 43 OF INTERNAL REVENUE CODE

A. Tax on failure to satisfy the Cobra Health Care Continuation Requirements.

1. Examples of failures that would trigger excise taxes are COBRA notice failures (missing, late, or incomplete initial or qualifying event notices); COBRA premium violations (overcharging, or not complying with grace period rules); and procedural failures such as not allowing COBRA recipients to make changes at open enrollment, or on special enrollment events.

2 If the failure was not discovered despite exercising reasonable diligence or was corrected prior to the date of notice of examination by the IRS was sent to the employer, and was due to reasonable cause, no excise tax will be due. Reporting is still required.

3. If the failure was not corrected before the date the notice of examination by the IRS was sent to the employer and the failure continued during the examination period, the excise tax due will be the lesser of $2,500 multiplied by the number of qualified beneficiaries for whom the failures occurred or $200 per day (per family) multiplied by the number of participants impacted. The $2,500 per beneficiary limitation is increased to $15,000 to the extent the violations were more than *de minimus* for a qualified beneficiary.

4. In no event will the excise tax for failure due to reasonable cause and not to willful neglect exceed the lesser of $500,000 or 10% of the aggregate amount paid during the preceding tax year for group health plan coverage. For insurers and third-party administrators the maximum excise tax for unintentional failures is $2,000,000.

5. Cobra failure due to willful neglect or otherwise not due to reasonable cause: The $500,000 and $2,000,000 caps do not apply.

B. Failure to comply with the Code §4980D group health plan requirements

1. The excise tax applicable Code §4980D includes the failure to comply with the following:

    a. Limitations on preexisting conditions and exclusions;

    b. Certificates of creditable coverage;

    c. Failure to comply with the HIPAA special enrollment rights rules;

    d. Failure to comply with the non-discrimination in eligibility to enroll and premium contributions;

    e. Failure to comply with the 48 hour and 96 hour hospital stay requirements in connection with childbirth for mothers and newborns;

    f. Parity in mental health and substance abuse disorder benefits;

    g. Failure to comply with the prohibition against lifetime and annual limits, the prohibition on rescissions, and the extension of dependent coverage to age 26, as provided under PPACA.

Note: No excise tax reporting or penalties under Code §4980D will generally apply to fully insured health insurance plans of employers who employed less than 50 employees in the prior calendar year if the failure is due solely because of the health insurance.

2. Applicable Excise Taxes. The excise taxes for the employer's failure to comply with Code §4980D group health plan requirements are the same as provided above with respect to the failure to comply with the Cobra Health Care Continuation Requirements.

3. Tax on failure to make comparable HSA contributions under Code §4980G or Archer MSA contributions under Code §4980E:

   a. Under the HSA comparability rule, a 35% excise tax is imposed on the employer's failure to make comparable contributions to the HSA's of comparable participating employees for that calendar year. Making smaller contributions to highly compensated employees is permitted without violating this rule.

      Example One. An employer makes a $1,000 contribution to the HSA of each non-highly compensated employee without making contributions to the HSA of each highly compensated employee. No excise tax will be applicable since discrimination against highly compensated employees is permitted.

      Example Two. During 2011, the employer has 8 non-highly compensated employees who are eligible individuals with self-only coverage under a high deductable health plan provided by the employer. The deductable for the high deductable health plan is $2,000. For the 2011 calendar year, the employer contributes $2,000 to the HSAs of two employees and $1,000 each to the HSAs of the other six employees, for total HSA contributions of $10,000. The employer's contribution does not satisfy the comparability rules. The employer is subject to an excise tax of $3,500 (35% multiplied by $10,000) for its failure to make comparable contributions to its employees' HSAs.

b. The excise tax problem can be corrected by the employer, even after the close of the calendar year. An employer that determines that it has not satisfied the comparability rules for a calendar year cannot recoup from an employee's HSA any portion of the employer's contribution to the HSA. The employer has until April 15th of the following year in which to make additional HSA contributions to satisfy the comparability rules (plus reasonable interest). In the alternative, part or all of the excise tax for non-compliance may be waived by the IRS for failures due to reasonable cause and not due to willful neglect, if payment of the tax would be excessive relative to the failure involved.

Note: Employer HAS contributions made through a Section 125 Cafeteria Plan are not subject to this comparable contribution requirement.

c. When to File. For failure to comply with the Cobra Health Care Continuation Requirements or under Code §4980B or the group health plan requirements under Code §4980D, the Form 8928 must be filed by the due date for filing the employer's federal income tax return for the year.

d. For failures relating to comparable health savings contributions for all participating employees under Code §4980G, the Form 8928 must be filed on or before the 15th day of the 4th month following the calendar year in which the non-comparable contributions were made (April 15th).

e. File a Form 7004, application for automatic extension of time to file certain business income tax, information, and other returns, to request an automatic extension of time to file the Form 8928. The timely filing of the Form 7004 will provide for an automatic six-month extension for filing.

III. COMMON HEALTH PLAN PROBLEMS – EXAMPLE

Client has 7 franchise restaurants each owned by corporations and are referred to as Franchise 1 through 7. Franchise 1 through 7 is owned 100% by a single individual, Mr. Big.

Mr. Big oversees the 7 restaurants with his regional supervisor and an office manager. These three individuals are employed by Franchise Services, Inc. which is also owned 100% by Mr. Big.

Mr. Big also owns all the stock of another company, Management Company, Inc. This company employs two store managers with health problems and Mr. Big's 80 year old father.

Since Mr. Big owns 100% of each corporation, all 9 entities will be considered as a brother-sister controlled group under IRC 1563(a)(2) and must be aggregated for employee benefit purposes under IRC 414(b).

Health Plan #1. The application for the group health insurance names Franchise #1 as the employer. It was disclosed on the application that the company had 15 full-time employees, no part-time employees and all 15 full-time employees are eligible for the health insurance benefit. The health insurance policy provides that any employee that works at least 30 hours per week will be eligible to participate in the health insurance plan on the first day of the month following 90 days of employment.

The health insurance company also asked the following questions:

1. Do you have any other locations?

2. Are you a member of a controlled group or an affiliated service group?

A negative response to both questions was provided.

Thirteen of the 15 employees were managers and assistant managers at restaurants owned by Franchises 2 through 7 and all received a weekly salary. The 13 managers and assistant managers were not employed by Franchise #1 as the application indicated. Furthermore, Mr. Big is also covered under this health insurance and he is employed solely through Franchise Services, Inc. Lastly, of the 400 hourly employees working at the various restaurants, approximately 200 regularly work at least 30 hours per week.

Health Plan #2. In order to reduce the health insurance premiums for Health Plan #1, a $5,000 deductible applies to each employee. A medical expense reimbursement plan ("MERP") was instituted for to cover the $5,000 deductible and is fully paid for by the company. The company did not have a copy of the plan and the attorney requested a copy from the third-party recordkeeping company ("TPA") that drafted the MERP. After further discussions with the TPA is was discovered that the MERP was never executed by Mr. Big and the TPA never pressed him for an executed document. Further, an amendment to the MERP was sent to Mr. Big in 2010 to amend the MERP to comply with the new age 26 dependent coverage requirement imposed under PPACA. As expected, the MERP amendment was also never executed.

The unexecuted MERP document provided that the participant must be employed by the "Employer" in order to be eligible for benefits under the plan. The "Employer" was defined as Franchise #2 even though the insurance policy for Health Plan #1 was in the name of Franchise #1. None of the other related entities adopted the plan for its employees. Under the terms of the MERP only the manager and the assistant manager employed by Franchise #2 were technically eligible for benefits.

Section 125 Cafeteria Plan**.** A Section 125 Cafeteria Plan ("125 Plan") was also drafted by the TPA and the document was never signed. This plan defined the "Employer" as Franchise Services, Inc. None of the other related entities adopted the 125 Plan for its employees. As with the MERP, the manager and assistant manager at the 7 restaurants participated in this plan. None of the 400 employees were offered this benefit.

The 125 Plan provided that employees were eligible to participate in the plan if they satisfy the eligibility provisions of the employer's group health plan. The hourly employees were offered participation in a health care plan made available by the franchisor at the employee's expense. The franchisor's health plan is considered a multi-employer welfare benefit arrangement ("MEWA"). Is this MEWA considered an "employer's group health plan" permitting the hourly employees to participate in the 125 Plan?

Management Company, Inc. Health Plan. The separate health insurance plan offered to the three employees of this company provides extensive benefits. Since the company only has three employees, the insurance agent established the policy so the claims payable for the father of Mr. Big would be first payable by Medicare and the insurance company would be the secondary payor.

Legal Issues

Health Plan #1. Notwithstanding the negative answers to the controlled group/location questions, employees of other related entities are participating in the health insurance policy. If there is a benefit claim that causes the insurance company to further review the employee's eligibility for coverage and benefits and the employee is not employed by an employee of Franchise #1, Franchise #1 could be responsible for all costs incurred in providing medical care to such employee. We have seen insurance companies review small benefit claims as well as large benefit claims. We have seen insurance companies go after the employers to recoup the health insurance benefit expenditures for ineligible employees.

Employee Waivers. Since Franchise #1 is permitting employees of other related entities who are managers or assistant managers to participate in the health insurance, an argument can be made that the hourly employees working at least 30 hours per week are eligible for coverage. The terms of the health insurance policy requires a written waiver of coverage by the employees. No such waiver was sought or received from the eligible hourly employees. Furthermore, U.S Department of Labor guidance provides that a Notice of Special Enrollment Rights under HIPAA must be provided to employees on or before the time they are offered the opportunity to enroll in the group health plan. The failure to provide Notice of Special Enrollment is subject to the excise tax provisions of Code §4980D and is reportable on Form 8928 as well as penalties under ERISA.

Health Plan #2. IRS regulations under Code §105 require that each employer making payments under a self-insured medical reimbursement plan such as the MERP must have its operative provisions in writing. The IRS could take the position that payments made to the employees by employers that have not adopted the MERP should be treated as taxable compensation the employees and not as tax-free medical payments.

A larger issue relates to the employees eligible to participate in the MERP. 200 of the hourly employees are regularly scheduled to work at least 30 hours per week. Under the terms of the MERP they are potentially eligible for benefits. The failure to meet the eligibility testing required under Code §105 can cause the formerly non-taxable benefits paid under the MERP to be taxable to the highly-compensated employees. For purposes of the MERP, the term “highly-compensated employee” means one of the highest paid 25% of all employees. This term will likely encompass all of the managers and assistant managers currently covered under the MERP. It is likely that the TPA was not made aware that such a large number of hourly employees work at least 30 hours per week. Employees who were otherwise eligible under the MERP and who did not receive benefits under the MERP could also potentially have a cause of action for benefits under ERISA.

Section 125 Cafeteria Plan.

The failure to specifically name the other entities in the plan and to have them affirmatively adopt the provisions of the plan raises an issue as to the pre-tax treatment of the payments made by the employees for their health benefits. Furthermore, the corresponding FICA and Medicare tax that is generally inapplicable to payments made under a cafeteria plan could be jeopardized by this failure. Code §125 requires the employer to have a written plan document setting forth the terms of its plan. No employer other than Franchise Services, Inc. (although the document was never signed) adopted this plan.

