TWENTY-FIRST
ANNUAL TAX SYMPOSIUM

November 10, 2012
SHERATON DETROIT NOVI
NOVI, MICHIGAN

PRESENTED BY THE LAW OFFICES OF
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November 10, 2012

Dear Tax Symposium Participant:

Welcome to our Twenty-First Annual Tax Symposium. As we prepare for this year's program we are struck by the many uncertainties that we, as tax practitioners face. Presumably by the time you read this, the Presidential election will be decided (unless there is a re-run of the 2000 election). However, even with the knowledge of who is the President and which party controls Congress, the tax environment will remain uncertain.

Will the Bush tax cuts be allowed to expire? What will the estate tax exemption amount be set at? Will millionaires pay a higher rate of tax? What deductions and "tax loop holes" may be capped or eliminated? Will health care reform be reformed? The simple and somewhat whimsical response is; if we knew the answer to these questions, we wouldn't have to "slug it out" as tax practitioners.

So where does that leave us? The only certainty we have is what the tax law will be in 2012. It leaves us, however, with the responsibility to educate our clients on the options and opportunities available during 2012 and the spectrum of what the tax environment might be in 2013 and years thereafter. A crystal ball would certainly help.

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,
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TWENTY-FIRST ANNUAL TAX SYMPOSIUM PROGRAM

** Seminar Qualifies for Four CPE Credits **

IDENTIFYING WAGE & HOUR COMPLIANCE ISSUES

By: Ronald A. Sollish, Esq.

I. COMMON QUESTIONS

A. Do I have to pay my salaried employees overtime?

B. Is every minute an employee spends at work compensable time?

C. When do I have to pay an employee overtime?

D. Can I give an employee "comp time" instead of overtime pay?

E. What are the proposed changes to the "white collar" exemptions to the Fair Labor Standards Act?

II. A BRIEF HISTORY OF WAGE AND HOUR LAWS

A. What are the primary laws which regulate payment of wages and fringe benefits in Michigan?

1. Federal Law: Fair Labor Standards Act of 1938 ("FLSA")

2. Michigan Law: Minimum Wage Act of 1964 ("MMWA")

3. Michigan Law: Wages and Fringe Benefits Act ("MWFBA")

B. Background

1. Fair Labor Standards Act:

a. The FLSA was enacted in 1938 and has subsequently been modified through amendments or enactments of related acts approximately two dozen times since the Act was initially passed. The first minimum wage provided by the FLSA was $0.25 an hour in 1938 and was most

recently increased in 2004 to $7.25 per hour. Michigan utilizes a minimum wage of $7.40 per hour, which generally controls. The FLSA initially only applied to employees engaged interstate commerce. The Act now applies to nearly all employees and has been extended to cover employees engaged in large retail and service enterprises, local transit, construction, gas stations, hospitals, nursing homes, schools, laundries, dry cleaners, hotels, motels, restaurants, and farms.

b. The FLSA was enacted to govern payment of overtime wages, create record-keeping requirements for hours worked by employees, and to prevent exploitation of child labor.

c. The FLSA does not regulate the following:

i. Vacation, holiday, severance, or sick pay;

ii. Meal or rest periods, holidays off, or vacations;

iii. Premium pay for weekend or holiday work;

iv. Pay raises or fringe benefits; and

v. Discharge notices, reason for discharge, or immediate pay of final wages to terminated employees.

2. Michigan Minimum Wage Act of 1964: The Act was passed in 1964 in order to regulate overtime, record-keeping, and use of child labor by any employers which fall outside of the scope of the FLSA.

3. Michigan Wages and Fringe Benefits Act:

a. The Act (in its modern form) was enacted in 1978.

b. The Act does not regulate the amount of wages paid, but provides procedures for the time when wages are to be paid and governs the payment of fringe benefits to employees.

III. APPLICATION OF THE FLSA AND THE MICHIGAN MINIMUM WAGE ACT ("MMWA")

A. Who is an "employer" under the FLSA?

An "employer" is defined as "any person acting directly or indirectly in the interest of an employer in relation to an employee and includes a public agency, but does not include any labor organization (other than when acting as an employer) or anyone acting in the capacity of officer or agent of such labor organization."

B. What industries are covered?

1. Generally: All employees of enterprises having workers engaged in interstate commerce, producing goods in interstate commerce, or handling, selling, or otherwise working on goods or materials that have been moved in or produced for such commerce (referred to as "covered enterprises"). These "covered enterprises" have been extended to include not only businesses engaged in production of goods for interstate commerce, but also employed by a business engaged in any closely related process or occupation which is directly essential to such production, including employees who work in communications or transportation, regularly use the mails or telephones for interstate communication, keep records of interstate transactions, regularly cross state lines in the course

of employment, or work for employers who contract to do clerical, custodial, maintenance, or other work for firms engaged in interstate commerce or in the production of goods for interstate commerce.

2. In 1990, additional requirements for determining whether an employer is a “covered enterprise”, and therefore subject to the FLSA, were added. These requirements provide that:

   A covered enterprise is defined as the related activities performed through unified operation or common control by any person or persons for a common business purpose, and

   a. whose annual gross volume of sales made or business done is not less than $500,000.00; or

   b. is engaged in the operation of a hospital, an institution primarily engaged in the care of the sick, the aged, or the mentally ill who reside on the premises; a school for mentally or physically disabled or gifted children; a preschool, an elementary school or secondary school, or an institution of higher education (whether operated for profit or not for profit); or

   c. is an activity of a public agency.

3. Grandfather Clause: Any enterprise that was covered by the FLSA on March 31, 1990, and that fell outside of the act because of the new $500,000.00 test, remains subject to the overtime pay, child labor, and recordkeeping provisions of the FLSA.

C. Where does the MMWA fit in?

1. It is the rare local exception which falls outside of the FLSA. In such cases, the MMWA (the provisions of which mirror the FLSA, including exemptions from coverage) applies.

2. The MMWA covers all employers not covered by the FLSA and defines employers as "a person, firm, or corporation, including the state and its political subdivisions, agencies, and instrumentalities, and a person acting in the interest of the employer, who employs twi or more employees at any one time within a calendar year." An employer shall be subject to this act during the remainder of that calendar year.

IV. MINIMUM WAGE REGULATIONS

A. All employees must be paid the minimum wage set by federal law unless your business is one of those that falls outside the scope of the Fair Labor Standards Act. The current minimum wage is $7.40 per hour. However, there is a youth minimum wage of $4.25 per hour which may be paid to employees under the age of 20 years old during the first 90 consecutive calendar days of employment with the employer. Employers may not displace employees in order to hire other employees at the youth minimum wage. Michigan provides for a youth minimum wage of 85% of the adult minimum wage.

The most common minimum wage issues which arise are listed below.

B. Average Wages Over a Work Week. The earnings of employees paid by the hour or by the piece cannot be averaged over any time period longer than a work week. Amounts earned in excess of the minimum wage during one work week cannot be used to offset amounts earned below the average in another work week.

C. Employees Paid in Whole or in Part on Commission.

1. Commission as sole compensation. Payments to the employee for each work week must satisfy the minimum wage requirement for that work week.

2. Commission and hourly wages. If an employee is paid part of the work week on a hourly basis and part of the work week on a commission basis, the employer may not average the wages earned while being paid hourly to make up for a deficiency in earnings while the employee is being paid on commission.

3. Payment of commissions on a monthly basis. An employer may pay commissions on a monthly as opposed to a weekly basis. However, the computation of hours worked and the employee's earnings must be done on a work week basis, and the employee must be paid at least the minimum wage for all hours worked during a work week on the pay day for that work week.

4. Effect of a draw against commissions. An employer may allow employees to draw against their future commissions. However, the employer cannot use that draw to offset the required payment of the minimum wage for that work week.

D. Employees Paid in Whole or in Part Based on Production Quantity. For employees paid by the piece, or a combined hourly wage plus a piece rate, the calculation to determine if the minimum wage requirements are satisfied is based upon a regular 40-hour work week. If the average hourly earnings of the employee for non-overtime hours in each work week satisfy, equal or exceed the minimum wage then the requirements are satisfied for that work week.

For employees who split time between jobs paid at an hourly wage and jobs paid by the piece, the hourly rate must equal or exceed the minimum wage and the average hourly rate for the time spent working at the piece work must equal or exceed the minimum wage.

E. Employees Paid in Part by Tips. Tipped employees are those employees who regularly receive more than $30.00 per month in tips. An employer may consider tips received by an employee as part of the employee's wages, but the employer must pay the employee at least $2.13 per hour in actual wages. (The MMWA increases this amount to $2.65 per hour.) If an employer elects to credit tips towards the minimum wage, the employer must inform the employee prior to crediting tips. In the event an employee's direct wages of $2.13 and credited tips do not equal at least the minimum wage, then the employer must make up the difference. Other tipping issues include:

1. Proof of amount of tips received. The burden is on the employer to determine the amount of tips actually received. The employer may not rely exclusively upon the amount of the business generated at a particular table or tables, because, barring other evidence, there is no absolute correlation between the revenue generated and the tips received.

2. Tip pooling. Tip pooling arrangements are permissible and the employer may take the minimum wage percentage exemption for tipped employees if all members of the pool are employees who regularly receive tips. The pool cannot include employees who do not receive tips unless the employees voluntarily pool their tips.

3. Time spent on other work. If an employee spends time on work for which tips are not customarily given, in most cases, the employee must be paid the full minimum wage for such time.

4. Deductions for walkouts, cash shortages, etc. An employer may not make a deduction from an employee's wages which would result in the employee earning less than the required minimum wage. Thus, if an employer sought to pass along the amount of a cash shortage to an employee, the employer may only make such a deduction to the extent that the employee's wages exceed the minimum wage. For this purpose the employer cannot argue that the employee receives tips which make the employee's wages greater than the required minimum wage.

F. Permissible Deductions from Wages. An employee must be paid the required minimum wage "free and clear." This means that deductions from wages which the employer may wish to impose cannot be taken if the effect is to lower the employee's wage below the required minimum wage.

1. Permissible deductions. An employer may deduct the fair value of board, lodging or "other facilities."

a. "Other facilities" are items that are "like board or lodging" including meals furnished at company cafeterias, housing, merchandise from a company store or commissary, utilities for company supplied housing, and transportation provided to and from work. "Other facilities" do not include such items as trade tools, laundering of uniforms, sleeping facilities for employees required to be on duty, meal expenses for employees on the job, and transportation during the course of employment.

b. The amount of the deduction cannot include any profit to the employer or an affiliate. The cost can include

adequate allowances for depreciation and interest (not more than 5.5%) on the invested capital, but in no event may the cost exceed the fair market value for the item.

2. Other permissible deductions. An employer may deduct the cost of certain other items/benefits from an employee's wages provided that the deduction does not work to reduce the employee's wages below the required minimum wage. Thus, an employer may deduct the cost of providing uniform cleaning, cash register shortages, mathematical errors or non-paying customers.

3. Uniforms. If an employer requires employees to pay for a uniform from the employee's wages, THE DEDUCTION IS PERMITTED, IF THE DEDUCTION does not reduce the employee's wages below the applicable minimum wage or reduce the required payment of overtime wages. An employer may require a prospective employee to purchase a uniform in advance, but the employee must be reimbursed that portion of the cost of the uniform which would result in the employee earning less than the required minimum wage or overtime compensation. The employer may deduct the cost over several pay periods to avoid this problem. The cost of cleaning the uniforms (unless the uniforms can be washed in the same manner as the employee's personal clothing) must be paid by the employer unless the employer is paying the employees an amount sufficiently in excess of the minimum wage so that the cleaning cost would not have the effect of reducing the employee's wages below the required minimum wage.

V. OVERTIME COMPENSATION

A. Overtime Rate. Federal law requires employers to pay non-exempt employees overtime wages at a rate not less than 1 1/2 times their regular rate of pay for each hour or fraction of an hour worked by the employee in excess of 40 for any given work week. No overtime is required for hours worked in excess of normal time for a particular day, or for work on Saturdays, Sundays or holidays.

B. Requirements Cannot be Waived. The overtime requirements cannot be waived by an employee, and cannot be overridden by an employment contract which prohibits the employee from working overtime where both the overtime worked and the employee's duties are known to the employer.

C. Overtime Calculated on a Work Week Basis. The calculation as to whether an employee worked any overtime is determined by the work week basis. An employer is not required to pay overtime wages on a weekly basis. The employer must pay the overtime wages in the pay period applicable to the period worked. If it is not possible to determine the overtime worked before the regular pay day the employer may pay the overtime wages as soon as possible thereafter.

D. Calculation of Hours Worked. The determination as to whether an employee is "working" is not always easy. In the absence of a contract, custom or practice to pay for such items, time spent by employees in reaching their work stations, and time spent by employees in preparing to work or leave from work need not be considered work time.

E. Waiting Time. Employees who are engaged to work such as the receptionist who reads a magazine waiting for the phone to ring must be paid for such time. However, employees who are waiting to work

such as the workers who arrive at the factory before it is open are not compensated for such time.

F. On Call Time. An employee who must remain on call while on the employer's premises must be compensated for such time. An employee who is on call at home, or is allowed to call in for messages, is not entitled to be compensated for such time.

G. Travel Time. An employee's ordinary travel from home to work and work to home is not compensable time. When an employee works at a fixed location and is required to travel to another city on a temporary basis, then the travel time is work and must be compensated. Finally, where an employee travels as part of the employee's principal work activity, then such travel time must be compensated.

H. Unauthorized Overtime. If an employer knows and permits an employee to work beyond his or her normal work hours, the employer must pay wages at the applicable rate to the employee even if the employer has a written policy prohibiting overtime or unauthorized work.

I. Lunch/Dinner Breaks. Generally, time provided for meals is not work time requiring compensation. Barring special exceptions, a meal period must be at least 30 minutes long and the employee must be completely relieved from duty. The employee should be able to leave his or her work station. If meal periods are frequently interrupted for work requirements, then the entire period is compensable time.

J. Rest/Coffee Breaks. Employers are not required to grant rest or coffee breaks. If such breaks are granted, they count as compensable work time if 20 minutes or less and cannot be offset against other types of work time. The general idea is that such breaks promote employee efficiency and thus benefit the employer.

K. Time Spent in Meetings/Training. Time spent attending training programs, meetings or lectures need not be counted as hours worked if the following criteria are met:

1. The meetings take place outside normal working hours;
2. Attendance is truly voluntary;
3. The meeting, lecture, etc., is not directly related to the employee's job; and
4. The employee does not do productive work during the meeting.

L. Use of "Comp" Time in Lieu of Paying Overtime. An employer may not trade "comp" time for overtime under the FLSA (unless the employer is a public agency). Employers who are not subject to the FLSA may provide for “comp” time pursuant to the MMWA if the time off is given at the rate of 1 ½ hours off per hour of overtime, there is a written comp time agreement between employer and employee before the overtime work is performed, and comp time does not exceed 240 hours per year. Currently, bills are pending in Congress that would permit workers to elect to accept time off from work instead of accepting overtime pay. However, such bills have yet to be enacted into law.

VI. WHAT IS AN EMPLOYEE’S REGULAR RATE OF PAY FOR DETERMINING OVERTIME?

A. Various types of compensation (other than actual wages) must be included in calculating an employee's "regular rate" for overtime purposes. These forms of compensation include:

1. Awards or prizes received based on the quality, quantity or efficiency of work performed;
2. Bonuses based on the quality, quantity or efficiency of work performed;

3. Bonuses that depend on hours worked;
4. Commission payments;
5. Payments for meals, lodging and other facilities;
6. Shift differentials or "dirty work" premiums; and
7. Tip credits taken by an employer to fulfill minimum wage requirements.

B. In calculating an employee's regular wage rate, employers do not need to take into account additional compensation consisting of the following:

1. Discretionary bonuses;
2. Gifts and certain employee benefit plan contributions;
3. Employee referral bonuses;
4. Paid leave from work;
5. Severance pay;
6. Subsistence pay;
7. Talent fees; and
8. On-call or call-back pay.

C. For employees which are paid on a piece rate, commission, salary or other non-hourly basis, the compensation must be converted to an hourly rate which is usually done by dividing the work week compensation by the number of hours worked.

VII. EXEMPTIONS FROM MINIMUM WAGE AND OVERTIME REGULATIONS

A. The FLSA provides an exemption from both minimum wage and overtime rules for “any employee employed in a bona fide executive, administrative, or professional capacity . . . or in the capacity of an outside salesman.” These are typically called the “white collar” exemptions and are defined by DOL regulations. They do not apply to manual laborers or other “blue collar” workers who perform work

involving “repetitive operations with their hands, physical skill and energy.”

B. General Rules

1. For the purpose of the exemptions, “salary basis” means an employee regularly receives a predetermined amount of compensation each pay period on a weekly, or less frequent, basis. If the employee is paid an agreed sum for a single job, regardless of the time required for its completion, the employee will be considered to be paid on a “fee basis.”

2. Deductions from pay are permissible when an exempt employee:

   a. Is absent from work for one or more full days for personal reasons other than sickness or disability;

   b. For absences of one or more full days due to sickness or disability if the deduction is made in accordance with a bona fide plan, policy or practice; or

   c. To offset amounts employees receive as jury or witness fees, for military pay; or for certain workplace penalties.

3. The employer will lose an exemption if it has an “actual practice” of making improper deductions from salary (there is, however, a safe haven available to employers).

C. Exemptions for Executives.

1. An employer is not required to pay overtime wages to "executives." The following test can be used to determine if a particular employee qualifies as an "executive" for this purpose (NOTE: All of the factors must be met):

a. The employee's primary duty must be the management of the enterprise or a recognized division or subdivision;

b. The employee must customarily and regularly direct two or more other employees;

c. The employee must have authority to hire and fire employees or the employee's recommendations as to hiring, firing, promotions, pay or other aspects of the employment status of other employees must be given particular weight; and

d. The employee must be paid on a salary basis and earn not less than $455.00 per week (less if employed in American Samoa).

2. The executive employee exemption also applies to any employee who owns at least a 20-percent equity interest in the enterprise in which the employee is employed, and who is actively engaged in its management (irrespective of the other requirements).

D. Exemptions for Administrators.

1. An employer is not required to pay overtime wages to administrative employees. An "administrative" employee is someone who satisfies ALL of the following criteria:

a. His or her primary duty is the performance of office or non-manual labor directly related to management policies or the general business operations of his or her employer or the employer's customers. (NOTE: Special definitions and rules apply for persons employed in an

administrative capacity by educational institutions which are not addressed in these materials.);

b. He or she customarily and regularly exercises discretion and independent judgment;

c. The employee is paid on a salary or fee basis at a rate of not less than $455.00 per week (less if employed in American Samoa).

2. The phrase “directly related to the management or general business operations” refers to the type of work performed by the employee. To meet this requirement, an employee must perform work directly related to assisting with the running or servicing of the business, as distinguished from working on a manufacturing production line or selling a product in a retail or service establishment.

3. The most difficult clause to interpret is that requiring an employee to “exercise discretion and independent judgment.” Insurance claim adjusters, tax experts, and employees in the financial services industry are examples of positions that will generally qualify for the administrative exemption. Those doing ordinary inspection or screening work will generally not qualify.

E. Exemptions for Professionals.

1. Exemptions to the overtime pay laws also exist for employees who are "professionals." An employee may qualify as a "professional" if the following criteria are satisfied:

a. The employee's primary duty is either:

(i) Performing work requiring advanced knowledge in a field of science or learning customarily acquired

by a prolonged course of learning ("learned professionals"); or

(ii) Performing original or creative work in an artistic field ("creative professionals");

b. The employee receives a salary or fees at a rate of not less than $455.00 per week (less if employed in American Samoa).

2. This creative professional exemption is generally met by actors, musicians, composers, and sometimes journalists. However, the exemption depends on the extent of the invention, imagination, originality, or talent exercised by the employee.

3. Separately, the rules exempt teachers as well as licensed attorneys and doctors.

F. Exemption for highly-compensated workers.

1. The regulations contain a separate rule for highly-compensated workers. A highly-compensated employee is deemed exempt if the ALL of the following apply:

a. The employee be paid total annual compensation of $100,000 or more (which must include at least $455 per week paid on a salary or fee basis);

b. The employee performs office or non-manual work; and

c. The employee customarily and regularly performs at least one of the duties of an exempt executive, administrative or professional employee identified in the standard tests for exemption.

2. For example, an employee can qualify as an exempt highly-compensated employee if the employee customarily and regularly directs the work of two or more other employees, even though the employee does not meet all of the other requirements for the executive exemption. (NOTE: while the new rule requires only that the employee satisfies one of these duties, the rule demands that the employee customarily and regularly perform these duties.)

3. The regulations include a requirement for those exempt as highly-compensated employees to have a salary of $100,000 a year or almost $2,000 per week. Total annual compensation includes salary, commissions, nondiscretionary bonuses, and other nondiscretionary compensation even if not paid out to the employee as due on at least a monthly basis.

H. Computer Employees

1. Regulations extend the application of the "professional" exemption to certain computer related jobs and fields. To qualify for the computer employee exemption, the following must be met:

a. The employee must be compensated either on a salary or fee basis at a rate not less than $455 per week or, if compensated on an hourly basis, at a rate not less than $27.63 an hour; and

b. The employee’s primary duty consists of on of the following;

(i) The application of systems analysis techniques and procedures;

(ii) The design, development, documentation, analysis, or modification of computer systems or programs; or

(iii) A combination of the aforementioned duties, the performance of which requires the same level of skills.

2. Although job titles are not determinative of the applicability of this exemption, the regulations specifically state that “computer systems analysts, computer programmers, software engineers [and] other similarly skilled workers” are eligible for the exemption.

3. The computer employee exemption does not include employees engaged in the manufacture or repair of computer hardware and related equipment.

I. Exemptions for Outside Salespersons.

1. An exemption from the overtime wage laws also exists for employees who are "outside salespersons." The criteria for determining if an employee qualifies as an “outside salesperson” are as follows:

a. The employee’s primary duty must be making sales, or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and

b. The employee must be customarily and regularly engaged away from the employer’s place or places of business.

NOTE: The salary requirements of the regulation do not apply to the outside sales exemption. However, an employee who does not satisfy the requirements of the outside sales exemption may still qualify as an exempt employee under one of the other exemptions.

VIII. CHILD LABOR REGULATIONS

A. The FLSA places certain restrictions on the employment of persons under the age of 18. Children aged 16 and 17 are prohibited from working in hazardous occupations, and children aged 14 and 15 are limited in the hours they may work. Children under the age of 14 generally cannot be employed at all except for entertainment/performing arts, newspaper delivery and by their parents if they are sole proprietors of a business.

B. Hazardous Occupations for 16 and 17-Year Olds include:

1. Jobs in plants where explosives, or goods containing explosives, are handled or stored;

2. Driving motor vehicles except when the driving is only occasional and incidental to the job; and only if the vehicle is less than 6,000 pounds;

3. Mining;

4. Any equipment operation in a sawmill;

5. Any job requiring the operation of any woodworking machine;

6. Any job involving exposure to radioactive materials (watch for x-ray equipment);

7. Any job requiring the operation of power lifting equipment including elevators;

8. Any job requiring the operation of power metal forming tools;

9. Any job requiring the operation of power meat cutting tools including slicers used at deli counters;

10. Any job requiring the operation of power baking machines;

11. Any job requiring the use of power paper making/recycling machines;

12. Any job involved in the manufacture of brick, tiles or similar products;

13. Any job requiring the use of a circular or band saw or guillotine shears;

14. Any job involving the wrecking/demolition of buildings;

15. Any job involving the building of ships;

16. Any job involving the application of materials to roofs; and

17. Any job involving excavation work.

C. Hazardous Occupations for 14 and 15-Year Olds include:

1. Any occupation/job listed in B above;

2. Any job involving duties in work rooms where goods are manufactured, mined or processed (i.e., factory or shop floor jobs);

3. Public messenger services;

4. Helpers on motor vehicles; and

5. Jobs other than office or sales work pertaining to the transportation of persons or goods, warehousing or storage, communications, public utilities, and construction. (NOTE: Any

office/sales work pertaining to construction must be conducted off-site.)

D. Permissible Occupations for 14 and 15-Year Olds include:

1. Office/clerical work;

2. Cashier, sales, modeling, art work, work in advertising, window trimming/display, comparative shopping, price marking, assembling orders, packing and shelving;

3. Bagging and carrying out customers' orders;

4. Errands/delivery work if done on foot, bike or by public transportation;

5. Clean-up work (may operate a vacuum or floor waxer);

6. Outdoor maintenance, but may not use a power mower or cutter;

7. Kitchen/food prep work (including use of small machines such as milk shake makers, pop corn poppers, toasters, dumbwaiters, dishwashers, and coffee makers and grinders);

8. Dispensing gas/oil for cars and trucks, car cleaning/waxing, general courtesy service (washing windows, etc.); and

9. Cleaning fruits and vegetables, wrapping, labeling, and/or pricing food if in an area away from where meat is prepared for sale, and away from freezers.

E. Specifically Prohibited Jobs for 14 and 15-Year Olds include:

1. Any job in a boiler room;

2. Any job repairing or maintaining equipment;

3. Any job washing exterior windows requiring work from window sills or on a ladder/scaffold;

4. Any cooking or baking job except at soda fountains, lunch counters, snack bars or cafeteria serving counters;

5. Any job relating to the use or operation of food slicers, grinders, choppers and bakery mixers;

6. Any job requiring work in a freezer or meat cooler;

7. Any job involving the loading or unloading of goods from trucks, railroad cars or conveyers; and

8. Any job in a warehouse except for office work.

F. Restrictions on Hours Worked by 14 and 15-Year Olds include:

1. Must be outside school hours;

2. No more than 3 hours a day on a school day, and no more than 8 hours on a non-school day;

3. No more than 18 hours a week during any school week, and no more than 40 hours during a non-school week; and

4. No work before 7:00 a.m. and no work after 7:00 p.m., except from June 1 through Labor Day the child may work until 9:00 p.m. unless those are school days.

IX. RECORDKEEPING REQUIREMENTS

A. Employers are required to maintain records to establish their compliance with minimum wage, overtime, equal pay and child labor laws. These records for non-exempt employees must include the following:

1. Name used for social security purposes;

2. Home address;

3. Date of birth if under age 19. The burden is on the employer to prove the employee is not a minor if there is a question;

4. Sex and occupation;

5. The time and day on which each work week begins;

6. The employee's regular rate of pay for every week in which overtime pay is owed. This should be detailed enough so that it can be determined how the overtime wage is calculated;

7. The amount and nature of any regular rate exclusions;

8. The employee's wage, salary or earnings for each pay period;

9. The hours worked for each workday and work week including starting and ending times each day;

10. All "straight time earning" including all wages for regular hourly work, piece rates, commissions and/or salary;

11. All overtime pay;

12. Any deduction/addition to wages;

13. Pay dates and pay periods covered; and

14. The total wages paid each employee for each pay period.

B. Records for exempt employees do not have to be as detailed. These records must include the following:

1. The basis on which wages are paid;

2. Total pay including fringe benefits; and

3. Records sufficient to establish requirements of the exemption.

C. Preservation of Records.

1. Generally, employers should keep payroll and other required records for at least three years. Employers should also preserve any collective bargaining agreements and any documents pertaining to any deduction from wages for the same three-year period.

2. Records from which the above are taken, such as timecards, production cards, wage rate tables, work schedules, and order/shipping/billing records, must be kept two years from the last effective date.

3. Records should be kept at the place of business or a central records office. Records must be available within 72 hours after receipt of a notice from a Wage Hour administrator.

D. Posting Requirements.

Employers who employ anyone subject to the minimum wage requirements must post a notice published by the Wage Hour Division.

E. Telecommuting Employees.

1. Although no new amendments have been enacted to address telecommuting employees (those employees who work off the job site via computer), the FLSA has always provided for regulation of off-site workers as “Industrial Homeworkers.” An industrial homeworker is a person who produces industrial homework which is defined as “the production by any person in or about a home, apartment, tenement, or room in a residential

establishment of goods for an employee who suffers or permits such production, regardless of the source (whether obtained from an employer or elsewhere) of the materials used by the homeworker in such production. 29 CFR §516.31(a).

2. "Goods" which are produced by industrial homeworkers include wears, products, commodities, merchandise, or articles or subjects or commerce of any character, or any ingredient thereof . . ." This definition extends to intangibles, such as ideas, telegraphic messages, newspapers, magazines, reports, or insurance policies. 29 CFR §776.20.

3. All minimum wage, overtime, and record keeping requirements under the FLSA apply to homeworkers. However, additional recordkeeping requirements also apply. The following additional records must be maintained for homeworkers:

   a. Date on which work is given out to worker, or begun by a worker, and amount of such work given out or begun.

   b. Date on which work is turned in by worker, and amount of such work.

   c. Kind of articles worked on and operations performed.

   d. Piece rates paid, if applicable.

   e. Hours worked on each lot of work turned in.

   f. Wages paid for each lot of work turned in.

4. Industrial homeworkers must also maintain a homeworker handbook. The handbook must be obtained by the employer from the U.S. Department of Labor and supplied to each homeworker. It is the employer's responsibility to insure that

the hours worked and other information required is entered by the homeworker in the handbook. The handbook must remain in the possession of the homeworker except at the end of each pay period when it is returned to the employer. The handbook (when full) must contain a written verification by the employer attesting that the homeworker was instructed to accurately record information in the handbook. All handbooks must be maintained by the employer for at least two years after completion.

X. PENALTIES FOR VIOLATION OF WAGE AND HOUR LAWS

A. Civil Actions by the U.S. Department of Labor. Generally, the Department of Labor may take action to enforce the provisions of the Fair Labor Standards Act. This is commonly done by bringing a civil action to recover back wages and an equal amount as liquidated damages on behalf of harmed employees. Additionally, suit may be brought for injunctive relief to restrain further violations or to prevent the sale or transportation of "hot goods" (those produced in violation of the Fair Labor Standards Act). The injunction obtained, if any, remains in effect indefinitely and exposes the employer to contempt penalties if violated.

1. A civil penalty of up to $1,000.00 per violation may be imposed if the employer repeatedly or willfully violates the minimum or overtime wage requirements.

2. A civil penalty of up to $10,000.00 per employee may be imposed.

B. Criminal Actions by the Department of Justice. The Department of Justice may bring criminal charges against employers who willfully violate the Fair Labor Standards Act.

1. The penalty for a first offense is a fine of up to $10,000.00. A second conviction can include prison time for up to six months.