The IRS could take the position that since the non-adopting employers permitted a select group of employees to participate in the cafeteria plan; all eligible employees should be permitted to participate in the plan.

The failure to amend the plan for compliance with the age 26 dependent requirements as required under PPACA raises an excise tax issue

IV. POST 2012 FEDERAL TAX AND PENALTIES

A. The Medicare Tax On Investment Income - 2013

Medicare is currently funded by two equal payroll taxes paid by employers and employees. Employees pay a Medicare tax of 1.45% of the wages they earn while employers pay a corresponding Medicare tax of 1.45% on the wages they pay. In the case of self-employed individuals, Medicare is financed today by a tax of 2.9% on the self-employment income earned by such persons.

1. High Income Taxpayers - Effective in 2013, PPACA amends the Code to impose an additional Medicare tax of 3.8 percent on the investment income of high income taxpayers. For these purposes, the "threshold amount" triggering this new tax is "modified adjusted gross income" of $250,000 for a married couple filing jointly or for a surviving spouse, $125,000 for a married individual filing separately and $200,000 for a single individual and for a head of household. There is no provision for inflation-adjusting these threshold amounts.

2. Application of Tax - This new Medicare tax applies to the lesser of a taxpayer's "net investment income" for the taxable year or the excess of the taxpayer's modified adjusted gross income for the year over the relevant threshold amount.

   Example. If a single individual's net investment income in 2013 is $10,000 while his modified adjusted gross income is $300,000, this individual will owe an additional Medicare tax on his investment income of $380. For this individual, the relevant figure is the net investment income of $10,000 rather than the modified adjusted gross income over the threshold amount

($300,000 - $200,000 = $100,000). At a rate of 3.8%, this produces a tax of $380, i.e., $10,000 x 3.8% = $380.

For purposes of the new Medicare tax, “net investment income” is defined to include interest, dividends, annuities, royalties, and rents. In addition, a taxpayer’s “net investment income” includes income from passive activity and certain trading activity as well gains from certain amounts of foreign earned income excluded from the taxpayer’s gross income. The tax also applies to estates and trusts. All of these items of investment income are reduced by the deductions allowed against them for income tax purposes.

B. Increased Medicare Tax Rate For High Income Earners - 2013

In addition to the new Medicare tax on the investment income of high income taxpayers, the PPACA increases the Medicare taxes paid by high income employees and high income self-employed persons. If an employee is married and files a joint return for federal income tax purposes, the employee will, starting in 2013, pay an additional Medicare tax of 0.9% on annual wages over $250,000. If a married employee files separately, an additional tax of 0.9% on annual wages over $125,000 will apply. Single individuals will, starting in 2013, pay an additional Medicare tax of 0.9% on their respective annual wages over $200,000. Employers will not pay any additional Medicare taxes. The same income limits will also apply to elf-employed individuals.

Example. Bill is married and is the family’s sole earner and files a joint return with his spouse. Bill is employed by a corporation at an annual salary of $300,000 and he has dividend and interest income of $50,000. Today, Bill pays a Medicare tax on his salary of $4,350.00 while Bill’s employer pays an equal Medicare tax. In 2013, Bill (but not his employer) will pay an additional $2,350 in Medicare taxes.

This additional tax will consist of $1,900 imposed by the new Medicare tax on investment income and $450 stemming from the additional 0.9% tax on his salary income in excess of $250,000.

C. Tax for Failure to Provide Coverage - 2014. Employers with 50 or more FTEs (these employers are considered “large” employers) will be subject to this new tax. Employers that fail to offer the essential health benefits during any month for which a full-time employee has enrolled in a subsidized plan using a premium assistance tax credit or certain government cost-sharing reductions would be liable for an additional tax. The annual tax per employee is $2,000. The additional tax for any month is 1/12 of the $2,000 ($166.67) multiplied by the number of actual full-time employees employed by the employer during such month. In calculating this monthly tax, the first 30 employees are subtracted from the penalty.

For purposes of this penalty tax, a full-time employee is defined as an employee working during a month an average of at least 30 hours or more per week. An employer will not be considered to have 50 FTEs if the employer’s workforce exceeds 50 FTEs for 120 days or fewer during the calendar year, or the employees in excess of 50 FTEs employed during any 120-day period are seasonal workers. Seasonal workers are defined as a worker who performs labor or services on a seasonal basis as defined by the Secretary of Labor, including H-2A workers, and retail workers employed exclusively during holiday seasons.

D. Tax for Employer Failure to Pay a Specific Amount of Health Costs - 2014. Employers with 50 or more FTEs who offer health coverage to full-time employees are also subject to a tax if any full-time employee enrolls in an insurance plan offered through a government insurance exchange and qualifies for taxpayer-subsidized coverage. A full-time employee is anyone who works on average at least 30 hours per week during a month.

An individual may qualify for taxpayer-subsidized coverage if:

1. The individual's household income for the tax year is between 100% and 400% of the federal poverty line for a family of the size involved; and

2. The individual is not eligible to participate in an employer sponsored group health plan or is eligible but the employer does not pay at least 60% of the allowed costs under the health plan of the employee's required contribution <u>or the cost of such coverage is more than 9.5% of the employee's household income.</u>

   Note: The IRS has indicated that it will modify this household income requirement and allow the employer to look solely at the W-2 income paid by the employer. See Notice 2011-73 for the proposed safe-harbor.

   The amount of the monthly employer tax penalty is $3,000 divided by 12 ($250/month), for each full-time employee who is eligible and enrolls in taxpayer-subsidized health coverage for the month. The total tax penalty may not be greater than the tax penalty that would apply if the employer offered no coverage at all.

E. The Tax-Enforced Individual Mandate - 2014

The PPACA also imposes a tax on individuals who fail to maintain health insurance coverage for themselves or their dependents. The federal tax-enforced mandate on individuals initially takes effect in 2014 but does not become fully effective until 2016. This issue is currently before the U.S. Supreme Court and a ruling is expected in 2012.

The mandate-enforcing tax is computed on a monthly basis and applies to any "applicable individual" who fails to obtain acceptable health insurance coverage for the individual or his or her dependents. An "applicable individual" is anyone legally present in the United States except for individuals qualifying for religious exemption from the health insurance mandate and individuals who are permanently incarcerated. Members of Indian tribes are also exempted from PPACA's individual insurance mandate.

1. "Minimum Essential Coverage" Required. Under the PPACA, all individuals subject to the statute's insurance requirement must, starting in 2014, have in force "minimum essential coverage." Such coverage can take one of five forms:

    a. Health services from approved government programs such as Medicaid, Medicare, the Children's Health Insurance Program (CHIP) and federal veterans medical care qualify as minimum essential coverage, satisfying the individual insurance mandate.

    b. Participation in an "eligible employer-sponsored" plan constitutes such coverage.

    c. Health coverage acquired in a state's "individual market" qualifies as "minimum essential coverage" and thus discharges the individual insurance mandate.

    d. The individual mandate is satisfied through health coverage "under a grandfathered health plan," which generally means any "group health plan or health insurance coverage” in effect on the day PPACA was enacted, March 23,2010.

e. The Secretary of Health and Human Services, after consulting with the Secretary of the Treasury, may recognize any other program as constituting minimum essential coverage for purposes of the individual mandate.

An applicable individual required to minimum essential coverage but who fails to do so will pay an excise penalty tax unless an exemption from such tax applies.

2. Tax Penalty. The tax penalty will be calculated on a monthly basis and will apply in each month that an applicable individual fails to maintain required health coverage for himself or for his dependent.

The amount of the excise tax penalty for violating the individual insurance mandate is determined in four steps. As to any applicable individual, the following shall apply:

a. The initial step in determining such penalty is to add together one-twelfth of “the applicable dollar amounts” for all persons for whom the individual is responsible for maintaining insurance coverage but fails to do so.

b. In the second step, the total in #1 above is then compared with one-twelfth of “300 percent of the applicable dollar amount” to determine which of these two figures is smaller. This smaller figure is then contrasted with the number derived by determining the excess of the applicable individual’s “household income” over the gross income which requires the filing of a federal income tax return, multiplying that excess household income by a specified percentage, and then dividing the resulting product by twelve.

c. Finally, the larger amount emerging from this contrast is compared with the "national average premium" for "bronze level" medical coverage offered through the state-run exchanges for a family of the size of the applicable individual's family. The excise tax penalty is the lesser of the two numbers which emerges from this fourth step.

For purposes of this four-step formula, the applicable dollar amount is $95 for 2014, $325 for 2015 and $695 in 2016. Thereafter, the applicable dollar amount will be $695 adjusted for inflation. The specified income percentages will be 1 percent in 2014 and 2.0 percent in 2015. This percentage will increase to 2.5 percent for 2016 and all subsequent years.

If an individual fails to have in force minimum essential coverage for his or her dependents under the age of 18, the applicable amount as to such minor dependent is halved in the first step of this formula. In the third step of the formula, the applicable individual's household income is the modified adjusted gross income plus the incomes of the dependents who must file federal income tax returns.

Example. Assume that in January of 2016, an adult who is an "applicable individual" and files for income tax purposes as a head of household has two dependent children, one age 16 and the other is age 19. Both children are also "applicable individuals" and that, for the month, no health coverage is in effect for this adult or for his dependents. Also suppose that this individual has yearly modified adjusted gross income of $37,000, that his dependents have no income, that “bronze” coverage for a family of three in 2016 costs $4,000 per year and that in 2016 a head of household must file a federal income tax return if he has gross income of at least $13,000.

On these facts, this hypothetical adult, by virtue of his noncompliance with the individual mandate as to himself and his dependents in January of 2016, must pay a penalty tax for that month of $400. This penalty is calculated as follows:

We start with the applicable dollar amount for 2016, namely, $695. One-twelfth of this amount is $57.92. As to the uncovered sixteen year old, this amount is halved to $28.96. Thus, the first step in the process yields a total of $144.80. In the next step, this amount is contrasted with one-twelfth of 300% of the applicable dollar amount, i.e., $173.76. Since $144.80 is less than $173.76, it is then contrasted with $400, that is, with 2% of one-twelfth of the applicable individual’s annual income to the extent such income exceeds his filing threshold for federal income tax purposes. Since $400 is the larger figure at this stage, it is then compared with the average national premium for bronze coverage, assumed in this example to be $4,000 for the year. Since $400 is less, it is the monthly penalty tax this hypothetical applicable individual owes for the failure to maintain “minimum essential coverage” for himself and his dependents for the month of January, 2016.

Assume that the facts remain the same through 2016. Each month, as a result of the applicable individual’s continuing failure to maintain medical coverage for himself and his family, he owes an additional monthly penalty tax of $400. Finally, in

November, the bronze premium for the year ($4,000) becomes smaller than the cumulative monthly penalties for eleven months of no coverage. At that point, the premium amount becomes the amount of the penalty tax.