2. A criminal conviction may result from violation of the "hot goods" provisions if the defendant knows that it is doing business with companies that are violating the act.

3. The number of violations does not necessarily depend on the number of employees affected or the time periods covered. Thus, the failure to pay the required minimum wage is only one violation of the act. However, the failure to pay the required overtime wage can be a second violation, and the failure to keep the required records can be a third violation.

4. Criminal liability for willful violations rests with the employer and its officers.

C. Lawsuits by Employees. Employees may individually or collectively bring an action to require compliance with the Fair Labor Standards Act.

1. Suits can recover any unpaid wages plus liquidated damages in an equal amount.

2. Attorney fees are also recoverable.

3. An employer may enter into an out-of-court settlement with an employee. However, unless the settlement is supervised and approved by the Department of Labor, the employee can later reject the settlement.

4. Good faith defenses exist if the employer is acting in compliance with a written ruling from the Wage Hour administrator even if the ruling is later determined to be improper. The employer may avoid the liquidated damage

aspect if it establishes that the failure to comply with the act was in good faith and that reasonable grounds existed for believing that no violation took place.

XI. HOT GOODS, TELECOMMUTING, AND OTHER MISCELLANEOUS ISSUES

A. Prohibition against the Sale/Shipment of "Hot Goods." The FLSA prohibits the shipment of goods in interstate commerce which were produced in violation of the overtime, minimum wage, or child labor provisions of the act. Such goods are deemed “hot goods.”

1. Goods Produced with Oppressive (Illegal) Child Labor. No producer, manufacturer or dealer may ship any goods produced within the United States if within 30 days of the shipment the producer of the goods employed oppressive child labor. However, any purchaser who acquires the goods in good faith, for value, and without notice of the producer's use of oppressive child labor, may ship the goods if the purchaser has written assurance from the producer, manufacturer or dealer that the goods were produced in compliance with the requirements of the Fair Labor Standards Act.

2 Goods Produced by an Employer Who Fails to Comply with Minimum Wage and Overtime Laws. The same prohibition applies to the shipment or sale of goods where the employer producing the goods fails to comply with the minimum wage and overtime requirements of the Fair Labor Standards Act. However, a good faith purchaser who acquires the goods for value and without notice of the violation may transport/sell the goods if the purchaser has written assurance from the producer that the goods were produced in compliance with the Fair Labor Standards Act.

3. Janitorial Services. One way employers may unwittingly violate the FLSA results from janitorial service contracts. Janitorial service contractors, which often employ workers who perform their jobs at night without close scrutiny, are forced to work without overtime pay, or without lunch breaks, in violation of the FLSA. In addition, the workers are frequently assigned so high a volume of work that they are forced to enlist the aid of family members (and often minors) to complete their assignment. These additional helpers become workers subject to the FLSA, and thereby implicate the minimum wage and child labor provisions. If the building owner or tenant directs the janitorial service when and how to clean, the owner or tenant company may become a joint employer of the janitors as determined by the Department of Labor. Accordingly, the owner or tenant company may be imputed with a violation of the FLSA and (in extreme cases) may be held to violate the hot good prohibitions of the FLSA and subject the employer to an injunction prohibiting the transportation of such goods.

B. Overtime Liability for Telecommuters. Because telecommuters perform their work off of the employer's job site, and are unsupervised, there is potential liability to the employer for unapproved overtime. The FLSA requires compensation for overtime regardless of whether the employer approved the overtime work. Therefore, it is necessary that the employer and telecommuting employee define their relationship up front through an agreement providing for expected hours of work, methods of communication, and pre-approval for overtime work. Monster.Com quoting Workforce Online, February 1999.

C. Use of Independent Contractors. Employers are increasingly using independent contractors, rather than hiring employees, because of the

financial benefits resulting from the fact that employers do not have to provide benefits to independent contractors. However, in the rush to hire independent contractors to perform more and more functions for the employer, employers must beware not to blur the lines between an employee and an independent contractor. It is important to determine whether a worker is an employee or an independent contractor because the minimum wage and overtime provisions of the FLSA apply only to employees. The following questions are asked by the U.S. Department of Labor in determining whether an individual is an independent contractor and not subject to the Act:

1. How much control does the employer exert over the worker? The employer should not control when or for what period of time the independent contractor works, nor should the employer control the manner in which the contractor completes the work assigned.

2. What is the worker's opportunity for gain or loss? The independent contractor should bear the risk of loss or gain depending on the success of the project.

3. Does the worker have any special talents or skills that set the worker apart from the employer organization? Independent contractors should be hired to provide services which the employer's workers cannot typically perform.

4. Does the worker bring his or her own tools to the job site?

5. What is the permanence of the working relationship between the independent contractor and the employer? Is the relationship limited for a short period of time and for one project, or is the relationship continuing both in projects and time?

6. Are the services rendered by the worker an integral part of the employer's business operations? Generally speaking, an independent contractor will not perform primary functions for the hiring organization, i.e., management of the company.

D. Stock Options.

1. The value of stock options for non-exempt employees were formerly included in calculating the regular rate of pay of a non-exempt employee for the purposes of determining overtime pay. Recent amendments to the FLSA were passed excluding income from stock options, stock appreciation rights, or employee stock purchase plans from calculation of the overtime rate in certain circumstances. In order for a stock option compensation to be excluded from an overtime calculation, the following requirements must be met:

   a. The employer's stock option plan must require the employee to hold the stock for at least six months before cashing in the stock;

   b. The plan must require the option price to be at least 85 percent of the market price for the stock when the option is granted;

   c. The employee's participation in the plan must be voluntary; and

   d. The terms of the plan must be disclosed to the employee.

2. Plans which existed prior to August 16, 2000, are protected from FLSA overtime liability if the stock options meet the following requirements:

a. The stock options were obtained prior to August 16, 2000.

b. The stock options were issued to employees within one year of August 16, 2000; or

c. The stock options are part of a collective bargaining.

XII. MICHIGAN WAGES AND FRINGE BENEFITS ACT

A. The MWFBA regulates the timing of payment of wages to employees and the payment of compensation other than wages. The MWFBA applies to all "employers," which term is broadly defined as "an individual, sole proprietorship, partnership, association, or corporation, public or private; this state or an agency of this state; a city, county, village, township, school district, or intermediate school district; an institution of higher education; or an individual acting directly or indirectly in the interest of an employer who employs one or more individuals."

B. The term "fringe benefits" is defined as "compensation due an employee pursuant to a written contract or written policy for holidays, time off for sickness or injury, time off for personal reasons or vacation, bonuses, authorized expenses incurred during the course of employment, and contributions made on behalf of an employee."

C. Time for Payment of Wages. An employer must pay employees based on a regular schedule. Permissible schedules are as follows:

1. On or before the 1st and 15th of each month provided that the payments encompass wages earned during the 15 days of the preceding calendar month for the payment on the 1st of the month, and during the preceding calendar month from the 16th through the last day of the month for the payment on the 15th.

2. Weekly or bi-weekly so long as the wages are paid on a regularly recurring payday and the payday occurs on or before the 14th day following the end of the work period in which wages were earned.

3. Monthly provided that the employer pays the employee on or before the first day of each calendar month for all wages earned in the preceding month.

D. Voluntarily Terminated or Discharged Employees. An employer may not withhold fringe benefits which are to be paid at the employee's termination date unless there is a written contract or statement providing for such withholding. Upon termination of the employment relationship, the employer is required to pay the employee all wages earned and due as soon as the amount can be determined through the exercise of due diligence.

E. Form of Payment. Payment of wages must be made in U.S. dollars or by a negotiable instrument which may be converted to U.S. dollars.

F. Deductions from Wages. An employer may not deduct any amount from an employee's wages without the employee's full, free, and written consent.

G. Payment to Employer as Consideration for Employment. An employer may not "demand or receive, directly or indirectly from an employee, a fee, gift, tip, gratuity, or other remuneration or consideration, as a condition of employment or continuation of employment." This prohibition applies to all employers except state licensed employment agencies.

H. Reimbursement of Training Expenses. Employers increasingly seek to recover training costs for employees. In a job market where employees frequently move from job to job acquiring training along the

way, employers have become more sensitive to the costs which are incurred in training employees who, once trained, may leave for other employment. Employers seeking to recover training and educational expenses must be careful not to run afoul of the MWFBA. The MWFBA provides that an employer shall not condition an employee's employment upon payment of any consideration or remuneration. In the recent case of Sands Appliance Services, Inc. v. Wilson, 463 Mich 231 (2000), the Michigan Supreme Court addressed the situation where an employer required an employee (prior to beginning employment) to execute a contract in which the employee agreed to remain employed with the employer for six years in return for formal and informal training provided by the employer. In the event the employee did not remain with the employer for six years, the employee would be responsible to reimburse the employer $50.00 a week for a total of 156 weeks. The Supreme Court struck down this agreement as void for violating the MWFBA because the contract was an express condition upon the employee's employment. The Supreme Court distinguished the situation in Sands Appliance from workplace rules which require employees to reimburse employers for personal phone calls or for employer provided tools kept after employment. The Supreme Court indicated that the latter policies were workplace rules and were not conditions of employment, i.e., it is optional whether employees make personal phone calls at work or take tools after leaving employment. The contract in Sands Appliance was not optional. In addition, the Supreme Court distinguished the Sands Appliance contract from cases where employers offer to fund an employee's education in return for the employee's agreement to repay the educational costs if the employee does not remain with the employer for a specific period. The distinguishing factor in these cases is that such agreements are not required at the start of employment and are not a condition of being hired, but simply provide

the employee with the choice to receive educational benefits in exchange for the obligation to repay costs for such benefits.

I. Pay Statements. Employers must provide employees, at the time wages are paid, with statements containing the hours worked by an employee (unless the employee satisfies the requirements for an executive, administrative, or professional employee, or is a teacher), the gross wages paid, identification of the pay period covered, and an itemization of deductions authorized by the employee or required by law.

J. Payments to Deceased Employee. An employer shall pay fringe benefits on behalf of a deceased employee as provided by the terms of a written contract, written policy, or submission of a designation form to the employer before the employee's death. In the event no such written statements exist, payments of wages and fringe benefits shall be made according to the following priority:

1. The employee's surviving spouse.

2. The employee's surviving children.

3. The employee's surviving mother or father.

4. The employee's surviving sister or brother.

K. Prohibitions, Penalties, and Remedies.

1. An employee may file a complaint with the Michigan Department of Labor ("MDOL") concerning violations of the MWFBA within 12 months of the violation. However, if an employee asserts that he/she has been discharged or discriminated against due to the employee's proposed filing of a complaint for violations of the act, then the employee must file the complaint within 30 days of the alleged violation. In the

event an employee's complaint for discrimination is substantiated, MDOL will order the reinstatement of the employee with back pay.

2. An employer may not direct or require an employee not to disclose his/her wages and may not discipline, discharge, or discriminate against the employee for such disclosure.

3. An employer which violates the MWFBA with intent to defraud is guilty of a misdemeanor punishable by $1,000.00, 1 year in jail, or both. The MDOL may also assess civil penalties against the employer up to $1,000.00.

OFFICER LIABILITY IN MICHIGAN: PERSONAL LIABILITY FOR DELINQUENT BUSINESS-ENTITY TAXES

By: Jason M. Fisher, Esq.

STANDARDS OF OFFICER LIABILITY: MICHIGAN VS. IRS

I. IRS – Internal Revenue Code ("IRC") § 6672(a): Trust Fund Recovery Penalty ("TFRP")

A. "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over." I.R.C. § 6672(a).

B. Purposes of the TFRP

1. Encourages payment of income and employment taxes withheld from employees;

2. Makes the responsible person liable for 100% of the unpaid trust fund taxes; and

3. Facilitates collection of trust fund taxes from secondary sources.

C. Penalty is 100% of the tax owed and applies to any responsible person who willfully fails to collect or pay the taxes.

D. The TFRP is limited to the “trust fund” portion of the tax.

1. Trust Fund Taxes are taxes that are required to be collected or withheld from the wages of employees (withheld income tax and the employee’s FICA tax).

2. Those funds are held “in trust” for the United States Treasury.

3. Penalty generally only applies to the employee’s share of payroll taxes.

4. TFRP does not apply to the employer’s portion of FICA or FUTA.

E. A person is liable for the TFRP if two statutory requirements are met:

1. The person is "responsible" — had the duty to account for, collect, and pay over the trust fund taxes to the government; and

2. The person "willfully" failed to collect or pay over trust fund taxes to the government.

F. Responsible Person. A responsible person is anyone who is responsible for collecting, accounting for, and paying over trust fund taxes.

1. Persons subject to the TFRP include, but is not limited to, the following:

a. Officer or employee of a corporation;

b. Partner or employee of a partnership;

c. Member or employee of an LLC;

d. Corporate director or shareholder;

e. Another corporation;

f. Surety or lender;

g. Payroll Service Provider (“PSP”);

h. Responsible parties within a PSP;

i. Professional Employer Organization (“PEO”) (i.e., Employee Leasing Companies);

j. Responsible parties within a PEO; and

k. Responsible parties within the common law employer (client of PSP/PEO).

2. An employee can be liable for the TFRP if he or she made the decision not to pay the taxes due.

3. Determination of liability takes into account all facts and circumstances.

4. A responsible person may be held liable for the TFRP if such person willfully fails to perform any one of the three duties listed in the statute: collecting, truthfully accounting for, and paying over the taxes.

   a. An officer will not be a responsible person if he or she is an officer in title only and has no substantive duties with the business.

5. “Responsibility” depends on the facts and circumstances of each case, including but not limited to the following common factors:

a. Identification of the person as an officer, director, or principal shareholder of the corporation, a partner in a partnership, or a member of an LLC;

b. Duties of the officer as set forth in the by-laws;

c. Authority to sign checks;

d. Identification of the person as the one in control of the financial affairs of the business;

e. Identification of the person as the one who had authority to determine which creditors would be paid and those who exercised that authority;

f. Identification of the person as the one who controlled payroll disbursements;

g. Identification of the person as the one who had control of the voting stock of the corporation; and

h. Identification of the person as the one who signed the employment tax returns.

6. The crucial test is whether the person has the "effective power to pay the taxes owed."

a. A person is deemed to have such power if he or she possesses the authority to exercise significant control over the company’s financial affairs whether or not such control is in fact exercised.

b. Significant control generally relates to the person’s status, duty, and authority in the business that failed to carry out one of the three statutory duties.

c. Those performing ministerial duties without exercising independent judgment will not be deemed responsible.

G. Willfulness. For personal liability to attach, the failure to collect or pay over trust fund taxes must be willful.

1. Willfulness means that the person acted intentionally, deliberately, voluntarily, consciously, recklessly, knowingly. Not accidental.

2. Person must have been, or should have been, aware of the outstanding taxes and either:

a. Deliberately chose not to pay the taxes; or

b. Recklessly disregarded an obvious risk that the taxes would not be paid, intentionally disregarded the law, or was plainly indifferent to its requirements.

3. No evil intent or bad motive is required.

4. A responsible person acts willfully if the person knows the required actions are not taking place.

5. Reckless disregard and gross negligence can suffice for willfulness.

6. Failure to investigate or correct mismanagement after being notified that withholding taxes have not been paid satisfies the willfulness requirement.

7. Reliance on a party who previously failed to remit payments.

8. Failure to act where it is clear that the person ought to have known.

9. A showing of a conscientious deliberate voluntary decision to use available funds to pay other creditors, including employee wages, when the business is unable to pay employment taxes to the IRS is an indication of willfulness.

a. An employee owed wage is merely another creditor of the business: giving preferences to employees over the government constitutes willfulness.

b. A mistaken belief that payments to other creditors were required to be made in preference to trust fund taxes does not make the failure to pay non-willful.

H. Collection

1. The unpaid trust fund taxes are collected only once.

a. If the company pays the delinquent tax, the TFRP assessment against the responsible person will be abated.

b. The TFRP is generally nondischargable in bankruptcy.

II. MICHIGAN – MICHIGAN COMPILED LAWS ("MCL") Section 205.27a(5)

A. If a corporation, limited liability company, limited liability partnership, partnership, or limited partnership liable for taxes administered under this act fails for any reason to file the required returns or to pay the tax due, any of its officers, members, managers, or partners who the department determines, based on either an audit or an investigation, have control or supervision of, or responsibility for, making the returns or payments is personally liable for the failure.

1. A person's signature on tax returns or checks in payment of the unpaid taxes is prima facie evidence of their responsibility for making the returns and payments.

2. Dissolution of the company does not discharge the person's liability for a prior failure to make a return or remit tax due.

B. Elements

1. If the company fails to file returns or to pay taxes;

2. For any reason; then

3. Any officer, member, manager, partner who the Department of Treasury determines has control or supervision of, or responsibility for, making the returns or payments is personally liable for the unpaid taxes.

C. Analysis

1. Was the person an officer of the company during the time period in question?

    a. This element is relatively easy to satisfy.

    b. If the person was not an officer of the company (or similar role) during the time period in question, then they cannot be held personally liable.

    c. Proof that the officer resigned from his or her position and no longer had tax-specific responsibilities prior to the time period in question can absolve the officer from personal liability.

2. Was the person a "responsible officer" within the meaning of the statute?

a. The Department of Treasury considers an officer's signature on any of the following as an indication that the person was responsible:

i. Application for registration;

ii. Returns filed by the corporation during the period noted on the proposed assessment;

iii. Michigan Annual Reports which include the period assessed;

iv. Audit or collection reports that identify an individual officer as responsible for payment and reporting of taxes;

v. Correspondence from the taxpayer that identifies an officer as responsible for payment or reporting of taxes;

vi. Collector reports establishing regular contact with a corporate officer regarding unpaid taxes;

vii. Sales, use and withholding returns that identify corporate officers;

viii. Payment plan agreements signed by corporate officers;

ix. Checks in payment of taxes signed by an officer, or subpoenaed bank signature cards for the periods in question; and

x. Any other documents that would tend to prove or disprove corporate officer liability.

b. In determining whether the person was responsible, the following is also considered:

i. The designation of the officer on an application for sales, use and withholding tax registration as one in control of or charged with the responsibility of preparing the relevant state tax returns; the authority of the officer to sign corporate checks;

ii. The officer's awareness of the financial condition of the corporation;

iii. The degree of participation the officer had in active management of the corporation;

iv. The officer's signature on relevant tax returns; and

v. The officer's authority to direct payment of taxes.

D. A person’s signature on tax returns or checks in payment of the unpaid taxes is prima facie evidence of their responsibility for making the returns and payments.

1. Once the Department of Treasury produces evidence showing the officer’s signature on tax returns or checks in payment of the unpaid taxes, it is presumed that the officer was responsible.

2. The burden of proof shifts to the officer to rebut the presumption and prove that he or she did not have control or supervision of, or responsibility for, making the returns or payments of taxes.

a. Mere proof that an individual was an officer in a corporation is not sufficient to demonstrate responsibility for officer liability.

b. Once the presumption arises that the officer is responsible for the company's taxes, it is the officer's burden to rebut the presumption by presenting sufficient credible evidence that he or she was not responsible for making the company's returns or payments.

c. Personal tax liability will not attach to corporate officers who simply have significant involvement in the financial affairs of a company; their involvement must be tax specific.

3. Liability will arise only if the officer's involvement with the company is "tax specific". Tax specific involvement includes:

a. Has control over the making of the company's tax returns and payments of taxes;

b. Supervises the making of the company's tax returns and payment of taxes; or

c. Is charged with the responsibility for making the company's returns and payments of taxes to the state.

4. So long as the officer has ultimate authority over expenditures of company funds and effective power to see to it that taxes are paid, he or she qualifies as a responsible officer.

E. Rebutting the Presumption

1. There are several ways to rebut the presumption that someone is a responsible officer.

2. Once the burden is shifted to the officer, the officer must demonstrate through credible evidence that he or she had no control, did not supervise, or was not charged with the responsibility for making the company's returns and payments of taxes.

3. Common Scenarios

   a. Although the officer prepared and signed the return, the officer was not responsible for filing the return with the state.

      i. "Making the returns" includes everything leading up to and including filing the return with the Department of Treasury.

         - It is often the case where an officer signs a return, but another officer tightly controls all major aspects of the business. Where one officer cannot unilaterally act without the other controlling officer's consent, then this can be used as evidence that the officer was not responsible.

      ii. Where an officer has no control or supervisory authority over tax matters and a controlling majority owner exercises total control over the business and financial operations of the company, the officer may not be liable.

      iii. A corporate officer can be held derivatively liable even if he or she has only supervisory authority over filing and remitting a company's tax return.

         - An officer cannot escape personal liability by choosing to delegate responsibility to an employee who was not an officer.

- The responsibility to make returns and payments of taxes cannot be delegated to a non-officer.

b. Person was an officer in title only with no corresponding "officer" duties.

   i. Employees informally appointed/promoted to Treasurer, Secretary, or Vice President.

   ii. Still have duties of a regular employee without any benefits or duties of an officer.

   iii. Although title suggests person was an officer, they had no tax-specific involvement with the company.

c. Person was acting at the will of another.

   i. Person was a mere "pawn" for another person that retained ultimate control over the company's finances.

d. Lack of check-signing authority.

   i. If an officer did not have the authority to sign the checks and pay the taxes, then the officer did not have sufficient control to be personally liable.

   ii. When an officer is a signatory on the company's bank account, but payments require the signature of more than one officer, this can be used as evidence that the officer was not responsible.

e. Unauthorized Use of a Signature Stamp.

i. Many companies use signature stamps to sign documents. Sometimes, an officer's signature stamp is used by other officers or employees without authorization. In situations where unauthorized signature stamps were used to sign returns and checks without the officer's knowledge or consent, then personal liability generally will not attach.

III. KEY DIFFERENCES BETWEEN MICHIGAN'S OFFICER LIABILITY STATUTE AND THE IRS'S TRUST FUND RECOVERY PENALTY

A. Responsible Parties

1. The TFRP can apply to employees; it applies to any person required to collect, truthfully account for, and pay over taxes.

2. In Michigan, employees cannot be personally liable unless they are officers, members, managers, or partners.

3. Standard for determining who is responsible is very similar.

B. Types of Taxes Subject to Personal Liability

1. TFRP generally applies only to withholding taxes:

a. Income tax withholdings

b. FICA withholdings

2. Michigan – applies to all taxes imposed under the Michigan Revenue Act, including:

a. Income Taxes

b. Withholding Taxes

c. Michigan Business Tax (MBT)

d. Single Business Tax (SBT)

e. Corporate Income Tax (CIT)

f. Sales and Use Taxes

g. Fuel and Tobacco Taxes

C. Intent

1. The TFRP has a willfulness requirement. It requires some affirmative act of wrongdoing.

2. In Michigan, the reason for nonpayment is irrelevant.

LIFE INSURANCE – FRIEND OR FOE

By: Robert D. Kaplow, Esq.

I. WHY HAVE LIFE INSURANCE?

A. Family Funding – mortgage, college expenses, living expenses

B. Estate Planning – estate taxes, family inheritance

C. Investment Vehicle

D. Business

II. INSURANCE APPLICATION

A. Importance often overlooked

B. Correct information required

C. Suicide exclusion

D. Owner:

* Individual(s)

* Spouse

* Trust – Revocable

ILIT – Irrevocable Life Insurance Trust

Dynasty Trust

* Business

* Incidents of Ownership

* Insurable Interest

E. Beneficiary:

* Estate

* Trust

* Spouse

* Children (Adult/Minors)

* Business

* Partnership

* Charity

* Primary/Contingent

III. PREMIUM PAYMENTS

A. Seven pay test – To avoid the detrimental provisions of being classified as a Modified Endowment Contract (see below), the life insurance policy must meet the "seven-pay test". This requires that the accumulated amount paid during the first seven years under the contract cannot exceed the sum of the "net level premiums" that would have been paid on or before such time had the contract provided for paid up future benefits after the payment of the seven level annual premiums. §7702A(b). The insurance company has to compute this.

B. Modified Endowment Contract (MEC)

1. Definition. §7702A. A life insurance contract that:

a. is entered into after 6/20/88 and fails the seven-pay test; or

b. passes the seven-pay test but later undergoes a material change and then fails the seven-pay test; or

c. is exchanged for an MEC. Once a policy is an MEC, it is always an MEC

2. Consequences of being an MEC.

a. Distributions, cash value loans – ordinary income to extent of gain in the policy.

b. Policy loans, pledges of policy treated as distribution.

c. 10% penalty tax on includible amount of the MEC distribution (with certain exceptions).

C. Gifts – Crummey Powers

D. Premium Financing

1. Commercial lender

2. Borrow from insurance company

3. Borrow from bank

E. Split Dollar

1. Loan regime

2. Economic benefit

3. Grandfathered agreement

IV. USES

A. Family funding – mortgage, college expenses, etc.

* Creditor protection

B. Estate planning

C. Investment vehicle

1. Cash value build-up

2. Variable life

D. Business

1. Buy Sell Agreement

2. Key Man

3. Compensation

4. Special Rules for Employer Owned Life Insurance – need written consent from employee prior to obtaining the insurance. §101(j)

E. Death proceeds – income tax free assuming no transfer for value, but may be subject to estate tax if insured had incidents of ownership.

F. Insurance review

V. TRANSFER

A. Change of owner

B. Change of beneficiary

C. Gift: §2035 - will be included in estate if die within 3 years of gift.

D. Sale of policy: Transfer for value-proceeds will be subject to income tax to extent above basis

E. Exceptions to transfer for value - § 101

1. To the insured or grantor trust

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D. Surrender of policy to life insurance company – taxable on gain

E. Sale of policy – life settlement to 3rd party or hedge fund - taxable on gain. Ordinary income up to cash surrender value – capital gain on excess. Rev. Rul. 2009-13

FATHER KNOWS BEST
(Or So He Thinks)[1]

I. INTRODUCTION

A. America is aging. Deal with it.

1. America is aging and living longer than ever before. While this is not earth-shattering news, it is interesting to note that there are 35 million Americans over age 65 of whom 4.6 million are over age 85 and 60,000 are over age 100.

2. In addition, over 50% of women as well as 30% of men who reach 65 will live until age 85.

B. With aging comes the possibility that clients may not be fully aware of what they are doing with respect to many of their legal and financial things, including estate planning and related family matters.

1. Aging-related illnesses should send a warning flag to all professionals (CPAs, Attorneys, Financial Planners, etc.) as, for a number of reasons, an elderly client is more likely than a younger client to be or become incapacitated.

a. The elderly are particularly at risk for many diseases and disorders that are associated with dementia and delirium.

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[1] Much of the content of this presentation was compiled from various third party sources, including "*It's My Property and I Can Do With It What I want, Dammit!!!,"* by George D. Karibjanian, Esq., of Proskauer Rose LLP.

b. Dementia and delirium are highly correlated to the loss of mental capacity, which in turn can result in legal incapacity.

c. At least 5-8% of all persons over the age of 65 suffer from dementia; among elders 80 and older, this figure climbs to more than 50%. Medical professionals estimate that Alzheimer's disease causes 50% to 70% of all dementia.

2. As individuals age, physical and mental abilities "slow down," even lacking a specific illness such as dementia or delusion.

a. Most of the very old have diminished short-term memory, with the result that they have difficulty recalling information. For example, the estate planning attorney explains the advantages of a transfer tax planning technique that involves leaving assets to the grandchildren instead of the children and the client acknowledges that not only does she understand the explanation during the meeting, but she recites a perfect example illustrating that she completely grasps the concept. The next day, however, she is confused as to why she is not making a gift to her son in the will and instead is creating trusts for the grandchildren.

b. For some very old clients, the problem of grasping and remembering complicated estate planning proposals is compounded by a loss of vision and hearing. During the meeting, clients can appear to have difficulty understanding what is being discussed when in reality; they are of very sound mind. The problem is that they cannot comprehend what they haven't heard or can't

read. Professionals must therefore be alert to physical limitations that may make a very old client seem unable to grasp even basic planning concepts.

II. TESTAMENTARY CAPACITY

A. An individual has "testamentary capacity" when he or she understands or is able to comprehend the following four elements, often referred to as a "Four-Pronged Test:"

1. The nature and extent of his or her property.

   a. At a minimum, the testator should possess a general knowledge of his or her assets.

   b. The level of knowledge required regarding his or her holdings varies in that the testator need not know the exact fair market value of his or her property, nor be able to list all of his or her assets.

2. The natural objects of his or her bounty.

   a. The term "natural objects" means those persons related to the testator by ties of blood or affection who would naturally be thought of as having a stake in the testator's estate.

   b. The testator is not required under this prong to leave anything in the will to the natural objects of his or her bounty, but he or she is required to know who they are.

   c. This element is apparently satisfied if the testator understood who would naturally be expected to receive his or her property at his or her death.

d. Note that the specificity with which the testator must know the names and the relationship to him or her of the natural objects varies considerably.

3. The disposition he or she wishes to make of his or her estate.

a. The testator is required to dispose of his or her property according to some plan formed in his or her mind.

b. The testator must clearly know to whom he or she intends to give his or her property through the will.

4. The act of making a will.

a. The testator must know that the document he or she is signing will serve to dispose of his or her property at his or her death according to the directions therein.

b. The testator must be aware that the function of a will is to distribute his or her property after his or her death, and he or she must understand that he or she is about to execute such a document.

B. A testator/testatrix must understand how these elements are related so that he/she can express the method of disposition of property.

C. The law favors a finding of sufficient testamentary capacity; further, **testamentary capacity is the lowest level of capacity needed to act.**

D. Capacity when you least expect it – the “lucid interval.”

1. Even if an individual is adjudicated to be incapacitated, testamentary capacity may still be present as a result of a “lucid interval,” which can be defined as an interval of apparent

mental clarity (or at least capacity) for an otherwise incapacitated individual.

2. If a will is executed during a lucid interval, it is valid despite evidence that the individual exhibited significant loss of mental capacity near the time of the execution of the will.

3. While the doctrine may appear to be a bit dubious as a description of mental capacity, it may be applied to defend a will as valid even if the will were signed by a person suffering from dementia.

4. The key is to have the person sign the will during a period when he or she understands what is occurring.

5. Courts recognize a distinction between specific and general competency; "specific" competency is competency that can occur during a single lucid moment and can be transient. As a result, assessment of testamentary capacity can be difficult.

E. Incapacity when you least expect it – the "insane delusion."

1. An insane delusion exists when a "person persistently believes supposed facts that have no real existence, and so believes such supposed facts against all evidence and probabilities and without any foundation or reason for the belief, and conducts himself as if such facts actually existed."