3. Exemptions. PPACA also contains a number of exemptions which excuse individuals from the excise tax penalties they would otherwise owe for failing to maintain minimum essential coverage for themselves or for their dependents.

   a. If an individual's noncompliance with the mandate lasts for less than three months, the penalty is forgiven.

   b. The excise penalty tax is forgiven if the Secretary of Health and Human Services determines that an applicable individual has "suffered a hardship with respect to the capability to obtain coverage under a qualified health plan."

   c. If an individual's household income is less than the minimum income which requires the filing of a federal income tax return, the penalty for violating the individual mandate is also forgiven.

   d. An applicable individual is excused from the individual insurance mandate and its excise penalty tax in any month when the "required contribution" such individual would pay for medical coverage exceeds eight percent of his household income.

4. Employer Insurance Available. If an applicable individual can purchase minimum essential coverage from his employer, the required contribution is the premium payment such individual would pay for coverage for himself.

Example. A single individual has modified adjusted gross income of $20,000 annually, that he has one dependent child who has no income or earnings, and that, to participate in his employer's medical plan, this individual must pay an annual premium of $2,000. In this case, this individual's household income is the same as his personal income since his dependent child has no income of his own. On these facts, the individual is excused from the individual insurance mandate and its excise penalty tax since the premium he must pay for employer coverage ($2,000) exceeds eight percent of his household income ($1,600). In the case of an individual who must purchase individual coverage, his "required contribution" equals the premium such individual must pay for so-called "bronze" coverage through his state's insurance exchange reduced by the tax credit for which such individual is eligible. For years starting with 2015, the Secretary of Health and Human Services will increase the eight percent figure to "reflect the excess of the rate of premium growth between the preceding calendar year and 2013 over the rate of income growth for such period."

J. The Premium Assistance Tax Credit - 2014

The PPACA added a new Code Section 36B. Starting in 2014, a refundable premium assistance tax credit is available to defray an applicable taxpayer's outlays for individual market health care coverage purchased through a state-run insurance exchange.

People with income between 133% and 400% of the federal poverty line (FPL) will be eligible for tax credits or cost-sharing subsidies on a sliding scale to help pay insurance premiums. Based on current FPL figures, premium assistance would be available to a single person with income between around $14,400 and $43,300 or to a family of four with income between around $29,300 and $88,200. The credits are designed to ensure that qualifying individuals do not spend more than a certain percentage of their income (ranging from 3% to 9.5%) on health insurance premiums.

K. The Excise Tax On "Cadillac" Health Pans - 2018

The PPACA imposes an excise tax on "high cost" health plans ("Cadillac Plans"). Under current law, an employee excludes from his gross income both his employer's contributions for his health coverage and the value of the medical services the employee (and his dependents) receive pursuant to such coverage. This favorable tax treatment effectively immunizes the employee from confronting the cost of medical coverage and services.

The "Cadillac" tax is a 40% excise tax on any "excess benefit" provided under "applicable employer-sponsored coverage." In general, a health plan constitutes applicable employer-sponsored coverage if the value of such coverage is excludable from the covered employee's gross income for federal income tax purposes. The tax on high cost medical plans is scheduled to take effect in 2018.

For the years in which this excise tax applies, an "excess benefit" triggers the tax if the annual cost of applicable coverage for an individual exceeds $10,200 multiplied by the "health cost adjustment percentage." For family coverage, an excess benefit triggers the tax if the annual cost exceeds $27,500 multiplied by the "health cost adjustment percentage." The health cost adjustment percentage is based on the post-2010 growth of the premiums of "the Blue Cross/Blue Shield standard benefit option under the Federal Employees Health Benefits Plan." These annual thresholds are also increased for health plans which cover certain retirees, persons in "high-risk profession[s]" and employees who "repair or install electrical or telecommunications lines." For these purposes, the "high-risk profession[s]" is defined broadly to include longshoremen, law enforcement and fire personnel, and EMTs as well as construction, mining, agricultural and forestry workers, and fishermen.

OPERATION
OF THE BOARD OF ACCOUNTANCY
AND EXPERIENCES AS A MEMBER

By: Steven M. Wolock, Esq.

I. BOARD MEMBERS

The Michigan Board of Accountancy consists of 9 voting members; 6 certified public accountants and 3 public members, including 1 attorney and a full time instructor of accounting above the elementary level at an accredited college or university.

Professional Members	Public Members
Matthew Howell	Sally Fedus
Michael J. Swartz	Mary Miller
Neil F. DeBoer	Steven Wolock
Thomas R. Weirich	
Daniel Lord	
Carla E. Sledge	

II. BOARD MEETING MINUTES OF NOVEMBER 19, 2010 (EXHIBIT A) (NAMES OF RESPONDENTS HAVE BEEN REDACTED)

III. PORTIONS OF THE OCCUPATIONAL CODE REFERRED TO IN THE ABOVE BOARD MEETING MINUTES (EXHIBIT B)

A. Michigan Complied Laws Annotated ("MCLA") 339.203 License or registration; issuance upon demonstration of unfair or inadequate requirements; review; fees; limitation; notice; approval or disapproval; practice by person licensed, registered, or certified under repealed act.

B. MCLA 339.601 Practicing regulated occupation or using designed title without license or registration; operation of barber college, school of cosmetology, or real estate school without license or approval; effect of suspended, revoked, or lapsed license or registration; violation as misdemeanor; penalties; person not licensed as residential builder or residential maintenance and alteration contractor; person not licensed as architect, professional engineer, or professional land surveyor; restitution; injunctive relief; exceptions; “affected person” defined; investigation; forfeiture; remedies; performance of services by interior designer; notice of conviction to department.

C. MCLA 339.604 Violation of article regulating occupation or commission of prohibited act; penalties.

D. MCLA 339.723 Use of title, terms, or abbreviations indicating person is certified public accountant; prohibited conduct; display or uttering of certain instrument or device as prima facie evidence that person caused or procured display; use of certain designations in connection with firm name; violation; fine; investigation and enforcement.

YEAR 2: PTINs AND REGISTERED RETURN PREPARERS

By: Charles M. Lax, Esq.

I. THE BACKGROUND

A. In 2009, the IRS released a report which recommended all paid return preparers ("PRPs") must obtain a Preparer Tax Identification Number ("PTIN"). It also recommended:

1. A competency test for PRPs who were not already enrolled to practice before the IRS.

2. Requiring annual continuing professional education.

3. Subjecting all PRPs to the obligations and standards of Circular 230.

B. The registration process opened in September of 2010.

1. Done online or by a paper Form W-12.

2. Registration fee was $64.25.

3. A tax compliance check was required.

4. Announced there would be an annual renewal.

5. There are currently 738,000 with PTINs.

C. Testing requirements.

1. The testing would be postponed at least until mid-2011.

2. Individuals who had valid PTINs before testing began had until December 31, 2013 to pass.

3. No test would be required for those already authorized to practice before the IRS (CPAs, attorneys, EAs, and ERPAs).

4. Separate tests were contemplated for 1040 return preparers and business return preparers.

D. Continuing professional education.

1. No separate CPE would be required for those already authorized to practice before the IRS.

2. Generally, will require 15 hours of CPE per year.

   a. 3 hours of federal tax updates.

   b. 2 hours of tax ethics.

   c. 10 hours of other federal tax topics.

3. Can only get CPE from a qualified sponsor.

   a. Must be preapproved by OPR.

   b. Even the program itself must be preapproved.

E. Circular 230 was amended to add the category of Registered Tax Return Preparer (“RTRP”).

1. Recognized as enrolled to practice before the IRS.

2. RTRPs could engage in the following:

   a. Prepare or assist in the preparation of returns commensurate with the level of competency demonstrated by exam.

   b. Sign returns.

c. Represent taxpayers before the IRS if they signed the return.

d. Give tax advice on returns they prepare.

II. IRS NOTICE 2011-6

A. Forms requiring a PTIN:

1. Preparers of all tax returns, claims for refund, or other tax forms submitted to the IRS generally require a PTIN unless the preparation of a return is exempted.

2. The following are some of the returns which are exempt:

a. SS-4

b. W-2 series of returns

c. 872 - Consent To Extend the Time To Assess Tax

d. 1098 series of returns

e. 1099 series of returns

f. 2848 - Power of Attorney

g. 5300 series of returns for retirement plan determination letters

h. 5500 series of returns

B. Supervised tax return preparers.

1. A supervised preparer is an individual who prepares or assists in the preparation of a return, or claim for refund; if:

a. They are at least 18.

b. Supervised by an attorney, CPA, EA, ERPA, or Enrolled Actuary.

c. The supervising individual signs the return or claim for refund.

d. They are employed by a law firm, CPA firm, or other recognized firm (80% of the firm is owned by an attorney, CPA, EA, ERPA, or Enrolled Actuary).

e. They pass the requisite compliance check and suitability check.

2. Supervised preparers:

a. Will still need a PTIN, but in their applications they must certify that they are supervised.

b. Will not be subject to the competency exam or continuing education requirements.

c. May not sign returns or represent taxpayers before the IRS.

d. Are subject to the duties and restrictions that enrolled practitioners are subject to in Circular 230.

C. Preparers of non-1040 returns.

1. Preparers of non-1040 returns while needing a PTIN will have no competency exam for the foreseeable future.

2. They may obtain their PTIN if:

a. They certify in their PTIN application that they don't prepare 1040 series returns.

b. They pass the requisite tax compliance and suitability check.

3. These individuals have no continuing education requirement at this time.

4. These individuals may represent taxpayers during the course of an audit on returns they signed.

5. Presumably, at some point there will be a non-1040 exam which allows these individuals to become RTRPs.

III. IRS NOTICES 2011-80 AND 2011-105

A. PTIN renewal will be annually on a calendar year basis.

1. Each year, PTINs must be renewed between October 16 and December 31 to make their PTIN valid for the subsequent calendar year.

2. Renewal procedure:

   a. Either online or on a paper Form W-12.

   b. Renewal fee will still be $63.00.

3. PTINs issued between September 27, 2010 and December 31, 2010 will not expire until December 31, 2011.

4. New procedures

   a. If supervised, the preparer must provide supervisor's PTIN.

   b. Credentialed preparers (CPAs, attorneys, etc.) must provide expiration date for their licenses.

B. Fingerprinting requirements:

1. As part of the IRS' suitability check requirement to obtain a PTIN, certain individuals must be fingerprinted.

2. Attorneys, CPAs, EAs, ERPAs, and Enrolled Actuaries will not require fingerprinting <u>at this time</u>.

3. The IRS will not require fingerprinting prior to obtaining a PTIN until at least April 18, 2012 (giving at least 30 days advance notice).

4. Individuals who obtained a PTIN prior to the April 18, 2012 or a later specified date will not be required to be fingerprinted until their first renewal after December 31, 2013.

5. Information about fingerprinting process:

   a. The IRS has announced that they have established a $33 user fee for its processing of the fingerprints.

   b. They are also working with third party vendors who will collect and process the fingerprints and separately charge a fee.

   c. The combined fees are expected to be between $60 and $90.

C. Continuing education requirements:

1. Registered tax return preparers must complete a continuing education requirement on an annual basis.

   a. CPAs, attorneys, EAs, ERPAs, and Enrolled Actuaries have no requirement but presumably have separate CPE requirements for their designations.

b. This CPE requirement will begin in 2012; therefore, there is no requirement for 2011.