2. Accordingly, if there is any factual basis for a testator's otherwise irrational belief, the courts will not find an insane delusion.

3. Examples of insane delusions:

a. In a Pennsylvania case:

i. The testator was determined to have been operating under an insane delusion when she disinherited her niece, a natural object of her bounty, based on the unjustified belief that the niece had stolen certain silver articles from her.

ii. The court stated that the testator, "…believed that plaintiff had stolen from her is beyond question under the evidence. That no sane mind could entertain this belief in view of the circumstance is too clear for controversy. … That this delusion was a potent factor in her mind when she sought to dispose of her property by the paper in question would seem to be plain."

b. In a Florida case:

i. The testator originally left a remainder of his estate to a Masonic Lodge of which he was a member, but several months later, after developing a belief that he had been expelled from the Masons, the testator attempted to execute a new will in which he planned to substitute the Ohio Mechanics Institute for the Masons.

ii. After the testator's original attorney refused to draft the new will, on the basis that the testator lacked the requisite capacity, the testator then acquired another attorney to draft a will that would disinherit the Masons.

iii. At trial, no evidence was offered by any doctor or other authority as to the testator's mental state; thus, the presiding judge relied on testimony of witnesses who insisted there was no basis for the testator's belief.

iv. The Court of Appeals, in affirming the county court's rejection of the will, stated that there was "no evidence to establish any basis for the decedent's belief that he had been expelled from the Masons" thereby reaffirming the proposition that if the testator had any reason whatsoever to support a belief that he had been expelled from the Masons, the court would not have found him to be suffering from an insane delusion.

c. Sometimes, however, an insane delusion is not enough to overcome testamentary capacity.

i. In one case, the testator had used alcohol and cocaine for several years before his death, who suffered from mood swings, and "worried excessively about threats against his and his dog's life."

ii. The threats included the belief that there were listening devices in his home and assassination plots against him and his dog.

iii. Despite the apparent insane delusions, the trial court upheld the will on the basis that the testator possessed the requisite testamentary capacity.

iv. The court reached this conclusion, in part, because the testator: "(1) could index the major categories of the property comprising his estate; (2) knew his home and rental addresses; and (3) identified the devisee by name and provided her current address."

v. In upholding the probate court's finding, the Colorado Supreme Court stated that "the insane delusions from which the decedent was suffering did not materially affect or influence his testamentary disposition."

4. Not all "capacities" are created equal – lack of capacity for some transactions may not necessarily be lack of capacity for others.

a. Capacity when a Guardianship is in Effect.

i. Courts not infrequently conclude that a person who is subject to a conservatorship or guardianship nevertheless has the necessary capacity to execute a valid will.

b. That clients may have differing degrees of capacity underlies the statement that "a client with diminished capacity often has the ability to understand, deliberate upon, and reach conclusions about matters affecting the client's own well-being."

c. Testamentary Capacity vs. Donative Capacity.

i. States vary on whether “testamentary capacity” is the same as “donative capacity,” which is the capacity level required to make a gift.

ii. Some courts have characterized “donative capacity” as having a lower or the same degree of capacity than “testamentary capacity.”

iii. Other courts have held that donative capacity is similar to contractual capacity (which requires that the person contracting bargain for and understand the consequences of his or her actions).

5. Burden of Proof for Capacity Challenges.

a. In most states, a presumption of testamentary capacity is met upon proof that the will has been executed in conformity with state law.

b. In most states, the burden for finding lack of testamentary capacity is extremely high, as the burden for proving testamentary capacity is the usual civil burden, which is carried by a fair preponderance of the credible evidence.

III. UNDUE INFLUENCE

A. Generally

1. Illness may not be the only reason that clients may not fully comprehend certain aspects of their estate plan in that their decisions may be unduly influenced by others.

2. Defined

a. Black's Law Dictionary defines "undue influence" as "coercion that destroys a testator's free will and substitutes another's objectives in its place."

b. Undue influence has been recognized as "one of the most bothersome concepts in all the law," and to prove undue influence, the person seeking to set aside the transfer must show that the undue influence was enough to "overpower the will of the grantor to the extent that he was prevented from voluntary action and was deprived of free agency."

c. Many states defines two categories of undue influence:

i. One category is the gross, obvious and palpable type of undue influence which does not destroy the intent or will of the testator but prevents it from being exercised by force and threats of harm to the testator or others close to him.

ii. The other category is the insidious, subtle, and impalpable kind of undue influence that subverts the intent or will of the Testator and internalizes within his mind the desire to do that which is not his intent but the intent of another.

B. "Undue Influence" as distinguished from "Testamentary Capacity"

1. Because undue influence, like mental capacity, raises the question of whether an individual is acting freely, the two concepts are often confused. Although diminished mental capacity may contribute to a person's vulnerability to undue

influence, the two are distinct, and cognitive assessments cannot identify the presence of undue influence.

2. Generally, a document procured by “undue influence” will generally not deem the entire document void, but just the particular provisions procured by “undue influence;” lack of “testamentary capacity,” however, renders the entire document void.

3. Thus, a client might decide to change the terms of her will to the benefit of an unlikely third party; her decision might be “her own” but still the product of incapacity; for example, a client may add a substantial bequest to a neighbor who does nothing more than say “hello” to her each morning. Conversely, a fully capable client may fall victim to an unscrupulous family member, health care provider, or other third party; for example, a “never do well son” may return home to visit Mom in the nursing home after 20 years absence and suddenly Mom changes her will to leave such son the family house.

C. Typical circumstances providing an evidentiary basis for a finding of undue influence in the will contest context include the following:

1. Confidential Relationships.

a. The threshold issue of the existence of a confidential relationship is a question of fact.

b. A common fact pattern involves a donor living with or relying on a caretaker, often a family member or close friend, especially as the donor’s health and cognitive functions begin to decline.

c. A confidential relationship can exist, however, “whenever one person, by acting or pretending to act for the benefit or in the interest of another, gains the trust and confidence of the other person (and, as a result, is put in a position to exercise influence and control over the other).”

d. Case law examples of common, confidential relationships include the following:

i. Guardian and ward

ii. Trustee and beneficiary

iii. Agent and principal

iv. Attorney and client

v. Doctor and patient

vi. Nurse and patient

vii. Pastor and parishioner

viii. Bank employee and bank customer

ix. Hospice volunteer and elderly patient

x. Informal relationships formed from moral, social, domestic, or purely personal relationships.

xi. Relationships of blood, business, friendship, or association in which one party reposes special trust and confidence in the other who is in a position to have and exercise influence over the first party.

e. Friendship and family, including a parent/child relationship, is sometimes not enough to be classified as "confidential."

i. Determination of a confidential relationship depends on the amount of control exerted over the testator. Proof of the additional elements of dominion and control are usually necessary.

ii. Not every close relationship, of course, is a confidential relationship. "Friendly relations or even intimacy of relationship present an entirely different question from what is understood as a confidential relation in the law."

f. Spouses and Confidential Relationships

Generally, spousal relationships are not considered confidential or fiduciary in nature for purposes of determining whether undue influence was exerted.

g. In most states, the mere presence of a confidential relationship is not enough to prove undue influence; for example, evidence showing only an opportunity to influence and a substantial benefit under the will does not show the exercise of undue influence.

h. Caution must be exercised in applying the presumption of undue influence based solely on the existence of a fiduciary or confidential relationship, as well as in finding the existence of a confidential relationship giving rise to the presumption in the first instance. Some states do not allow a trier of fact to presume "that a person used

undue influence on another person solely because they were in a fiduciary or confidential relationship."

i. The challenger must show more than just a close relationship – he or she must show that a confidential relationship existed in fact, which includes circumstances making the donor susceptible to influence.

2. Fiduciary Relationship

a. While this would encompass the standard trustor/trustee scenario, it may also include the holder of a durable power of attorney.

b. Many states would find that a beneficiary who held the testator's power of attorney was in a confidential or fiduciary relationship with the testator, while at least one other court has held that an unexercised power of attorney alone is not sufficient.

3. Other Factors

a. Undue influence present at will execution.

b. A relationship between the attorney drafting the will and the influencer.

c. Knowledge of the contents of the will by the influencer.

d. An influencer instructing the preparation of a will, making first contact with the attorney, or meeting alone with the attorney drafting the will.

e. An influencer paying the drafting attorney.

f. An influencer securing witnesses to the will.

g. The execution of the will being kept a secret from potential challengers.

h. Old age of the donor.

i. An opportunity and motive for the exercise of undue influence.

j. Weak physical and mental health of the donor.

k. A beneficiary treating a new will execution as an urgent matter.

l. A dramatic change in the testamentary disposition of assets.

D. If undue influence circumstances are present, specific factors that may support a finding of undue influence are as follows:

1. Old age.

2. Physical and mental weakness.

3. The person signing the paper is in the home of the beneficiary and subject to his or her constant association and supervision.

4. Others have little or no opportunity to see the person executing the instrument.

5. The will is different from and revokes a prior will.

6. The will is made in favor of one having no blood ties.

7. The will disinherits the natural objects of the testator’s bounty.

8. The beneficiary has “actively procured” the will’s execution.

a. As to “active procurement,” a major decision discussing factors involved is in a Florida case where the Florida Supreme Court cited seven, non-exclusive criteria in which “active procurement” may be found; such criteria are:

b. Presence of the beneficiary at the execution of the will;

c. Presence of the beneficiary on those occasions when the testator expressed a desire to make a will;

d. Recommendation by the beneficiary of an attorney to draw a will;

e. Knowledge of the contents of the will by the beneficiary prior to execution;

f. Giving of instructions on preparation of the will by the beneficiary to the attorney drawing the will;

g. Securing of witnesses to the will by the beneficiary; and

h. Safekeeping of the will by the beneficiary subsequent to execution.

E. Burden of Proof

1. The burden of proving undue influence is on the objectant.

a. Some states, however, presume the existence of undue influence when certain criteria are met.

2. Shifting of the Burden

a. The circumstances under which the burden of proof is shifted is a fairly complicated and complex topic as the various state appellate courts have struggled mightily with this issue without a great deal of consensus.

IV. DIMINISHED CAPACITY AND CONFLICTS OF INTEREST WITH COUNSEL UNDER DISPOSITIVE INSTRUMENTS

A. In some instances, elderly clients may feel such an affinity to their lawyer where they wish to benefit the lawyer the lawyer's causes in the testamentary documents. **(The lawyer could very well also be the CPA or the financial planner or any other professional who has become a trusted advisor to the client.)**

B. If the bequest is not present in prior documents, questions of undue influence and/or conflict of interest may arise.

C. For lawyers in particular, there is a Michigan Rule of Professional Conduct (MRPC 1.8(c) which is directly on point prohibiting such bequests). The rule is not subject to client waiver. Other professionals must be cognizant of their own industry rules and prohibitions.

V. ASSESSING CAPACITY

A. In determining the extent of a client's diminished capacity, lawyers (other professionals) are advised to consider and balance such factors as: the client's ability to articulate reasoning leading to a decision, variability of state of mind and ability to appreciate consequences of a decision; the substantive fairness of a decision; and the consistency of a decision with the known long-term commitments and values of the

client. In appropriate circumstances, the lawyer (other professional) may seek guidance from an appropriate diagnostician.

B. Generally.

1. Determining whether a client lacks sufficient legal capacity to perform particular acts, such as executing a will or understanding its testamentary dispositions, is one of the estate planning practitioner's most difficult and important obligations.

2. Depending on the degree of impairment that is suspected, the lawyer (other professional) may need only make informal inquiries that are intended to satisfy possible doubts about the client's ability to understand the consequences of the specific legal act that she is about to undertake.

3. At the other end of the spectrum, a lawyer (other professional) may need to consult with health care and/or gerontology professionals who are qualified to make evaluations concerning competency and capacity, and who can provide appropriate interventions and treatment if necessary.

4. With all clients, the practitioner must also be mindful of the ethical considerations associated with counseling a client who is, may be, or becomes incapacitated.

C. With respect to capacity, the key element is whether the client had capacity at the time of execution of the document creating the transfer.

D. The attorney should be cognizant of signs that the client may be suffering from "dementia" or "delirium." Symptoms of "dementia" or "delirium" include the following:

1. "Dementia" symptoms include:

a. Progressive loss of memory;

b. Inability to concentrate;

c. Decrease in problem solving skills and judgment capability;

d. Severe confusion;

e. Hallucination, delusions;

f. Altered sensation or perception;

g. Altered sleep patterns;

h. Motor system impairments;

i. Disorientation;

j. Specific disorders of problem solving or learning;

k. Memory deficits (short, long term);

l. Absent or impaired language (aphasia);

m. Personality changes; and

n. Lack of spontaneity.

2. “Delirium” symptoms include:

a. Attention disturbance (disrupted or wandering attention);

b. Disorientation to time or place;

c. Changes in sensation and perception (increases in disorientation);

d. Altered level of consciousness or awareness;

e. Altered sleep patterns, drowsiness;

f. Alertness may vary, usually more alert in the morning, less alert at night (see drowsiness);

g. Decrease in short-term memory;

h. Changes in motor activities, movement (for example, may be lethargic or slow moving);

i. Movements triggered by changes in the nervous system (psychomotor restlessness); and

j. Emotional or personality changes.

E. If capacity is in question, the attorney should consider performing several informal objective tests which can prove to be helpful.

1. Unless an attorney has appropriate education and training, he should not use complex assessment instruments designed for medical and psychological professionals as a basis for forming judgments about a client's legal capacity, unless such professionals are involved in administering and scoring the tests.

2. The lawyer (other professional) should always obtain the client's consent before administering any formal instruments or questionnaires intended to gauge client capacity.

3. Types of Tests

a. Mini-Mental Status Exam ("MMSE")

i. First presented in the mid-1970's, the MMSE is a 30 point cognitive test used to evaluate an adult's cognitive mental status. It takes 10 minutes to

administer. The client's score can be adjusted for age and educational status, and places the individual on a scale of cognitive function.

ii. Despite its relative limitations compared to some of the more extensive assessment instruments used by medical professionals to diagnose various mental disorders, the MMSE is a useful tool for making a threshold, informal assessment of a client's cognitive functioning on discrete occasions.

iii. The MMSE generally tests five areas of cognitive function:

(a) Orientation;

(b) Registration;

(c) Attention and calculation;

(d) Recall; and

(e) Language.

b. Legal Capacity Questionnaire

i. The LCQ is a short test designed specifically for use by an attorney; it can be administered as a formal test, or through discussions with the client.

ii The LCQ was developed primarily as a tool for assessing and documenting testamentary capacity. Like the MMSE, the LCQ can be administered in just a few minutes; results offer a

rough estimate of the client's level of cognitive functioning as it relates to the execution of a will. Outcomes of the LCQ are closely correlated with those of the MMSE.

iii. Examples of questions include general information concerning the client's assets, the client's intended testamentary dispositive scheme, personal and family information and basic financial and estate planning questions.

c. The lawyer (other professional) can ask general knowledge and other questions intended to reveal whether a client is suffering from reduced concentration or impaired memory as well.

i. General knowledge questions that may be asked include questions intended to test current affair cognitive ability, such as the date, the current president, the client's address and questions concerning the client's recent activities.

ii. Additional questions can be the "serial three" or "serial sevens" test, which requires the client to count backwards from 100 by threes or sevens (depending on which test is administered).

iii. In addition, the lawyer (other professional) can ask the client to recite the months of the year in reverse order, to spell a simple word backwards, or to recall three objects that the lawyer (other professional) asked the client to remember earlier in the meeting.

F. Other Warning Signs

1, Depression

2. Emotional Issues

G. What to do if the client fails the informal capacity tests.

1. The lawyer (other professional) is faced with a challenging situation if a person appears to lack testamentary capacity. Whenever a question exists in the professional's mind that is asking to perform a service for the client as to the client's capacity, the professional must pause and take proper steps to ensure himself/herself of the assessment.

2. Medical professionals should be consulted to protect all individuals involved once the lawyer (other professional) has made a determination that he/she is uncomfortable proceeding.

VI. CONCLUSION

A. Representation of an elderly client presents a host of additional issues for all professionals, including the CPA, the financial planner and the estate planner.

B. The professional must have a predetermined course of action for matters involving elderly clients, including preliminary tests for identifying diminished capacity.

C. The professional must do his or her best in identifying signs of undue influence and must be certain to take all steps in avoiding any conflict of interest claim.

D. The professional must be defensive – in situations where undue influence could be presumed, he or she must take all steps in

anticipation that the document that he or she prepared will be challenged.

E. The professional should follow, to the best of his or her ability, all of the rules of professional conduct for his or her profession.

ROUNDUP OF RECENT TAX DEVELOPMENTS

By: William E. Sigler, Esq.

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I. FEDERAL

A. Capital Gains Taxes to Increase in 2013. Capital gains taxes are scheduled to increase sharply in 2013. First, the tax cuts enacted into the law in 2001 and 2003 are scheduled to expire January 1, 2013. This will result in the top rate on capital gains increasing to 20%. Second, the Pease provision, named after former U.S. Representative Donald Pease (D-H), which phases out the benefits of itemized deductions, such as deductions for mortgage interest, state and local taxes paid, and charitable contributions, for high-income taxpayers, will return in full force. This will add as much as an additional 1.2 percentage points to the effective capital gains rate for high-income taxpayers. Third, the health care reform legislation enacted in 2010 imposes a new tax on the investment income of high-income taxpayers, including capital gains. This would add another 3.8 percentage points to the capital gains tax rate. The result is an increase in the top capital gains rate from 15 percent to 25 percent beginning January 1, 2013. Of course, for anyone paying AMT, the top rate on capital gains may already be as high as 22 percent. This is because the phase out of the AMT exemption adds 25 cents back to AMT-taxable income for every dollar of capital gains. The tax on that 25 cents can be as high as 28 percent, resulting in an extra 7 cents of tax on that dollar of capital gains.

B. Transitional Relief for Reporting Organizational Actions. Section 6045(B) was added to the Code in 2008. It requires an issuer of stock to file a return with the IRS within 45 days after an organizational action, such as a stock split, merger or acquisition that affects the basis of the corporation's stock. The issuer must also furnish a corresponding statement to each nominee of the stockholder, or to each stockholder if there is no nominee, by January 15th of the year following the calendar year of the organizational action. The IRS announced in Notice 2011-18 that issuers could report 2011 organizational actions without penalty if Form 8937 is filed by January 17, 2012. Under Section 6721, the general penalty scheme is $100 per form, up to a maximum $1.5 million total per year for failing to file, although intentional disregard of the reporting requirement is higher, i.e., $250 per form, or 10 percent of the amount required to be reported, whichever is greater. The IRS did not release new Form 8937 until January 5, 2012. This has created a lot of frustration among practitioners because of the broad reach of the reporting requirement and the many questions left unanswered by the instructions to the form. For most privately owned corporations, the question is whether Section 6045(B) applies. It uses the term "specified security" and references Section 6045(g)(3)(B) which indicates that a specified security includes, among other securities, any share of stock in a corporation. Based on that definition, the reporting requirements provided in Section 6045(B) presumably could apply to organizational actions affecting the basis of stock in closely-held corporations, as well as publicly-held corporations. This would undoubtedly come as a surprise to many practitioners and small business owners, since the fundamental purpose of Form 8937 is to have companies tell brokers and shareholders how to adjust the basis in their stock, which is not a concern for small business owners as it is for stock market investors.

C. Third Offshore Voluntary Disclosure Program. The IRS announced on January 9, 2012, that it has reopened its offshore voluntary disclosure initiative for a third time. This initiative is designed to bring money in offshore accounts back into the U.S. tax system and help individuals with these kinds of accounts to get current with their taxes. The incentive is a reduced exposure to civil tax penalties and possible criminal prosecution. The third iteration of this initiative is different in some respects from the prior versions. First, there is no set deadline to apply. Second, individuals must pay a penalty of 27.5 percent of the amount in the foreign bank accounts in the year with the highest aggregate

account balance covering the 2003 to 2010 time period. Some taxpayers may be eligible for lower 5 percent or 12.5 percent penalties. However, back taxes and interest must also be paid for up to eight years, as well as accuracy-related and/or delinquency penalties. The 12.5 percent penalty rate generally applies to taxpayers with offshore accounts of less than $75,000 in each calendar year. The five percent penalty applies in limited circumstances to taxpayers who fall into one of three categories, e.g., a taxpayer who did not open or cause the account to be opened and who exercised minimal, infrequent contact with the account.

D. Final Debt-for-Equity Regulations. One of the questions left unresolved by the 2008 proposed regulations under Section 108(e)(8) was whether the partnership or its partners would recognize gain or loss if the partnership issued an interest in itself to pay accrued interest, rents or royalties owed by the partnership to a creditor of the partnership. Generally, when property is used to extinguish an obligation of the transferor, the transaction is treated as if the transferor first sold the property for cash equal to its fair market value and then used the cash to pay the obligation. However, under the final regulations, a partnership will not recognize gain or loss upon the transfer of a partnership interest to a creditor in a debt-for-equity exchange for unpaid rent, royalties or interest, including accrued original issue discount. Treas. Reg. § 1.721-1(d)(2). The preamble to the final regulations explain that in a debt-for-equity exchange, where the partnership has not disposed of any of its assets, the partnership should not be required to recognize gain or loss on the transfer of a partnership interest in satisfaction of its indebtedness for unpaid rent, royalties or interest.

E. Tax Provisions That Expired at the End of 2011. Although Congress spent much of its time in 2011 debating tax policy and its related budget implications, and it worked until December 23rd to pass a short term extension of the payroll tax cut, many other tax cuts were allowed to expire at the end of 2011. Examples include the following:

1. <u>Personal Incentives</u>

   - Increased exemption levels for the individual AMT (section 55(d)(1)) and personal tax credits allowed against regular tax and the AMT (Section 26(a)(2)).
   - Deduction for state and local general sales taxes (Section 164(b)(5)).
   - Above-the-line deduction for qualified tuition and related expenses (Section 222).
   - Deduction for elementary and secondary school teacher expenses (Section 62(a)(2)(D)).
   - Expansion of adoption credit and adoption assistance programs (Sections 36C and 137).

2. <u>General Business Incentives</u>

   - 100 percent bonus depreciation (Section 168(k)(5)).
   - Increased section 179 expensing limit of $500,000 with $2 million phase-out threshold and expanded definition of section 179 property (Sections 179(b)(1) and (2) and 179(f)).
   - Research credit (section 41).

- 15-year straight-line cost recovery for qualified leasehold improvements, restaurant buildings and improvements, and retail improvements (Sections 168(e)(3)(E)(iv), (v), and (ix)).
- Special rules for qualified small business stock (Section 1202(a)(4)).
- Reduction in S corporation recognition period for built-in gains tax (Section 1374(d)(7)(B)(ii)).

3. Charitable Provisions

- Enhanced charitable deduction for corporate donations of computer equipment for educational purposes (Section 170(e)(6)).
- Tax-free distributions from individual retirement plans for charitable purposes (Section 408(d)(8)).

F. Payroll Tax Cut Extended. Under the Middle Class Tax Relief and Job Creation Act of 2012, employees will continue to receive larger paychecks for 2012 based on a lower social security tax withholding rate of 4.2 percent, which is two percentage points lower than the 6.2 percent rate in effect prior to 2011. This reduced rate was originally in effect for all of 2011, and it was extended through the end of February by the temporary Payroll Tax Continuation Act enacted into law on December 23, 2011. The new law also repeals the 2 percent recapture tax included in the December legislation that effectively capped at $18,350 the amount of wages eligible for the payroll tax cut. Self-employed individuals benefit from a comparable rate reduction in the social security portion of the self-employment tax from 12.4 percent to 10.4 percent. For 2012, the social security tax applies to the first $110,100 of wages and self-employment income received by an individual.

G. Expiring Tax Provisions. In a January 6, 2012 report (JCX-1-12), the Joint Committee on Taxation listed tax provisions expiring from 2011 through 2013. For example, in addition to the various tax rate and estate and gift tax changes, the availability of additional first-year depreciation for 50 percent of a taxpayer's basis in qualified property under Sections 168(k)(1) and (2) expires on December 31, 2012. The provisions expiring in 2012 are also discussed in a report issued on April 17, 2012, by the Congressional Research Service.

H. Caregiving Services. Two recent cases illustrate the increasing importance of tax issues associated with providing caregiving services. *Estate of Olivo v. Commr.,* T.C. Memo. 2011-163, involved a tax lawyer, Anthony Olivo, who had given up his practice to care for his elderly parents. When his mother, the surviving parent, passed away, Anthony prepared an inventory of the estate, filed an estate tax return, and became the estate's administrator. On his mother's estate tax return, Anthony claimed $44,200 as an administrator's commission, $50,000 as estimated attorney fees, $5,000 as estimated accountant's fees, and $1.24 million as a debt owed to him under a purported compensation agreement with his mother. Because the only evidence the estate presented was Anthony's testimony, the tax court held that the estate had not sufficiently substantiated the deductions under Section 7491(a) of the Code to shift the burden of proof to the government on any of the factual issues. Anthony was unable to carry the burden of

proof, and ended up getting deductions only for the administrator's commission, in an amount based upon a statutory formula, $300 for a home appraisal, $200 in surrogate's fee, and $100 in filing fees. This case was similar to an earlier case, *Estate of Wilson v. Commr.*, T.C. Memo. 98-309, in which the estate was able to get deductions for amounts paid to settle lawsuits with two brothers who were distant relatives of the decedent's predeceased husband, and who had performed services for the decedent, pursuant to alleged oral contracts the brothers entered into with the decedent. However, in *Wilson*, unlike in *Olivo*, there was evidence of an agreement for services. The other case is *Baral v. Commr.*, 137 T.C. No. 1 (2011), Lillian Baral's physician diagnosed her as suffering from dementia and determined that she required assistance and supervision 24 hours a day for medical reasons. Lillian's brother, her attorney-in-fact, hired caregivers to provider the necessary assistance. During 2007, the year at issue, Lillian's brother paid $760 to Lillian's physicians and the New York University Hospital Center for medical care, $5,566 to Lillian's caregivers for supplies, and $49,580 to the caregivers for their services. The tax court allowed the deductions for the payments to the physicians and the hospital, and to the caregivers for their services, but denied the deduction for the caregivers' supplies. The tax court said that the $760 paid to the physicians and to the hospital were for the diagnosis, cure, mitigation, treatment or prevention of disease as defined in Section 213(d)(1)(A) of the Code, and that they were not reimbursed by insurance or otherwise. The deduction for the supplies paid to the caregivers was denied because Lillian's brother failed to establish that the amount paid was for medical care as defined in Section 213(d)(1) of the Code. In the case of the payments to the caregivers for their services, the tax court found that Lillian was certified by her physician, a licensed health care practitioner, as requiring substantial supervision to protect her from threats to her health and safety because of her severe cognitive impairment, and therefore she was chronically ill as defined in Section 7702B(c)(2)(A) of the Code. Therefore, the services provided to Lillian pursuant to her physician's plan of care constituted qualified long-term care services as defined in Section 7702B(c) of the Code. As such, these long-term care services constituted an amount paid for medical care under Section 213(d)(1)(C) of the Code.

I. Mortgage Debt Forgiveness. Canceled debt normally results in taxable income, but there are exceptions. One of those exceptions is available to homeowners whose mortgage debt is partly or entirely forgiven during tax years 2007 through 2012. Under the Mortgage Forgiveness Debt Relief Act of 2007, a homeowner may be able to exclude up to $2 million of debt forgiven on the homeowner's principal residence. The limit is $1 million for a married person filing a separate return. A homeowner may exclude debt reduced through mortgage restructuring, as well as mortgage debt forgiven in a foreclosure. To qualify, the debt must have been used to buy, build or substantially improve the homeowner's principal residence and be secured by that residence. Refinanced debt proceeds used for the purpose of substantially improving a principal residence also qualify for the exclusion. Proceeds of refinanced debt used for other purposes – for example, to pay off credit card debt – do not qualify for the exclusion. A qualifying homeowner may claim the special exclusion by filling out Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, and attaching it to the homeowner's federal income tax return for the tax year in which the qualified debt was forgiven. Debt forgiven on second homes, rental property, business property, credit cards or car loans does not qualify for the tax relief provision. In some cases, however, other tax relief provisions – such as insolvency – may be applicable. IRS Form 982 provides more details about these provisions. If debt is reduced or eliminated, the homeowner normally will receive a Form 1099-C, Cancellation of Debt, from the lender. By law, this form must show the amount of debt forgiven and the fair market value of any property foreclosed.

J. Temporary Regulations on Deduction v. Capitalization of Tangible Property. The IRS issued temporary regulations in late 2011 regarding the treatment of expenditures incurred in selling, acquiring, producing or improving tangible assets. The temporary regulations are generally effective for tax years beginning on or after January 1, 2012. The regulations provide guidance as to whether costs related to tangible property are currently deductible repairs or capital improvements that are deducted over a period of years. The regulations provide that a unit of property is improved if the amount paid or activities performed after the property is placed in service by the taxpayer results in a betterment of the unit of property, restores the unit of property or adapts the unit to a new or different use. The temporary regulations treat the unit of property for a building as the building and its structural components (walls, partitions, floors, windows and doors, etc.). However, in determining whether an amount paid is for an improvement to a building, the temporary regulations require the taxpayer to consider the effect of the expenditure on certain specifically defined components of the building, instead of the building and its structural components as a whole. As a result, a taxpayer will be required to capitalize a cost that results in an improvement to the building structure (building and its structural components) or any of the specifically enumerated building systems: (i) HVAC system; (ii) plumbing system; (iii) electrical system; (iv) all escalators; (v) all elevators; (vi) fire protection and alarm systems; (vii) security systems; and (viii) gas distribution systems. The temporary regulations do not change the rules for depreciable lives, bonus depreciation, or the availability of cost segregation studies to take advantage of shorter depreciable lives If it is determined that the expenditure must be capitalized. Prior to 2012, taxpayers were required to capitalize and depreciate the cost to replace a structural component of a building, and to continue to recover the cost of the original structural component. For example, if a taxpayer capitalized the cost of replacing an entire roof the taxpayer would have to continue depreciating the removed roof, and at the same time, capitalize and depreciate the replacement roof over the same recovery period as the building. The temporary regulations revise the definition of disposition so that a taxpayer may treat the retirement of a structural component of a building as a disposition of property. Most taxpayers will need to change their method of accounting to comply with the new regulations. The IRS indicated that they would issue revenue procedures that provide transition rules for taxpayers changing their method of accounting, and they subsequently issued Rev. Proc. 2012-19 and Rev. Proc. 2012-20. The regulations require that taxpayers make Code Section 481(a) adjustments to prevent duplicated or omitted tax benefits. Taxpayers will in effect have to apply the new rules to costs incurred prior to the effective date of the regulations. As a result, some taxpayers may have to capitalize amounts they previously deducted, and recognize income based on the difference in treatment. Conversely, other taxpayers may be able to deduct amounts previously capitalized, and take a deduction for the difference.