2. What is the requirement?

a. A minimum of 15 hours, including: 2 hours of tax ethics, 3 hours of federal tax law updates, and 10 hours of federal tax law topics.

b. CPE may only be obtained from a “provider of qualifying continuing education.”

c. The IRS will issue further information on how to apply to become an approved provider.

D. Deadline to obtain and maintain provisional PTINs.

1. Individuals who obtained provisional PTINs have until December 31, 2013 to pass a competency exam. During this period, they hold provisional PTINs.

2. In Notice 2011-6, the IRS said that they would continue to offer provisional PTINs until the competency exam was available, which would at least be mid-2011.

3. The issuance of provisional PTINs is now extended at least until April 8, 2012.

4. In order to maintain a provisional PTIN, individuals must annually renew the PTIN and continue to meet the CPE requirements.

IV. STATUS OF COMPETENCY EXAMINATION

A. Who must take the exam?

1. Attorneys, CPAs, EAs, ERPAs, and Enrolled Actuaries are exempt.

2. Preparers of non-1040 series returns are exempt at this time.

3. At this time, it is only 1040 series return preparers.

B. Those with provisional PTINs will have until December 31, 2013 to pass.

C. What is known about the exam?

1. The exams will only be offered at testing sites and not online.

2. Certain resources will be provided at the testing center to assist in taking the exam.

3. A company named Prometric has been selected to administer the exam.

4. The test will be developed by the vendor, but the IRS will have final approval of all questions.

5. The IRS has established a user fee of $27 for its portion of the testing process. The vendor will charge its own fee. The combined fees are expected to be between $100 and $125.

6. The IRS has listed on its website “Test Specifications,” which are intended to provide guidance on the content of the exam.

7. The IRS has also announced that although it will not offer a “study course,” there is, however, a list of recommended study materials. Not surprisingly, it includes such things as:

a. Form 1040

b. Form 1040 Instructions

c. Publication 7 - “Your Federal Income Tax”

d. Circular 230

e. Numerous other publications

<u>MANAGING UNEMPLOYMENT TAX LIABILITY</u>

By: Ronald A. Sollish, Esq.

I. <u>ASSESSING THE CURRENT UNEMPLOYMENT LANDSCAPE</u>

A. The landscape of unemployment benefits.

1. Michigan's historic unemployment rate has depleted the states unemployment trust fund and forced the state to borrow federal dollars.

2. The US Department of Labor reports that by 2013, the states will have borrowed a total of $65 billion for their unemployment programs.

3. Michigan currently owes the federal government approximately $3.9 billion for loans to support its unemployment program. California, carrying $10.5 billion in unemployment debt, tops the list, followed by Michigan.

4. As a result of the historic unemployment rate, unemployed workers have received unemployment benefits for up to 99 weeks (26 standard weeks + 53 weeks of emergency unemployment compensation + 20 weeks of extended benefits).

   Extended benefits equal 80% of what the individual received in state benefits.

   Emergency Unemployment Compensation consists of four tiers:

   Tier 1 – 20 weeks at 80% of what the individual received in state benefits

Tier II – 14 weeks at 54% of what the individual received in state benefits

Tier III – 13 weeks at 50% of what the individual received in state benefits

Tier IV – 6 weeks at 24% of what the individual received in state benefits

5. Starting in January 2012, Michigan will be the first state in the country to cut state-funded benefits from 26 weeks to 20 weeks. This change will benefit Michigan employers by lowering the unemployment taxes they will pay next year.

B. Qualifying for benefits.

1. The Michigan Unemployment Insurance Agency ("UIA") first looks at an unemployed worker's "standard base period" (the first four out the last five completed calendar quarters) to determine if an unemployed worker qualifies.

2. If an unemployed worker cannot qualify based on a standard base period, the UIA will consider an "alternate based period" (which is the four most recently completed calendar quarters).

3. There are two ways to qualify for benefits:

a. "Regular" qualifying method.

i. The unemployed worker must have wages in at least two quarters in a base period.

ii. Wages in one quarter must be at least $2,871.00.

iii. Total wages for the base period must equal at least 1.5 times the highest amount of wages paid in any quarter of the base period.

b. "Alternative Earnings Qualifier."

i. The unemployed worker must have wages in at least two quarters.

ii. Total wages for the base period must equal at least 20 times the state average weekly wage. For 2011, the amount is $16,467.00 (20 x $823.35).

C. Calculating benefits.

1. As a basic rule, to determine the specific amount of benefit payments, the UIA multiplies the highest amount of wages paid in any based period quarter by 4.1%.

2. For each dependent claimed, the UIA adds $6.00 per dependent up to five dependents.

3. The weekly benefit amount is capped at $362.00 per week. However, an additional supplement may be available when emergency changes to the process are made.

4. To determine how many weeks are available, the UIA multiplies the total base period wages by 43% and then divides by the weekly benefit amount.

5. The weekly benefit amount cannot be less than 14 weeks or more than 26 weeks.

D. Tax rate and tax base for employers in Michigan.

1. Determining the tax rate for new employers.

   a. The tax rate for all new employers, except certain construction companies involved in large projects, is 2.7%.

   b. That rate is paid on the first $9,000.00 of wages during the calendar year for each employee.

   c. The federal unemployment tax is 6.2% on the first $7,000.00 of wages; however employers receive a credit of 5.4% if their state taxes (contributions) are paid fully and in a timely fashion. The credit results in an actual federal tax of only .8% of taxable wages or $56.00.

2. Determining the tax rate for existing employers.

   a. There are three separate components that determine a fully experienced employer's tax rate. (A fully experienced employer is an employer who is in his/her fifth year or more of business.)

      i. The Chargeable Benefit Component ("CBC") is made up of the total unemployment charges against the employer for the most recent five years.

      ii. The Account Building Component ("ABC") is a reserve account for possible payment of future benefits. The amount required in this component is based on the payroll for the most recent year.

iii. The Non-Chargeable Benefits Component ("NBC") is used to pay benefits that cannot be charged to a specific employer's account.

b. All of these components are taken into consideration when determining an employer's tax rate. The maximum computed tax rate for 2011 for a fully experienced employer is 10.3%. The lowest computed tax rate is .06%. This does not include any penalties for missing reports which could add up to another 3%.

E. SUTA Dumping.

1. SUTA Dumping is defined as transferring a trade or business or a party of a trade or business for the purpose of reducing the contribution rate or reimbursement payments in lieu of contributions required under the Michigan Employment Security Act. It is characterized by the abandonment of an employer's unemployment insurance history.

2. A person that engages in SUTA Dumping is subject to personal liability.

a. A person that knowingly transfers a trade or business or a portion of the trade or business to another employer for the sole or primary purpose of reducing the contribution rate or reimbursement payments in lieu of contributions required under this act is liable. See MCL 421.22b;

b. An officer or agent of an employing unit that conspires with one or more persons to take the above action in an effort to reduce the employer's contribution rate is liable. See MCL 421.54b; or

c. A person that knowingly advises another person to transfer a trade or business to reduce the employer's contribution rate is liable. See MCL 421.22b(2)(c)(ii).

3. SUTA Dumping liability is significant.

   a. Liability will include the amount owed plus damages equal to three times that amount. (MCL 421.53(a)(i));

   b. If the amount obtained or withheld from payment as a result of the intentional failure to comply is $25,000.00 or more but less than $100,000.00, then liability may include one of the following:

      i. If imprisonment, for not more than two years.

      ii. The performance of community service of not more than two years but not to exceed 4,160 hours.

      iii. A combination of the above that does not exceed two years. (MCL 421.54b(1)(b)(i)).

   c. If the amount obtained or withheld from payment as a result of the intentional failure to comply is more than $100,000.00, then liability may include one of the following:

      i. Imprisonment of not more than five years.

      ii. The performance of community service of not more than five years but not to exceed 10,400 hours.

iii. A combination of the above that does not exceed five years. (MCL 421.54b(1)(b)(ii)).

d. In addition to the foregoing, a civil fine up to the amount of $5,000.00 may be imposed. (MCL 421.22b(2)(c)(ii)).

F. Employee misclassification.

1. Employers that utilize the services of independent contractors may be subject to severe penalties if such independent contractors are misclassified employees.

2. The State has determined that Michigan employers are all too often misclassifying the individuals they hire as independent contractors rather than employees.

3. Executive Order 2008-1 created an Interagency Task Force to target employers who may be misclassifying their employees.

4. The Task Force (a) evaluates and examines Michigan businesses for employee misclassification; (b) refers employers who are misclassifying employees to the Michigan Attorney General or local and federal prosecutors; and (c) enforces harsh penalties relating to employee misclassification, including paying quadruple the amount of taxes owed on any misclassified wages.

G. Voluntary Worker Classification Settlement Program.

1. On September 21, 2011 the Internal Revenue Service enabled employers to reclassify independent contractors as employees by making a minimal payment covering past payroll.

2. To be eligible, an applicant must have: (a) consistently treated the workers in the past as nonemployees; (b) filed all required

Forms 1099 for the workers' previous three years; and (c) not currently be under audit.

3. Employers may apply by completing Form 8952 at least 60 days before they want to begin treating workers as employees.

4. Employers accepted into the program will: (a) pay 10% of the employment tax liability that may have been due on the compensation paid to the workers for the most recent tax year at rates determined under section 26 USC 3509; (b) not have to pay any interest or penalties; and (c) not be audited on payroll taxes related to these workers for prior years.

5. Participating employers will, for the first three years under the program, be subject to a special six-year statute of limitations, rather than the usual three years that generally applies to payroll taxes.

II. DETERMINING ELIGIBILITY FOR UNEMPLOYMENT BENEFITS

A. Becoming a liable employer.

1. An employer that employs at least one employee for covered employment in at least 20 weeks during the calendar year and pays remuneration in the amount of at least $1,000.00. MCL 421.41(1);

2. An employer files an employer registration report when it intends to hire one or more employees in Michigan; or

3. The UIA in the course of adjudicating an application for unemployment benefits by an individual (i.e., independent contractor) that previously performed services for the employer, determines that the employer is liable. See MCL 421.14.

B. Becoming an eligible employee.

1. The employee has the burden of proving that the employee is:

a. Able to work;

b. Available for full-time, suitable work;

c. Actively seeking work; and

d. Reporting for benefits as directed by the Agency, or had good cause for not reporting or filing as directed.

2. The employee must be unemployed and register to work by filing his/her resume with the Michigan Talent Bank and by reporting to the local Michigan Works! Agency service center.

C. Charging an employer's account.

1. If the separating employer paid wages of at least $2,072.00, the separating employer is charged 100% of the first two weeks of benefit payments.

2. After the first two weeks of benefit payments, each employer that falls within the base period is responsible for its pro rata share of benefits.

3. If an employee left an employer to accept permanent full-time work for another employer, that should be reported to the UIA because benefits charges can be transferred to the new employer.

III. <u>CHALLENGING CLAIMS FOR UNEMPLOYMENT BENEFITS</u>

A. Protest the monetary determination by filing a request for redetermination with the UIA within 30 days of the mailing date of the determination. Practice Tip: Despite the 30 day deadline to file a protest, the UIA will start paying benefits to the unemployed worker and charging same to the Employer's account unless a protest is filed within 10 days from the mailing date of the monetary determination that specifies the reason(s) for ineligibility/disqualification and includes evidence.