K. Dividend Payments from S Corporations Subject to FICA. In most of the prior S corporation reasonable compensation cases, the shareholder-employees failed to take any salary, leaving the IRS and the courts with the simple task of reclassifying distributions as compensation for services. In *David E. Watson P.C. v. U.S.*, 8th Cir., No. 11-1589, 2/21/12, David Watson, a CPA, drew compensation of $24,000 in addition to sizeable distributions, leaving the court with the issue of quantifying reasonable compensation for Watson's services. In Rev. Rul. 74-44, the court said that the IRS took the position that the IRS would recharacterize dividend payments for FICA tax purposes when they were paid to shareholders in lieu of reasonable compensation for their services, and concluded that the concept of "reasonable compensation" for income tax purposes is equally applicable to FICA tax cases. In addition, the court found that the characterization

of funds distributed by an S corporation to its shareholder-employees turns on an analysis of whether the payments were made as compensation for services, not on the intent of the corporation making the payments. The IRS' expert witness valued Watson's services to his S corporation as $91,044 per year based on his 20 years of experience, his masters in taxation, and the hours per week he spent as one of the primary earners of a well-established accounting firm, and the court adopted this finding. The case illustrates how the IRS is taking a more quantitative approach towards determining reasonable compensation.

L. News from the Campaign Trail. In February, the President released a general framework for business tax reform. The centerpiece would be a lower corporate tax rate of 28 percent, with a lower 25 percent rate for manufacturing businesses. House Republicans previously proposed a different overhaul that would include moving to a territorial tax system and dropping the top corporate tax rate to 25 percent. Highlights from the President's proposal include the following:

- reduce the corporate tax rate from 35 percent to 28 percent.
- eliminate various "tax expenditures," such as LIFO accounting and oil and gas tax preferences, and taxing carried (i.e., profits) interests of hedge fund managers, private equity partners and other managers in partnerships as ordinary income instead of capital gain.
- reduce accelerated depreciation in favor of lower tax rates, reduce the bias toward debt financing, and establish greater parity between large corporations and large non-corporate counterparts.
- reduce the top corporate tax rate on manufacturing income to 25 percent (lower for "advanced" manufacturing activities), and expand, simplify and make permanent the R&D tax credit.
- require companies to pay a minimum tax on overseas profits, remove tax deductions for moving production overseas, and provide new incentives for bringing production back to the U.S.
- allow small businesses to expense up to $1 million in investments.
- allow cash accounting on businesses with up to $10 million in gross receipts.
- double the deduction for start-up costs from $5,000 to $10,000.
- reform and expand the health insurance tax credit for small businesses. The reform would allow small businesses with up to 50 workers to qualify for the credit (up from 25), provide a more generous phase-out schedule, and substantially simplify and streamline the tax credits rules.

Senate Budget Committee Chair Kent Conrad, D-N.D., announced April 17th that he will introduce the deficit reduction plan developed in 2010 by President Obama's National Commission on Fiscal Responsibility and Reform, co-chaired by Erskine Bowles and former Sen. Alan Simpson, as his own budget proposal but will postpone a full markup of the plan indefinitely.

M. Roth IRAs Cannot be S Corporation Shareholders. The Ninth Circuit, affirming the Tax Court, has held that a corporation whose sole shareholder was a Roth IRA is not a valid S corporation. *Taproot Administrative Services, Inc.,* No. 10-70892 (9th Cir. 3/21/12), aff'g 133 T.C.202 (2009). The taxpayer had argued that he, individually, should be treated as the S corporation shareholder, since he was the beneficiary of the Roth IRA or, alternatively, that the Roth IRA should be treated as a grantor trust or qualified subchapter S trust ("QSST"). In rejecting the taxpayer's argument, the Ninth Circuit noted that, unlike grantor trusts and QSSTs, both of which are taxed currently on their income, Roth IRAs are subject to differed taxation on current income and are therefore incompatible with the S corporation taxation rules. The court referenced Rev. Rul. 92-73 which specifically prohibits IRAs from being S corporation shareholders.

N. Partnership Insolvency Under Section 108(d)(3). The IRS has issued Rev. Rul. 2012-14, to extend the principles of Rev. Rul. 92-53 to apply to a partnership context and help partners measure their insolvency under section 108(d)(3). Rather than using the Section 752 rules, the Service chose a partner insolvency measurement approach whereby each partner is allocated a share of the partnership's excess liabilities in the same way that each partner is allocated cancellation of debt (COD) income. The reason the IRS gives the taxpayer credit for excess nonrecourse liabilities, which they actually wouldn't have to pay, is because the tax due on the COD income that the nonrecourse liabilities generate can cause the partner to be insolvent. Thus, it makes sense to use who's getting the COD income as the benchmark for allocating the debt.

O. Proposed Regulations on Back-to-Back Loans by S Corporation Shareholders. Numerous disputes have arisen between the IRS and S corporation shareholders regarding the extent to which shareholders can increase their basis of indebtedness in the S corporation through back-to-back loans. The Code does not define "basis of indebtedness," and as a result, courts have interpreted Section 1366 to require an investment in the S corporation that constitutes "an actual economic outlay" by the shareholder to create basis of indebtedness. The proposed regulations (Reg-134042-07) provide that shareholders can increase their basis of indebtedness in the S corporation only to the extent that the debt is bona fide. The proposed regulations look to general federal tax principles for determining whether the debt is bona fide and reaffirm that a shareholder simply acting as a guarantor of S corporation indebtedness does not create or increase basis. Basis of indebtedness is not created in those circumstances "unless the shareholder actually makes a payment, and then only to the extent of such payment."

P. IRS Tightens Procedures for Issuing Individual Taxpayer Identification Numbers. The Internal Revenue Service announced on June 22, 2012 (IR-2012-62) important interim changes to strengthen its procedures for issuing individual taxpayer identification numbers (ITINs) from now through the end of the year. Designed specifically for tax-administration purposes, ITINs are only issued to people who are not eligible to obtain a social security number. During this interim period, the IRS will only issue ITINs when applications include original documentation, such as passports and birth certificates, or certified copies of these documents from the issuing agency. ITINs will not be issued based on applications supported by notarized copies of documents. In addition, ITINs will not be issued based on applications submitted through certifying acceptance agents unless they attach original documentation or copies of original documents certified by the issuing agency. The changes, which are effective immediately, are designed to strengthen and protect the integrity of the ITIN process while minimizing the impact on taxpayers.

Q. IRS Issues Sample Language to be Used for Making a Section 83(b) Election. Rev. Proc. 2012-29 contains sample language that may be used (but it not required to be used) for making an election under Section 83(b) of the Internal Revenue Code. In addition, it provides examples of the income tax consequences of making such an election. Section 83(a) provides that if property is transferred in connection with the performance of services to any person other than the person for whom such services are performed, then the excess of the fair market value of the property (determined without regard to any restriction other than a restriction which by its terms will never lapse) as of the first time that the transferee's rights in the property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs first, over the amount (if any) paid for the property is includable in the service provider's gross income for the taxable year which includes such time. Section 83(b) permits the employee or other service provider to elect to include in gross income at the time of transfer the excess (if any) of the fair market value of the property over the amount (if any) paid for the property. This amount is then treated as compensation for services. Under Treas. Reg. § 1.83-2(c), the election is made by filing a copy of a written statement with the IRS office with which the person who performed the service files his or her tax return. In addition, the person who performed the services is required to submit a copy of the statement with his or her income tax return for the taxable year in which the property was transferred. Treas. Reg. § 1.83-2(d) requires that the person who performed the services also submit a copy of the election to the person for whom the services were performed. Under Treas. Reg. § 1.83-2(e), the statement must include the following information: the name, address and taxpayer identification number of the taxpayer; a description of each property with respect to which the election is being made; the date or dates on which the property was transferred and the taxable year for which such election is being made; the nature of the restriction or restrictions to which the property is subject; the fair market value at the time of transfer (determined without regard to any lapse restrictions as defined in Treas. Reg. § 1.83-3(i)) of each property with respect to which the election is being made; the amount, if any, paid for such property; and a statement to the effect that copies have been furnished to the other persons as required by Treas. Reg. § 1.83-2(d). An election under Section 83(b) may not be revoked, except with the consent of the Commissioner. The sample election is reproduced below.

Section 83(b) Election

The undersigned taxpayer hereby elects, pursuant to § 83(b) of the Internal Revenue Code of 1986, as amended, to include in gross income as compensation for services the excess (if any) of the fair market value of the shares described below over the amount paid for those shares.

1. The name, taxpayer identification number, address of the undersigned, and the taxable year for which this election is being made are:

TAXPAYER'S NAME: _____

TAXPAYER'S SOCIAL SECURITY NUMBER: _____

ADDRESS: _____

TAXABLE YEAR: Calendar Year 20__

2. The property which is the subject of this election is _____ shares of common stock of _____.

3. The property was transferred to the undersigned on [DATE].

4. The property is subject to the following restrictions: [Describe applicable restrictions here.]

5. The fair market value of the property at the time of transfer (determined without regard to any restriction other than a nonlapse restriction as defined in § 1.83-3(h) of the Income Tax Regulations) is: $_____ per share x _____ shares = $_____.

6. For the property transferred, the undersigned paid $_____ per share x _____ shares = $_____.

7. The amount to include in gross income is $_____. [The result of the amount reported in Item 5 minus the amount reported in Item 6.]

The undersigned taxpayer will file this election with the Internal Revenue Service office with which taxpayer files his or her annual income tax return not later than 30 days after the date of transfer of the property. A copy of the election also will be furnished to the person for whom the services were performed. Additionally, the undersigned will include a copy of the election with his or her income tax return for the taxable year in which the property is transferred. The undersigned is the person performing the services in connection with which the property was transferred.

Dated: _____

Taxpayer _____

I. <u>Service Acquiesces on Pro-Taxpayer Application of Passive Activity Loss Rules to Limited Liability Companies</u>. The passive activity loss rules impose limitations on the deductibility of losses. Under the current economic climate, many investors have experienced considerable losses. Generally, a person's ability to deduct losses from a passive activity, i.e., an activity in which the taxpayer does not "materially participate," is limited under Section 469 to income generated from other passive activities. In contrast, losses arising from an active activity can immediately offset taxable income from any source, including the taxpayer's salary, wages, interest and dividends. For investors using the limited partnership form of business, the correct characterization of an activity as active or passive simply depends on whether the investor is a general partner or limited partner. But for investors using the limited liability company form of business, the correct characterization of an activity has been uncertain. Recently, several courts have clarified that ownership interests in limited liability companies are not presumptively passive limited partnership interests. *Thompson v. United States*, 87 Fed. Cl. 728 (2009); *Newell v. Commr.*, 99 T.C.M. (CCH) 1107, 2010 T.C.M. (RIA) § 10,023; *Garnett v. Commr*, 132 T.C. 368 (2009); *Hegarty v. Commr*., No. 3730-07S, T.C. Summ. Op. 2009-153, 2009 WL 3188789 (T.C. Oct. 6, 2009). The IRS has acquiesced in these cases, albeit in the result only. A.O.D. 2010-02, 2010-14 I.R.B. 515. The IRS subsequently issued guidance in the form of proposed regulations, which address how the general passive activity loss rules apply to LLC members. Prop. Reg. § 1.469-5(e)(3)(i). The new guidance relies on an LLC member's right to participate in the management of the entity to distinguish between limited partners and general partners.

II. <u>MICHIGAN</u>

A. Update on Income Tax Changes for Retirement Benefits. The Michigan Department of Treasury issued an updated chart summarizing the income tax changes for retirement benefits that become effective for the 2012 tax year (i.e., tax returns filed in 2013). The release reflects the changes enacted into the law by 2011 P.A. 38, and the

changes mandated by the Michigan Supreme Court in *In re Request for Advisory Opinion Regarding Constitutionality of 2011 P.A. 38*, DKT. No. 143157, 11/18/2011.

1. Taxpayers Born Before 1946 (no change in current law).

   - Social Security is exempt
   - Senior citizen subtraction for interest, dividends and capital gains is unchanged
   - Public are pensions exempt
   - For 2012 private pensions subtract up to $47,309 for single filers and $94,618 for joint filers

2. Taxpayers Born in 1946 to 1952.

   a. Before the taxpayer reaches age 67

      - Social Security is exempt
      - Railroad pension is exempt
      - Military pension is exempt
      - Not eligible for the senior citizen subtraction for interest, dividends and capital gains
      - Public and private pension limited subtraction of $20,000 for single filers or $40,000 for joint filers

   b. After the taxpayer reaches age 67 (will first occur in 2013).

      - Social Security is exempt
      - Railroad pension is exempt (but see below)
      - Military pension is exempt (but see below)
      - Not eligible for the senior citizen subtraction for interest, dividends and capital gains
      - Subtraction against all income of $20,000 for single filers and $40,000 for joint filers
      - Not eligible for this income subtraction if choosing to claim a military or tier 2 railroad pension exemption

3. Taxpayers Born after 1952.

   a. Before the taxpayer reaches age 67.

      - Social Security is exempt
      - Railroad pension is exempt
      - Military pension is exempt
      - Not eligible for the senior citizen subtraction for interest, dividends and capital gains
      - Not eligible for public or private pension subtraction

   b. After the taxpayer reaches age 67 (will first occur in 2020).

      - Not eligible for senior citizen subtraction for interest, dividends and capital gains.

- Not eligible for public or private pension subtraction.
- Income exemption election:

  i. **ELECT** exemption against all income of $20,000 for single filers or $40,000 for joint filers

     - No exemption for Social Security, military or railroad retirement.
     - No personal exemptions.

  OR

  ii. **ELECT** to exempt Social Security, military and railroad pension. May claim personal exemptions.

B. Withholding for Pension and Retirement Benefits. As noted above, Michigan's tax treatment of pension and retirement benefits changed, effective January 1, 2012. In connection with this change, Michigan law now requires the administrators of pension and retirement benefits to withhold income tax on payments that will be subject to tax. Details can be found in the 2012 Pension Withholding Guide (Pub. 4927 [rev.01-12]) issued by the Michigan Department of Treasury.