1. Disqualification for "Misconduct."

    a. "Misconduct" is limited to conduct evincing such willful or wanton disregard of an employer's interests as is found in deliberate violations or disregard of standards of behavior which the employer has the right to expect of his employee, or in carelessness or negligence of such degree or recurrence as to manifest equal culpability, wrongful intent or evil design, or to show an intentional and substantial disregard of the employer's interests or of the employee's duties and obligations to his employer. *Carter v Michigan Employment Security Commission*, 364 Mich 538 (1961).

    b. "Misconduct" will not be found as a result of mere inefficiency, unsatisfactory conduct, failure in good performance as the result of inability or incapacity, inadvertencies or ordinary negligence in isolated instances, or good-faith errors in judgment or discretion. *Id.*

    c. The employer has the burden of providing that the employee was discharged for misconduct. MCL 421.29.

    d. Practice Tips to prove "Misconduct."

i. Identify the job duties of the employee in writing and require the employee to sign same**.**

ii. Prepare an employee handbook that is tailored to identify the procedures that the employee is required to follow.

iii. Document oral warnings on the date the warning was made and include a statement in the employee's personnel file.

iv. Prepare written warnings, a performance improvement plan, and a last chance agreement.

v. Request the employee to sign-off on all policies and warnings. If the employee refuses to sign a warning, give the employee an opportunity to respond to same in writing. If the employee does not provide a response, the administrative law judge ("ALJ") ALJ may not believe the employee's response provided for the first time at a hearing.

vi. Identify witnesses that have first hand knowledge of the "Misconduct" that could testify in the event of a hearing.

vii. Prepare a determination letter to the employee that identifies the "Misconduct."

2. Disqualification for "Voluntary Quit."

a. "Voluntary Quit" means that the unemployed worker left involuntarily or for good cause attributable to the employer. MCL 421.29(a).

b. Good cause exists where an employer's actions would cause a reasonable, average, and otherwise qualified employee to give up his/her employment. *Johnides v St Lawrence Hosp*, 184 Mich App 172 (1990).

c. The unemployed worker has the burden of proving that he/she left involuntarily or for good cause.

d. Practice Tips to defend a claim that an employee's "Voluntary Quit" was involuntary or for good cause.

   i. Request an employee to resign in writing.

   ii. Prepare correspondence to the employee confirming the employee voluntarily quit.

   iii. Prepare correspondence to the employee requesting the employee to return to work.

   iv. Save voice messages if the employee resigns by telephone and/or record a resignation conversation if possible.

   v. Identify witnesses that have first hand knowledge of the "Voluntary Quit" that could testify in the event of a hearing.

   vi. Prepare an employee handbook and/or policy that requires employees to identify any work problems/issues in writing to minimize the employee's ability to claim that the employer had oral knowledge of the improper working conditions.

vii. If an employer offers an individual who is going to be terminated the opportunity to resign, such resignation in lieu of termination may not be voluntary and may be with good cause attributable to the employer. However, the employer remains free to argue disqualifying misconduct. Therefore, even if an employee resigns, all misconduct shall still be documented in the employee's personnel file.

3. Disqualification for "Seasonal Workers."

a. The employer must apply to be a seasonal employer and post a copy of the application form for all workers to see.

b. The UIA must decide that the employer is a seasonal employer.

c. The employer must post a notice that informs workers that the UIA has classified the employer as a "seasonal employer" and specify the normal seasonal work period.

d. The employer must give the worker "reasonable assurance" of returning to work the next season.

4. Disqualification for refusal of suitable work.

a. An unemployed worker may be disqualified from receiving unemployment befits if he/she rejects suitable work.

b. The burden is on the employer to show that the employer made a specific offer, the work offered was suitable, and the unemployed worker refused the job. MCL 421.29 (6).

5. Disqualification for family employment.

   a. Family owned corporations.

      i. An individual who performs services for a corporation that is owned more than 50% by (1) the individual; (2) the individual in combination with the individual's son, daughter, or spouse, or (3) in any combination of the individual's son, daughter, or spouse, it is <u>not</u> disqualified from receiving unemployment benefits but is limited to seven weeks of benefits.

      ii. However, no benefit year may be established in whole or in part on wages earned in family employment unless both the individual and the employer notify the UIA of the family nature of the employment.

      iii. Directors of corporations who perform no duties are not entitled to unemployment benefits because they are not employees and their services are not taxed.

   b. Sole proprietors and partnerships.

      i. A sole proprietor is defined as the sole owner of a business that is not incorporated.

      ii. A partnership is a business owned by two or more people, but is not a corporation.

      iii. Sole proprietors (self-employed persons) and partners are excluded from receiving unemployment benefits.

iv. An individual who performs services for a sole proprietorship owned by his or her son, daughter, or spouse, is not entitled to benefits.

v. Example 1. An individual who performs services for a partnership, any part of which is owned by the individual, or 100% of which is owned by any combination of the individual's son, daughter, or spouse, is excluded from receiving benefits.

vi. Example 2. An individual who performs services for a partnership in which the individual has no ownership interest, and is owned more than 50% but less than 100% by any combination of the individual's son, daughter, or spouse, is not excluded from receiving benefits but is limited to seven benefit weeks.

c. LLCs and LLPs.

i. A limited liability company is an unincorporated business entity formed by one or more "members." A single member LLC is treated as a sole proprietorship. An LLC with two or more members who are individuals is treated as a partnership.

ii. A limited liability partnership is an existing partnership that may organize as an LLP by filing a registration form and paying a fee. Like partners in a general partnership, partners in an LLP are not entitled to benefits.

B. Appeal the redetermination to an ALJ within 30 days after the mailing date of the redetermination.

1. The appeal only needs to contain a simple statement requesting a hearing.

2. Notice of the hearing will be mailed at least 10 days before the scheduled hearing.

3. Parties may be represented by counsel, a nonlawyer agent, or they may choose to represent themselves.

4. A party has the right to review the administrative record before the hearing. A party may request subpoenas to compel witnesses to testify under oath at the hearing.

5. Each party may call witnesses, cross-examine witnesses, and introduce exhibits.

6. The ALJ may also cross-examine witnesses.

7. The ALJ typically mails the decision within 14 days after the hearing.

8. Practice Tip: Arrive to the hearing on time. The ALJ has cancelled the hearing when an appealing party is ten minutes late. Also, parties and witnesses are often allowed to participate by telephone if requested in advance.

C. Appeal the decision of the ALJ within 30 days after the mailing date of the decision.

1. Request a rehearing before the ALJ if you have additional facts that were not available to you at the time of the original hearing.

2. Appeal the decision to the Michigan Compensation Appellate Commission (the "Commission") (which replaced the former Michigan Employment Security Board of Review, effective August 1, 2011, pursuant to Mich Exec Order No 2011-6). Although the Commission is empowered to take additional evidence in any matter, it typically reviews the ALJ decision and hearing transcript and decides the appeal on the basis of the record made. The time to receive a decision can easily exceed one year from the date of the appeal.

3. Appeal the decision to the circuit court in the county in which the employee resides or the where the employee's place of employment is located.

   a. It is possible for the parties to bypass the Commission and appeal the ALJ decision directly to the circuit court by stipulation of the parties.

   b. Practice Tip: The UIA must be named as a party on the appeal and a corporate employer may not appear in the state courts except through an attorney authorized to practice law in Michigan.

   c. The circuit court may review questions of law or fact to determine if the decision is contrary to law or is not supported by competent, material, and substantial evidence on the whole record. MCL 421.38.

   d. If there is no dispute as to the underlying facts, questions on appeal are to be treated as matters of law.

   e. A decision of the circuit court may be appeals in the manner provided for appeals from the circuit court. MCL 421.38(4).

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

ATTORNEY BIOGRAPHIES

Michael W. Maddin is President Emeritus, a shareholder and a founder of the firm, and remains a member of its Executive Committee. Mr. Maddin has been practicing law for over 45 years, primarily in the areas of real estate, corporate and business law, estate planning and probate. His accomplishments for clients cover every range of his practice for local and national matters, and many unique transactions deemed not possible or too difficult to handle. Special skills, as described by others, include his ability to focus, develop consensus and negotiate, and most importantly complete the tasks effectively and timely. He is a member of the Southfield, Oakland, Michigan and American Bar Associations and the American Judicature Society. He is also a member of the Real Property Law Section Council of the State Bar of Michigan and for many years served as Chairman of the Commercial Leasing and Management Committee of the Real Property Law Section of the State Bar of Michigan. Mr. Maddin has been a speaker at numerous ICSC, ICLE, National Business Institute and State Bar of Michigan Real Property Law Section seminars, and has authored numerous real estate related articles in professional journals. He has been repeatedly selected by his peers for inclusion in "The Best Lawyers in America," named among the top 100 Michigan Super Lawyers, and has been awarded special recognition by Chambers USA: America's Leading Lawyers for Business. He has been President or Chairman of numerous civic, charitable or fraternal organizations and major groups.

Mark R. Hauser is a founder and Managing Director of the firm who specializes in the areas of real estate, partnerships, finance, corporate and business law, taxation and estate planning. A 1964 graduate of the University of Michigan, he obtained his Juris Doctor *magna cum laude* from Wayne State University in 1967 where he served as an Editor of the Wayne Law Review. A member of the Real Estate, Business Law & Taxation Sections of the State Bar of Michigan, Mr. Hauser has lectured at numerous professional seminars for attorneys and accountants on real estate and tax-related issues. He has been continuously selected by his peers to be listed in the "Best Lawyers in America," and is likewise listed in "Super Lawyers" and the "Chambers USA". He is a past President of the United Jewish Foundation of Metropolitan Detroit, and has served as a National Vice Chairman, Trustee and Member of the Executive Committee of United Jewish Communities.

Richard J. Maddin is a firm shareholder who has practiced law for over 42 years. He is a graduate of Michigan State University and University of Detroit-Mercy Law School. His areas of practice include general business, commercial and residential real estate construction, corporate, land use planning, zoning and probate law. Mr. Maddin is an active litigator, representing both plaintiffs and defendants in the above-described areas of practice, including real estate construction, zoning, real property tax appeals, alternative dispute resolution (ADR) and is a certified mediator. He is a member of the real estate, litigation, and ADR sections of the State Bar of Michigan, the Southfield and Oakland Bar Associations. He has been continuously selected by his peers for listing in the “Best Lawyers in America” and is likewise listed in “Super Lawyers.”

Richard F. Roth is a shareholder in the firm. He attended the Wharton School at the University of Pennsylvania where he received a Bachelor of Science in Economics. He graduated from the University of Michigan Law School, *cum laude*, in 1972. Mr. Roth has a business, estate planning and real estate practice, with a concentration in acquisitions, financing, taxation and estate planning for professionals and wealthy individuals. With regard to the real estate side of his practice, Mr. Roth has handled the acquisition, sale and financing of apartment complexes, shopping centers, and office buildings. He has also handled workouts for distressed properties. Mr. Roth’s most recent publication, entitled *Protect More of your Assets from the Estate Tax,* appeared in the September 2011 issue of Medical Economics®. He co-authored the Michigan statute, which exempts from sales tax the purchase of hi-tech computers used in computer integrated manufacturing and CAD-CAM. Mr. Roth has also lectured at numerous professional seminars. He is currently on the Advisory Board of Project Chessed, which provides full medical care and prescription drugs to thousands of families in the metropolitan Detroit area. Mr. Roth previously served as President of the Michigan Jewish Sports Foundation and the Sinai Health Care Foundation. He was previously a member of the Board of Trustees of Karmanos Cancer Institute, The Jewish Fund, Sinai Hospital, Huron Valley-Sinai Hospital, the Anti-Defamation League, Temple Beth Jacob, and Knollwood Country Club. Mr. Roth has been named as a Best Lawyer since 2010 by DBusiness and has been named in *Michigan Super Lawyers*® since 2007.

Harvey R. Heller is the shareholder in charge of our Insurance Coverage and Defense Practice Group. He is an honors graduate of Michigan State University, as well as a *cum laude* graduate of Detroit College of Law. In addition to being an active litigator, Mr. Heller is a member of the Michigan State Bar Foundation Fellows and the Michigan Defense Trial Council. On a national level, Mr. Heller is a member of the American Bar Association Standing Committee on Lawyers’ Professional Liability, the Defense Research Institute, as well as the International Association of Defense Counsel. He has authored articles on the subject of professional liability and has been a featured speaker at professional liability seminars. Mr. Heller has continually been selected by his peers to be listed in the “Best Lawyers in America.”

Michael S. Leib is a shareholder in the firm. He is a trial lawyer practicing in the areas of insolvency law, bankruptcy litigation, and commercial and business litigation. He is a graduate of Kalamazoo College, the University of Montana and Wayne State University Law School. He is a member of the State Bar of Michigan and is admitted to practice before several courts, including the United States District Court, Eastern District of Michigan and Western District of Michigan, 6th Circuit Court of Appeals and United States Supreme Court. Mr. Leib is also a member of the Board of Directors of the Federal Bar Association of the Eastern District of Michigan. He is a member of the State Bar of Michigan Judicial Qualifications Committee. He was also the chairperson of the State Bar of Michigan Character and Fitness Committee. Mr. Leib is listed in “Super Lawyers” and in the “Best Lawyers in America.”

Robert D. Kaplow is a shareholder in the firm. His practice is concentrated in estate planning and personal and corporate income tax planning. He is a graduate of Cornell University, receiving his law degree from the University of Michigan. He received a Masters in Tax Law from Wayne State University. He is a member of the State Bar of Michigan (Taxation and Probate and Estate Planning Sections), Oakland County Bar Association (Taxation Committee) and American Bar Association (Taxation, Real Property, Probate and Trust Law Sections). Mr. Kaplow is a frequent lecturer before professional groups pertaining to tax and corporate matters. He is listed in Who's Who in American Law and Who's Who of Emerging Leaders in America. Mr. Kaplow is a member of the Financial and Estate Planning Council of Metropolitan Detroit, and is also active in various charitable and Bar related activities.

William E. Sigler is a shareholder of the firm. His practice involves business planning, structuring and formation of business entities, mergers and acquisitions, real property acquisitions and dispositions, contract drafting and review, employee benefit plans, executive compensation, and estate and business succession planning. He graduated from Michigan State University and the University of Detroit School of Law where he was an editor of the Law Review. Mr. Sigler is a member of the Financial and Estate Planning Council of Metropolitan Detroit and is active in charitable and bar related activities. He served as chairperson of the Oakland County Bar Association Employee Benefits Committee and is a member of the Board of the Association for Corporate Growth.

Stewart C. W. Weiner is a shareholder of the firm who has concentrated his practice over the past 28 years in business, construction, securities, family and computer related matters with a particular focus on acquisitions and resolution of business, construction, partnership, shareholder and family disputes. He frequently counsels clients on construction contracts, succession planning, securities and computer related disputes and issues. He has served as an arbitrator for FINRA (Financial Industry Regulatory Authority) for many years, as a private arbitrator and is a member of the American Bar Association (Construction Forum, Family Law and Computer Law Sections), State Bar of Michigan, Family Law Section, and Oakland County Bar Association. He has been actively involved in a number of charitable organizations, is a former President of Jewish Family Service and the Franklin Baseball League and currently serves on the Board of Governors of the Jewish Federation of Metropolitan Detroit. **Education:** University of Detroit, Detroit, Michigan, Juris Doctor, 1983, University of Michigan, Ann Arbor, Michigan, M.S.W., 1976, Binghamton University, Binghamton, New York, B.A. 1974. **Professional Memberships:** American Bar Association, State Bar of Michigan, Oakland County Bar Association, and Construction Finance Management Association.

Charles M. Lax is a shareholder of the firm who has practiced primarily in the areas of employee benefits, taxation, corporate law and mergers and acquisitions. He has authored numerous articles appearing in legal and public accounting journals. Mr. Lax has lectured extensively on qualified retirement plans and other tax topics before the Michigan Institute of Continuing Legal Education, Michigan Association of Certified Public Accountants and other professional groups. He presently serves as Co-Chair of the 2010 and 2011 ASPPA Annual Conference and as a member of the IRS Great Lakes TE/GE Council. Mr. Lax has previously served as a member of the Advisory Committee on Tax Exempt and Government Entities Division of the IRS (ACT), the IRS Employee Plans, Ad Hoc Advisory Group for the Assistant Commissioner of Internal Revenue Service, EP, the IRS Regional Council Bar Advisory Group, Central Region, the Advisory Group to IRS Northeast Region's Chief of EP/EO Division, the Chairman of the State Bar of Michigan – Section of Taxation, Chairman of the State Bar of Michigan Employee Benefits Committee and Co-Chair of the IRS-ASPPA Great Lakes Benefits Conference for 2007 and 2008. He is a Fellow of the American College of Employee Benefits Counsel and recognized by his peers by inclusion in the Best Lawyers in America, (Best Lawyers' 2011 Detroit Area Benefits Lawyer of the Year) Chambers USA and as one of the Top 100 Lawyers in the State of Michigan for 2008 by Super Lawyers. Mr. Lax has extensive experience in representing clients in tax controversy matters before the Internal Revenue Service and Tax Court of the United States.

Stuart M. Bordman is a shareholder of the firm who is an attorney and a certified public accountant. He has extensive experience in general corporate matters including business purchases and sales, franchise matters, health care law and representation before the Internal Revenue Service. Mr. Bordman was the 1997-98 Chairman of the Oakland County Bar Association Tax Committee. Mr. Bordman is a frequent lecturer before the Michigan Association of Certified Public Accountants and a regular contributor to LACHES, the Oakland County Bar Association publication. He has written on use tax, corporate finance under the Michigan Business Corporation Act and single business tax. He is also a Council member of the antitrust, franchising and trade regulation section of the State Bar of Michigan. Mr. Bordman is a graduate of the Northwestern University School of Law.

Steven D. Sallen is a shareholder and member of the firm's Executive Management Committee. Mr. Sallen received his undergraduate degree from the University of Michigan and his law degree, *cum laude,* from the University of Detroit-Mercy School of Law where he served as Case and Comment Editor of the University of Detroit Law Review. Mr. Sallen concentrates his practice in the areas of real estate law, environmental law and corporate law, and his clients include real estate developers, general contractors, commercial real estate brokers and environmental consulting firms. Mr. Sallen publishes Real e-State, a Quarterly Electronic Newsletter for Real Estate Professionals. He resides in Orchard Lake, Michigan with is wife and three children.

John E. Jacobs is a shareholder of the firm who specializes in commercial transactions, real estate, litigation, and consumer law, including residential mortgage lending. He also engages in lobbying activities in state government on behalf of the Mortgage Bankers Association and the Michigan Mortgage Lenders Association. Mr. Jacobs has lectured at professional seminars on real estate, consumer law and residential mortgage lending. He also taught Consumer Credit Regulation at Wayne State University Law School. He has been the President of the Anti-Defamation League, Jewish Family Service and Temple Emanu-El. Mr. Jacobs is a member of the Board of Governors of the Jewish Federation of Metropolitan Detroit. He has been selected by his peers for inclusion in the Best Lawyers in America and is listed in Super Lawyers. He graduated from the University of Michigan Law School *cum laude* in 1971.

Julie Chenot Mayer is a shareholder of the firm who received her undergraduate degree from the University of Michigan. She obtained her Juris Doctor, *cum laude*, from the Detroit College of Law in 1986 where she was a member of the Law Review. Ms. Mayer concentrates her practice in the area of litigation with an emphasis on insurance coverage and professional liability defense. Ms. Mayer is a member of the State Bar of Michigan and the American Bar Association.

Ronald A. Sollish is a shareholder in the firm who specializes in the areas of employment, real estate, partnership, finance, corporate and business law. Ron is a frequent speaker on legal topics and has spoken to such groups as the Michigan Chamber of Commerce, Michigan Association of Certified Public Accountants, and American Society for Industrial Security. He is licensed to practice law in both Michigan and Illinois. He graduated from the University of Detroit-Mercy School of Law where he was the managing editor of the Law Review. Ron received his undergraduate degree from the University of Michigan. Ron is a member of the State Bar of Michigan, Illinois Bar Association, American Bar Association and Oakland County Bar Association.

Lowell D. Salesin is a shareholder in the firm and a member of the firm's Executive Committee. He has been practicing with the firm since graduation from the George Washington University National Law Center in 1993, where he graduated with high honors and served as an Associate Editor of the George Washington Law Review. He received his undergraduate degree from Indiana University in 1990. Mr. Salesin is a member of the Real Property and Business Law Sections of the State Bar of Michigan and is a member of the American and Oakland County Bar Associations. He concentrates his practice in the areas of real estate development and finance, business planning, lending, commercial leasing, partnership and corporate law. Mr. Salesin's experience includes the acquisition, financing, construction, development, and leasing of all types of commercial real estate. He represents both owners and lenders in a wide variety of real estate transactions.

Steven M. Wolock is a shareholder in the firm who received his law degree from the University of Michigan Law School in 1985 and obtained a Bachelor's of Science in Economics from the University of California at Santa Cruz in 1977. Mr.

Wolock specializes in general commercial litigation and professional liability litigation and has extensive experience in labor and employment law. Mr. Wolock is a member of the Labor and Employment and Negligence Sections of the State Bar of Michigan, American Bar Association and Oakland County Bar Association. He also serves as a panelist on the State Bar of Michigan Attorney Discipline Board. Mr. Wolock has been selected by his peer for inclusion in the "Best Lawyer in America" and in "Michigan Super Lawyers."

David E. Hart is a shareholder of the firm and a member of the firm's Executive Committee. He earned his Bachelor degree in Philosophy and Political Science from the University of Michigan in 1988 and received his Juris Doctor Degree, cum laude, from the Detroit College of Law in 1991. While at the Detroit College of Law, Mr. Hart was a senior member of the Detroit College of Law Review and he participated in several national Moot Court competitions. He concentrates his practice in the areas of title insurance, business disputes, real estate litigation, creditor's rights law, including bankruptcy, and general civil litigation. He lectures frequently on real estate and title insurance. Mr. Hart is licensed to practice in Michigan and Ohio. He is a member of the State Bar of Michigan, the Oakland County and Federal Bar Associations, and The Michigan Land Title Association.

George A. Contis is a shareholder of the firm. He earned his Bachelor of Arts degree in Economics from the University of Pittsburgh in 1982 and received his Juris Doctor degree from the University of Detroit School of Law in 1985. While at the University of Detroit, Mr. Contis participated in several local and national Moot Court competitions and was selected for membership to the Order of Barristers. He concentrates his practice in the areas of real estate development and finance, lending, transactional law, commercial leasing and business planning. His publications include: Tax Aspects of Divorce in Michigan, Michigan Tax Law Journal, 1984; Bring a Weapon to School, Get Expelled 370 LACHES 8, November 1996; and Year End Planning Considerations for 1031 Exchanges, Bar Briefs, December 2000.

Martin S. Frenkel is a shareholder of the firm. He graduated from the University of Michigan in 1991 and Wayne State University Law School in 1994. He is admitted to practice in Michigan and in the Federal District Courts for both the Eastern and Western Districts of Michigan. Mr. Frenkel was formerly employed by the Michigan Department of Attorney General and has been with Maddin Hauser since 1997 where he specializes in the areas of commercial and real estate litigation including construction, mortgage and title-related disputes. He is a member of the Real Property Section of the State Bar of Michigan and is also an affiliate member of the Associated General Contractors of America. Mr. Frenkel authored the article *"Navigating the Waters of Real Estate Arbitration"* published in Commercial, Inc. Magazine, discussing the dynamics of the real estate arbitration process. He is one of the firm's representatives to the National Mortgage Bankers Association and has authored the article "*Seven Common Mistakes in Selecting/Managing Outside Counsel in the Mortgage Industry"* which was published as a three part series in the MBA News Link. He has also authored the article "Five Common Mistakes in

Managing Attorneys in the Construction Industry," which was published in *Michigan Contractor and Builder*. Mr. Frenkel was also selected by his peers as one of the Michigan's Rising Stars and was identified as such in the *Michigan Super Lawyers and Rising Star Magazine*. Fewer than 5 percent of Michigan's attorneys attain the "Super Lawyer" or "Rising Star" status.

Gary M. Remer is a shareholder of Maddin, Hauser, Wartell, Roth & Heller, P.C., of Southfield, MI, who received his law degree from the Detroit College of Law at Michigan State University where he graduated summa cum laude in May 1997 and obtained a Bachelor of Arts in Accounting from Michigan State University in 1990. Mr. Remer was a Revenue Agent with Internal Revenue Service, Employee Plans Division, from 1992 through 1996. Mr. Remer joined the law firm in 1997 and concentrates his practice in the areas of employee benefits, corporate law, taxation, franchise law and estate planning. He has lectured extensively on qualified retirement plans and other tax topics. Mr. Remer is the co-author of *The Insider's Guide to IRS Plan Audits*. He is also called upon regularly as an expert in the media and has appeared on Channel 7 Action News and WWJ News Radio 950 as well as being quoted in such publications as the Detroit News and Detroit Free Press. He is a Certified Public Accountant and served as Chair of the MACPA Employee Benefits Task Force. Mr. Remer currently serves as a Council Member of the State Bar of Michigan Tax Committee. Mr. Remer is an adjunct professor for Walsh College. He teaches graduate tax classes focusing on pension and profit sharing plans, section 401(k) plans, various kinds of stock and stock option plans, IRAs, SEPs, ESOPs, tax sheltered annuities, nonqualified deferred compensation plans, VEBAs, flexible benefit plans, health care plans, insurance plans, and other common fringe benefits. Mr. Remer recently conducted a day long business law seminar for the AIPCA in Little Rock, Arkansas. Mr. Remer was also named in Chambers USA: America's Leading Lawyers for Business 2011 as a *Leader in his Field* of Employee Benefits & Executive Compensation.

George V. Cassar, Jr. is a shareholder in the firm who concentrates his practice in the areas of estate and business succession planning, taxation and probate. Mr. Cassar graduated from the University of Michigan with honors and received his law degree with honors from Drake University Law School. He also received his Masters in Tax Law from Wayne State University Law School and was named one of Michigan's Rising Stars by Michigan Super Lawyers. He is a member of the State Bar of Michigan, the American Bar Association, the Oakland County Bar Association and the Detroit Metropolitan Bar Association. Mr. Cassar frequently speaks before professional firms and organizations such as the MACPA and private companies, as well as to their clients, regarding estate planning, tax and probate matters. He is a Council Member of the Tax Committee for the State Bar of Michigan, a member of the Financial and Estate Planning Council of Metropolitan Detroit, a member of the National Academy of Elder Law Attorneys (NAELA) and an Executive Member of Inforum (a/k/a The Women's Economic Club of Detroit). Mr. Cassar has also been accepted as a Life Member of the National Registry of *Who's Who in American Law* and is active in several charitable and other community organizations including his service on the Board of Directors for The Miracle League of Plymouth, an Officer and Director for Don Bosco Hall, a Board Member for the Detroit Chapter of Legatus and a Board Member-elect for the Judson Center. He resides with his wife and two children in Grosse Pointe Shores, Michigan

David M. Saperstein is a shareholder of the firm. He graduated from the University of Michigan Law School in 1993, and University of California, Berkeley with High Honors in 1989. He clerked for the late Michigan Court of Appeals Chief Judge Pro Tem Myron H. Wahls. He has presented CLE presentations to attorneys in multiple states regarding securities arbitrations. Mr. Saperstein's publications include: “Why There are No Common-Law Exceptions to a Municipality's Governmental Immunity: A Municipal Perspective,” Public Corporation Law Quarterly, Spring 2001, No. 9, p.1, and “The Abominable Snowman, the Easter Bunny, and The Intentional Tort Exception to Governmental Immunity: Why Sudul v Hamtramck was Wrongly Decided,” 16 Michigan Defense Quarterly, No. 2, p. 7 (2000). Mr. Saperstein is admitted to practice law in Michigan, Ohio and California (inactive). He concentrates his practice in the area of professional liability defense, primarily defending lawyers, stockbrokers, accountants, real estate agents, and insurance agents. He also practices appellate law in Michigan and federal Courts.

Richard M. Mitchell earned his Juris Doctor degree from Indiana University Law School, Bloomington, in 1991, where he served on the Indiana University Law Review. He earned his Bachelor of Arts degree from the University of Michigan in 1988. Mr. Mitchell focuses his practice on complex insurance coverage disputes and civil litigation. He has authored publications and spoken in these areas. He is also a member of the Society of Chartered Property Casualty Underwriters (CPCU), a designation granted by the American Institute for CPCU in Malvern, PA, upon the successful completion of a series of national examinations relating to insurance and business related topics. Mr. Mitchell is also on the Board of Directors of the Greater Detroit CPCU Chapter.

L. Jeffrey Zauberman is a shareholder in the firm. He has been a practicing attorney since 1984 in both the Province of Ontario and Michigan. He received his Bachelor of Laws from Osgoode Hall Law School in Toronto, Canada and his J.D. from the University of Detroit School of Law. Mr. Zauberman is a member of the Real Property Section of the State Bar of Michigan. He concentrates his practice in the areas of real estate development and finance, asset based secured financing and leasing of commercial real estate. Mr. Zauberman is also licensed in the Province of Ontario and able to advise upon matters of Ontario law.

John P. Gonway is a shareholder in the firm and specializes in secured financing, real estate, mergers and acquisitions and commercial transactions. He received his Juris Doctor, *cum laude*, from the Wayne State University School in 1996. Prior to attending law school, he received his undergraduate degree from James Madison College at Michigan State University. Mr. Gonway is a member of the Real Property, Business Law, and Taxation Sections of the State Bar of Michigan and is a member of the Oakland Bar Association. Mr. Gonway’s expertise includes the acquisition, financing, construction, development and leasing of all types of commercial real estate, as well as the representation of clients in all aspects of corporate law, commercial law, mergers and acquisitions and commercial transactions.

Kathleen H. Klaus is a firm shareholder in the firm's Defense Practice and Insurance Coverage Group. Ms. Klaus graduated with High Honors from the University of Iowa with a degree in Economics and from the University of Michigan Law School. She practiced commercial litigation and bankruptcy in Chicago for twelve years before joining the firm. She now focuses her practice on defending attorneys and other professionals in malpractice litigation and employers in discrimination suits.

Kasturi Bagchi is a shareholder at Maddin Hauser Wartell Roth & Heller, PC. Kas manages risks for clients in loan, real estate, or asset-based transactions. She is a regular contributing writer and editor of the firm's Real e-State, a Quarterly Electronic Newsletter for Real Estate and has authored articles published in Michigan Lawyer's Weekly, Commercial Investment Real Estate, and Medical Law Report. She currently serves as the Events Committee Chair for TIE Detroit and is responsible for organizing and designing events which promote entrepreneurship. She received a Bachelor of Arts in Political Science with honors from UCLA and subsequently was awarded her Juris Doctor degree with honors from Tulane University School of Law. Kas is admitted to the Bars of New Jersey, Pennsylvania (inactive), California and Michigan.

Danielle M. Spehar is a firm shareholder. She attended Central Michigan University and earned a Bachelor of Science in Business Administration, *summa cum laude*. She also earned a Master's Degree in Business Administration from Wayne State University. She acquired her Juris Doctor, *magna cum laude*, from University of Detroit-Mercy School of Law in 1998. Ms. Spehar concentrates her practice in the areas of real estate transactions and corporate and business law. She is a member of the State Bar of Michigan and the American Bar Association.

Marc S. Wise is a shareholder of the firm who concentrates his practice in the areas of employee benefits, business planning and taxation. Mr. Wise has extensive experience in the design, financing, implementation and correction of pension and welfare benefit plans for large multi-state employers as well as smaller local employers. As part of his practice, he represents clients in Internal Revenue Service, U.S. Department of Labor and Pension Benefit Guarantee Corporation audits and investigations. He earned his Bachelor of Science degree from Western Michigan University with dual majors in Accounting and Economics. He was awarded his Juris Doctorate degree from Ohio Northern University and a Master of Laws degree in taxation from Wayne State University. Mr. Wise is admitted to practice before the state and federal courts in Michigan, the United States Court of Appeals for the Sixth Circuit and the United States Tax Court.

Brian A. Nettleingham is a shareholder in the Firm's Commercial Litigation Group, where he advises a range of clients on issues that include contract disputes, mortgage lending practices, employment disputes, and intellectual property claims. He regularly assists clients with the development, sale, and use of software, websites, e-commerce and other computer, network, and internet technology related issues, including data retention practices for electronically stored information. Brian earned his Bachelor of Arts in Pre-Law from Cedarville University in 1993, where he also earned minors in Religion and Philosophy. He studied philosophy at Miami University's Graduate School before earning his Juris Doctorate from Notre Dame Law School. At Notre Dame, Brian was a member of the Appellate Moot Court Team and worked with the law school's Legal Aid and Immigration Law Clinics. He also won the law school's Annual Client Counseling Competition. After graduating from Notre Dame, Brian clerked for the Honorable Joel P. Hoekstra of the Michigan Court of Appeals. He is admitted to the State Bar of Michigan. the Western and Eastern District Federal Courts for Michigan, and the Sixth Circuit Court of Appeals.

Geoffrey N. Taylor graduated *magna cum laude* from the University of Pittsburgh Law School in 1997. He obtained a Bachelor of Business Administration with distinction from the University of Michigan in 1992. Mr. Taylor concentrates his practice in the areas of estate planning, probate, and tax law.

Lori E. Talsky joined the firm as an associate after graduating *summa cum laude* from the Detroit College of Law at Michigan State University in January, 1996. Ms. Talsky has an extensive working knowledge of the Canadian legal system. She is a member of the State Bar of Michigan and the American Bar Association.

Sheryl K. Silberstein joined the firm in September, 2000. She is a 1986 graduate of the Detroit College of Law and earned her Bachelor of Arts Degree from the University of Michigan. Her concentration of law is in the area of real estate and related matters. Ms. Silberstein has over twenty years experience in the real estate industry in the corporate sector. She is a member of the State Bar of Michigan.

Michelle C. Harrell is a Shareholder and Manager of the firm's General and Complex Litigation Practice Group. She received her Bachelor of Science degree in accounting, summa cum laude, from the University of Detroit in 1990 and her Juris Doctor, cum laude, from Wayne State University Law School in 1993. While at Wayne State, Ms. Harrell participated in moot court competitions and received three American Jurisprudence Awards. Michelle is a Barrister Emeritus in the American Inn of Court, Oakland County Chapter, a Mentor in the Oakland County Bar Association Mentor Program and an Oakland County Circuit Court Case Evaluator (Complex Commercial Neutral). She was also appointed to serve as a member of the U.S. Courts Committee of the State Bar of Michigan to further the relationship and effective interaction between the Eastern and Western Districts of Michigan and Michigan State Courts. Ms. Harrell concentrates her practice in the areas of complex commercial, real estate, receiverships and family law litigation. Ms Harrell authored the article "Caveat Receiver: Practical Tips for Appointing or Serving as a

Receiver" for the Michigan Bar Journal. She was also named as a DBusiness Top Lawyer for 2010 in the areas of Real Estate and Litigation. Michelle is an active member of the Hydrocephalus Association, Michigan Chapter.

Brandon Buck received his Bachelor of Science degree with honors from Wayne State University in 1998 and his Juris Doctor degree with honors from Wayne State University Law School in 2001. During law school Mr. Buck received a Board of Governors Scholarship for Academic Excellence and placed first in the law school's Moot Court brief writing competition. Mr. Buck is admitted to practice law in Michigan and California and concentrates his practice in the areas of business disputes, real estate, commercial and general litigation and creditor's rights law.

Rebecca M. Turner is a shareholder with the firm and concentrates her practice in the areas of franchise law, corporate and business law and real estate transactions. Ms. Turner earned her Bachelor of Business Administration in Accounting from Western Michigan University Haworth College of Business in 1998 and earned her Juris Doctor, *cum laude*, from Syracuse University College of Law in 2001. Ms. Turner was selected as one of five 2006 Up and Coming Lawyers by Michigan Lawyers Weekly, one of 10 women showcased in an article entitled Raising the Bar published in the Crain's Detroit Business issue Focus Law, and named to the 2008, 2009 and 2010 Michigan Rising Star list as published by Michigan Super Lawyers. Fewer than 5 percent of Michigan's attorneys attain the "Super Lawyer" or "Rising Star" status. Ms. Turner is a member of the American Bar Association, State Bar of Michigan, Oakland County Bar Association (Sustaining Member), Oakland County Bar Foundation (Fellow), International Franchise Association (Certified Franchise Executive Candidate) and Women's Franchise Network of Southeast Michigan. Additionally, Ms. Turner is a Past President of the Women's Bar Association, Oakland Region of the Women Lawyers Association of Michigan.

Michael K. Hauser, a Shareholder in the firm, is a summa cum laude graduate of Wayne State Law School, and he is also a CPA. He received his B.A. magna cum laude from Dartmouth College. His practice focuses on partnership and corporate tax, federal taxation of real estate transactions, and general corporate and business matters. He is an Adjunct Professor in the Cooley Law School LLM program, where he teaches Taxation of Real Estate. He authored the Section 1031 volume for the Merten's Tax Treatise, and is also the author of numerous other tax publications, including "Avoiding Dealer Status to Obtain Capital Gains," "Dealer Status and the Condominium Conversion" and Special Allocations of Gain Between Partners In Section 1031 Transactions" (all published in the journal Real Estate Taxation). He formerly worked in a mid-sized CPA firm in suburban Detroit servicing small to mid-sized businesses. In law school, he served as a Note & Comment Editor for the Wayne Law Review, for which he authored "The Tax Treatment of Intangibles in Acquisitions of Residential Rental Real Estate." He also served as an intern with the IRS Chief Counsel's Large and Mid-Sized Business Division, where he researched international tax and tax shelter issues.

Lavinia S. Biasell received her Bachelor of Arts degree with High Honors from Michigan State University in 2000, and received her Juris Doctor degree, *magna cum laude*, from Michigan State University-Detroit College of Law in 2003. While in law school, Ms. Biasell was a member of American Inns of Court and earned the Carolyn Stell Award for outstanding achievements and public service from the Women Lawyers Association of Mid-Michigan. Ms. Biasell was admitted to practice by the State Bar of Michigan in 2003. She is also admitted to the Federal District Court for the Eastern and Western Districts of Michigan. Ms. Biasell concentrates her practice in the areas of commercial and real estate litigation. In addition, Ms. Biasell recently served as the Women's Bar Association's President-Elect, and has also served as WLAM Representative and Vice-President. She is also co-chair of the Bench Bar Culinary Challenge Committee that organizes a yearly charity event where judges compete for the title of "Best Judicial Chef."

James M. Reid, IV is an Associate in the firm who concentrates his practice in the areas of employment, business disputes, real estate, and commercial and general litigation. He received a Bachelor of Arts in Political Science-Prelaw with honors from Michigan State University in 2002 and his Juris Doctor degree with honors from Wayne State University Law School in 2005. While at law school, Mr. Reid was an associate editor of the Wayne Law Review. Mr. Reid is admitted to practice before the federal and state courts of Michigan.

Mark E. Plaza received his Bachelor of Arts degree with High Distinction from the University of Michigan in 1999, and received his Juris Doctor degree, Cum Laude, from Wayne State University Law School in 2003. While in law school, Mr. Plaza was a Senior Articles Editor for the Wayne Law Review and a member of Phi Alpha Delta Law Fraternity. Mr. Plaza was admitted to practice by the State Bar of Michigan in 2003. He is also admitted to the Federal District Court for the Eastern and Western Districts of Michigan. Mr. Plaza concentrates his practice in the areas of commercial and real estate litigation.

Courtney D. Roschek received her bachelor of arts magna cum laude from Western Michigan University in 2004. She earned her juris doctorate magna cum laude from Michigan State University College of Law in 2007. While in law school, she was an active member of MSU Law's Moot Court Advocacy Board and Trial Practice Institute and received the Carolyn Stell Award from the Women Lawyers Association. Previously, Ms. Roschek worked with the United States District Court for the Eastern District of Michigan in developing and conducting the certification program for trial attorneys wishing to use the shared advanced technology courtroom.

Suzanne S. Reynolds joined the firm in February, 2009. Ms. Reynolds concentrates her practice in real estate matters and has particular expertise in condominium law. After graduating summa cum laude from Detroit College of Law in 1987, Ms. Reynolds was in private practice for fifteen years and then served as general counsel for a commercial construction and development firm for six years. Ms. Reynolds is a member of the State Bar of Michigan

Brian R. Meyer is an associate in the firm's Defense Practice and Insurance Coverage Group. Brian received his Bachelors Degree from the University of Michigan in 1999 and his Juris Doctor from Emory University School of Law in 2003. While in law school, Brian served as President of the Emory Chapter of the Federalist Society. Prior to joining Maddin Hauser, Brian spent nearly five years in the United States Navy Judge Advocate General's Corps where he served at various times as a prosecutor, command advisor, and Special Assistant United States Attorney in San Diego, Kings Bay, Georgia, and Iraq. Brian is admitted to the State Bar of Michigan and the United States District Court for the Eastern District of Michigan. He is also a member of the American Bar Association, the Oakland and Washtenaw County Bar Associations, and the Veterans of Foreign Wars (VFW).

David G. Michael practices primarily in the areas of business law, bankruptcy and insolvency, landlord-tenant law and commercial and real estate litigation. He earned his Juris Doctor with honors from Wayne State University Law School, where he served as an associate editor of the Wayne Law Review. He is a director of the Wayne State University Law School Alumni Association and his professional affiliations include the State Bar of Michigan, Business Law Section; the American Bar Association, Litigation Section; and the Federal Bar Association. He joined the firm as an associate in 2010.

Ian S. Bolton practices primarily in the areas of business law, bankruptcy and insolvency, landlord-tenant law, commercial litigation and in the area of property tax appeals. He earned his Juris Doctor with high honors from Wayne State University Law School, where he served as a note editor of the Wayne Law Review and as a member of Moot Court. His professional affiliations include the State Bar of Michigan, the State Bar of Illinois, the State Bar of Texas; the American Bar Association, Young Lawyers Section; and the American Bankruptcy Institute. He joined the firm as an associate in 2010.

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Lindsey R. Johnson practices primarily in the areas of business law, bankruptcy and real estate litigation. She earned her Juris Doctor degree, Cum Laude, from Thomas M. Cooley Law School, where she served as a subcite editor of the Thomas M. Cooley Law Review, teaching assistant for the scholarly writing course, and a recipient of the Eugene Krasicky Award. While a student at Thomas M. Cooley Law School she authored Legislators and Grandparents, May I Have Your Attention: There is No Time for Grandparenting Time! A Casenote Focusing on the Michigan Court of Appeals Decision in DeRose v. DeRose, 19 Thomas M. Cooley L. Rev. 387 (April 1, 2003). She is licensed to practice in Michigan and her professional affiliations include the State Bar of Michigan, and Oakland County Bar Association - ADR Section. She joined the firm as an associate in 2011.

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Anne E. Linder is an associate in the firm's Defense Practice and Insurance Coverage Group. She earned her Juris Doctor from the University of Michigan Law School in 2005, and her bachelor of arts cum laude from Bates College in 2000. Prior to joining Maddin Hauser, Anne spent five years practicing reinsurance litigation and arbitration in Washington, D.C.

Thomas W. Werner joined the firm in 2011 as an associate in the firm's Defense and Insurance Coverage litigation group. In 2004, Tom graduated with honors from the Indiana University School of Law – Bloomington, where he served as Notes and Comments Editor to the Federal Communications Law Journal. He also served as clerk to the City of Bloomington legal department, where he aided in municipal litigation before multiple courts, including the Indiana Supreme Court. Before joining the firm, Tom concentrated his practice on commercial litigation, insurance coverage, and defense of product liability actions throughout the country. Tom has been twice published, and has made several professional presentations, including seminars teaching clients how to properly communicate and draft contracts in order to avoid litigation. Tom is admitted to practice before all courts in the State of Michigan, and before the United States District Courts for the Eastern District of Michigan, the Western District of Pennsylvania, and the Northern District of Indiana.

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