C. Michigan Unemployment Taxes. A 0.2% surcharge was added to the FUTA tax rate in 1976 to help shore up the federal unemployment tax system. It was repealed in 2011, reducing the rate applied to wages from 0.8% to 0.6%, effective July 1, 2011. However, Michigan had to pay an additional 0.9% FUTA tax rate (resulting from a reduction in the available FUTA tax credit), because of the money it borrowed from the federal government to finance unemployment benefits and was unable to repay. Thus, the total FUTA rate was 1.7% from January 1, 2011 to June 30, 2011, and 1.5% from July 1, 2011 to December 31, 2011. To offset this cost, Michigan offers a Michigan Unemployment Tax Credit to fully experienced employers (unemployment experience of 5 years or more), who have a positive reserve balance, a credit of either 50% of the additional FUTA taxes paid or the taxable wages for the year of the credit multiplied by the employer's Nonchargeable Benefits Component (NBC), which ever results in the lessor amount. Whenever the Unemployment Insurance Agency (UIA) borrows money from the federal government to pay unemployment benefits, a solvency tax is triggered by a provision of the Michigan Employment Security (MES) Act to pay the interest on the federal loans. The solvency tax can only be used to pay the interest. Only a contributing employer, that had a negative balance in their experience account as of June 30th of the preceding calendar year. A "Negative Balance Employer" is one that paid less in state unemployment taxes than their former employees received in unemployment benefits. The negative balance employer must also have had to pay unemployment taxes for five consecutive years. The solvency tax went into effect January 1, 2011. The solvency tax is 1/4 of the account building component (ABC) of the employer's contribution rate as determined under Section 19(a)(4) of MES Act. The maximum solvency tax rate is .75% (.0075)**,** based on a 3% maximum Account Building Component (ABC). The maximum tax increase per year would be $67.50 per employee, based on the annual taxable wage base per employee of $9,000. The solvency tax is in addition to an employer's calculated tax rate and would be displayed as a separate line item on Form UIA 1771, *Tax Rate Determination For Calendar Year 2012*. However, in December 2011, the state issued $3.32 million in bonds to repay the federal debt. As a consequence, neither the additional 0.9% FUTA rate nor the 0.75% Michigan solvency tax apply in 2012. Instead, the Michigan solvency tax has been

replaced with an "obligation assessment" (OA) which will be used to repay the Michigan bonds that were issued to repay the federal debt. The bonds are scheduled to take 10 years to repay. The OA rate will be determined yearly and included on the annual Tax Rate Determination. Instead of being billed, it will be included as a part of the annual tax rate determination. One of the components of the OA is based on the employer's individual tax rate. Therefore, the amount will vary. The OA is structured to incorporate the employer's experience rate and a base assessment of $42 per employee for 2012, and is currently estimated at $63 for 2013 and beyond. The calculation of the OA takes into consideration the employer's current tax rate, the OA ratio, a base assessment, and the taxable wage base. The OA ratio for 2012 is 0.08, the base assessment is $42.00 and the taxable wage base is $9,500.00. The formula is:

(*2012 tax rate X OA ratio*) + (*base assessment ÷ taxable wage base*)

When calculating an individual OA rate, an employer would use the tax rate that is shown on its 2012 tax rate determination form. The OA ratio, base assessment, and taxable wage base will be the same for all employers. The 2012 rates are as follows**:**

OA ratio - .080671

Base assessment - $42.00

Taxable wage base - $9,500

The obligation Assessment Rate will be set and calculated yearly until all the bonds have been retired.

For Example:

2012 tax rate = 2.4% = 0.0240	**X OA = 0.08 = .001920**
$42.00 ÷ $9,500.00	**= .004421**
.001920 + .004421= .006341	**X 100 = .634 Rounded = .64**
2012 Obligation Assessment =	**0.64 added to calculated 2012 tax rate**

Note that the taxable wage base is increased from $9,000 in 2011 to $9,500 in 2012. If the state's Unemployment Trust Fund reaches a certain surplus amount, the taxable wage base will be lowered back to $9,000. In addition, the tax rate, which was based on the past five years of unemployment claims in 2011, will instead be based on the past four years of unemployment claims in 2012, and the past three years of unemployment claims in 2013.

D. Federal Disregarded Entities. On January 26, 2012, the Michigan Department of Treasury issued a notice regarding the Michigan Business Tax ("MBT") treatment of federally disregarded entities. It was issued in response to 2011 P.A. 305. Under this legislation, an entity that is disregarded for federal income tax purposes that did not file as a separate entity for the 2008, 2009 or 2010 MBT tax year in either an original return filed before January 1, 2012, or an amended return filed prior to December 1, 2011, may not file as a separate entity for its 2008, 2009, 2010 or 2011 MBT year. However, an entity that is disregarded for federal income tax purposes that did file as a separate entity for the 2008, 2009 or 2010 MBT tax year in either an original return filed before January 1,

2012, or an amended return filed prior to December 1, 2011, may file an amended MBT return as a disregarded entity if the MBT return at issue is within the statute of limitations provided in MCL § 205.27a. An entity disregarded for federal income tax purposes that is eligible to file as a separate entity for its 2011 MBT tax year and does not file as a separate entity in that year must file all required forms and supporting schedules, including combining filing schedules if the entity is part of a unitary business group. The disregarded entity must identify its organization type before its MBT return will be processed. For example, if the entity is a limited liability company whose single member is a C corporation, it must select organization type "C corporation/LLC C corporation." The disregarded entity that is filing separately must prepare a corresponding pro forma federal tax return and attach that pro forma federal tax return to its 2011 MBT return. The parent entity must also prepare a corresponding pro forma federal return and attach that pro forma federal return to its 2011 MBT return.

E. Health Insurance Claims Assessment. Beginning January 1, 2012, the Health Insurance Claims Assessment Act ("HICA Act") requires certain third party administrators, carriers and self-insured entities to pay an assessment equal to one percent of their total paid health care claims. All payments under the HICA Act are required to be remitted to the Michigan Department of Treasury by electronic funds transfer ("EFT"). Quarterly payments are due April 30, July 30, October 30, and January 30. In order to be registered to make payments by EFT, taxpayers must complete and submit Form 4926 (Electronic Funds Transfer Application – Health Insurance Claims Assessment) to the Department.

F. Personal Property Tax Phase-Out. According to Lieutenant Governor Brian Calley on February 28, 2012, Michigan will begin phasing out its personal property tax by reducing the burden on the industrial sector. Bills to phase out the tax will be introduced "in a matter of weeks," and will include a filing threshold that gets the smaller taxpayers out of the system. Eliminating the tax on personal property "on a schedule that matches up with the exhaustion" of the $638 million in tax credits promised before the January 1 elimination of the State's tax-incentive program will "mitigate" the impact on local government. The incentive program was eliminated as part of Michigan's new corporate tax, but "for the next two years, will be paying out on tax-credit promises of the past," Calley said. The objective in eliminating the industrial classification for personal property is to increase investment in Michigan. The process will begin with the disallowance of new industrial property, and the phasing out of existing property as the State's tax-incentive payouts decrease. Many local officials are nonetheless concerned over the effect these changes will have on their communities.

G. Michigan Insurers are Required to Provide Autism Benefits. New legislation requires Michigan health insurance plans to provide autism benefits. Self-insured plans are not bound by this requirement, although there are incentives designed to promote such coverage. The new law creates a fund from which insurers are able to seek reimbursement for claims paid for the diagnosis and treatment of autism-related disorders. Theoretically, all autism claims paid by a health plan would be reimbursed from the fund. However, to the extent the fund has insufficient money to provide reimbursements, reimbursements will not be made.

H. *Eastbrook Homes, Inc v Department of Treasury*, Court of Appeals No 299612 (04/24/12). Individual buyers purchased vacant lots under warranty deeds from a developer, which paid transfer taxes on the value of the undeveloped lots. The next day,

the buyers entered into separate contracts with the builder to construct homes. The builder took quit claim deeds on the vacant lots as security and quit claimed the lots back to the buyers after construction was completed. The court held that the quit claim deeds were taxable and a transfer tax is owed on the value added by the completed construction.

I. Principal Residence Exemption. Public Act 114 of 2012, effective May 1, 2012, changes the deadline for a property owner to file an affidavit claiming the local Michigan property tax principal residency exemption has been changed. For taxes levied before January 1, 2012, the affidavit must be filed with the local tax collecting unit in which the property is located on or before May 1. For taxes levied after December 31, 2011, the affidavit must be filed on or before June 1 for the immediately succeeding summer tax levy and all subsequent tax levies or on or before November 1 for the immediate succeeding winter tax levy and all subsequent tax levies. In addition, a land contract vendor, bank, credit union, or other lending institution is allowed to retain the principal residence exemption on foreclosed property if the property is not occupied, is for sale, is not leased to any person other than the person who claimed the exemption immediately preceding the foreclosure, and is not used for any business or commercial purpose. A lending institution that retains the exemption is required to pay what it otherwise would have paid in school operating taxes and to pay an administration fee. The administration fee is retained by the local tax collecting unit.

J. Michigan Accelerates Personal Income Tax Rate Cut. On June 27, 2012, Governor Rick Snyder signed legislation that accelerates the date Michigan's personal income rate decreases to 4.25% from 4.35% to October 1, 2012. Previously, that rate cut was scheduled to take effect on January 1, 2013. On June 28, 2012, the governor also signed a bill that allows personal income taxpayers to claim qualifying annual personal or dependency exemption amounts equal to $3,950 effective October 1, 2012 ($4,000 effective January 1, 2014) or the amount previously allowed ($3,700 for 2012, adjusted for inflation in subsequent years), whichever is greater. The legislation requires the Michigan Department of Treasury to annualize the $3,950 amount mentioned above for the 2012 tax year, rounded to the nearest $1. (L. 2012, H5699, effective 06/29/2012; L. 2012, H5700, effective 06/29/2012.)

K. Multistate Apportionment. In the *Estate of Wheeler v. Department of Treasury*, Michigan Court of Appeals Nos. 302251, 302259, 302261 and 302262 (July 31, 2012), the court held that where Company A is 99 percent owned by Company B, which in turn is 99.5 percent owned by Company C, then Company A and Company C are not separate and distinct entities, but are in a parent/subsidiary relationship, and the companies should be allowed to use multistate apportionment under the Michigan Income Tax Act ("MITA") under the Unitary Business Principal ("UBP"). MITA does not exclude foreign entities from being considered under the UBP.

L. Unpaid SBT tax is Non-Dischargeable Excise Tax. A taxpayer's assessment for a company's unpaid Single Business Tax as a corporate officer was not dischargeable in bankruptcy because it was a non-dischargeable excise tax under 11 U.S.C. § 507(a)(8)(E). The SBT taxes at issue arose from the business activity of a limited liability company, of which the taxpayer was an manager or member. The return date for the taxes at issue was more than three years before the date of the filing of the taxpayer's petition in bankruptcy, which would mean the taxes would be dischargeable under 11 U.S.C. § 507(a)(8)(E) unless they were an excise tax on a transaction. The SBT is a tax upon the privilege of doing business that is measured by the "adjusted tax base" of persons

with business activity in Michigan. *Paul A. Henderson v. Mich. Department of Treasury*, Mich. Tax Tribunal, Dkt. No. 431375, 08/24/2012.

M. Supplies Were Purchased for Resale. Janitorial supplies were shipped directly from the taxpayer's supplier to GM facilities. The contract between the taxpayer and GM specified that GM would be billed for the cost of the supplies and equipment. The janitorial supplies were used by GM's janitorial staff. The taxpayer was not liable for Michigan use tax on the supplies, because they were purchased for resale. *Knight Facilities Management, Inc. v. Department of Treasury*, Michigan Court of Appeals, No. 305787, September 27, 2012.

III. EMPLOYEE BENEFITS

A. Determination Letter Program. It is hard to believe that we are beginning to go through for a second time the complex IRS system of five and six year cycles for obtaining a determination that qualified plan documents comply, as to form, with the requirements of the Code. This system divides plans between those which are based upon a document that the IRS has previously approved, which are amended according to a six year cycle, and those which are based upon a document that has been custom-drafted for the particular adopting employer (often referred to as a "individually designed" plan), which are amended according to a five year cycle. A "determination letter' is an IRS approval letter for a plan drafted for a particular employer, i.e., an individually designed plan. An "opinion letter" is a pre-approval letter for a prototype plan, which generally consists of an adoption agreement combined with a larger document comprising the "boiler plate." An "advisory letter" is a pre-approval letter for a "volume submitter plan," which is a single document including both the variable provisions of a plan and the "boiler plate." Prototype and volume submitter plans are intended to be used by more than one employer. Thus, opinion and advisory letters are typically issued to firms which then use their pre-approved documents to amend the plans of their clients or customers. Some clients or customers using a pre-approved document are comfortable relying upon the opinion or advisory letter issued with respect to the pre-approved document, while others prefer to obtain a separate determination letter, which would then apply to the pre-approved plan as specifically adopted by that particular employer. Although that has been a common practice in the past, it is becoming increasingly difficult for a particular employer using a pre-approved document to obtain a separate determination letter. This is discussed further below. If the foregoing is not sufficiently complex, it is made more so by the fact that the six year cycle for pre-approved plans is further divided into separate parts for defined contributions plans, such as profit sharing and 401(k) plans, and defined benefit plans. Further, the IRS takes the position that, apart from these cycles for restating plan documents, plans must nevertheless be amended on an annual basis for "interim amendments," i.e., changes in the law that become effective during the plan year. In certain cases, these amendments may be made by the firm which originally obtained the opinion or advisory letter with respect to the pre-approved plan document in which case they will apply to all of the individual employers adopting that pre-approved document. In other cases, typically where there are discretionary provisions, those interim amendments must be individually adopted by the particular employer. In the case of an individually designed plan, the interim amendments must always be adopted by the particular employer for whom the plan was drafted. Below are tables for individually designed and pre-approved plans showing the time periods for the first set of cycles, i.e., those relating to the restatement of qualified plans for the Economic Growth And Tax Relief Reconciliation Act of 2001, and the second set of cycles as currently scheduled by the IRS:

INDIVIDUALLY DESIGNED PLANS
5 YEAR CYCLE

Last digit of Plan Sponsor's TIN	Cycle	EGTRRA RAP Ends	Next RAP Ends
1 or 6, electing groups	A	1/31/2007	1/31/2012
2 or 7, multiple employers	B	1/31/2008	1/31/2013
3 or 8, governments	C	2/2/2009	1/31/2014
4 or 9, multi-employers	D	1/31/2010	1/31/2015
5 or 10	E	1/31/2011	1/31/2016

PRE-APPROVED PLANS
6 YEAR 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 Contributions	Mass Submitter (Lead & Specimen Plans) and Nat'l 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 & minor modifier applications)	02/17/2005 to 01/31/2006	04/30/2010	02/01/2011 to 01/31/2012	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	02/01/2007 to 01/31/2008	04/30/2012	02/01/2013 to	02/01/2013 to

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
	modifier applications)			01/31/2014	01/31/2019

***** Extended to April 2, 2012 by Announcement 2012-3.

B. New Changes to Determination Letter Program. The IRS determination letter program will undergo two key changes in 2012. The first is the elimination of the option to obtain a determination letter that a plan passes the coverage and non-discrimination requirements, known as Demos 5 and 6 of Schedule Q. The rational for eliminating this option is that these determinations are based on the specific data used in the test. Consequently, they do not relieve employers from further compliance testing as the data changes over time. The second change is to eliminate the option on the part of an employer adopting a pre-approved plan to obtain a determination letter, unless the employer has modified the pre-approved plan to such an extent that it causes the plan to be treated as individually designed. The official reason for this change in procedure is that employers adopting pre-approved plans should be able to rely on the opinion or advisory letter obtained by the firm from whom the employer obtained the pre-approved plan document. A more cynical view is that it evidences the failure of the IRS' complex five year/six year cycle program to effectively spread out the work of its agents and eliminate bottle-necks in the determination letter program, which was the ostensible reason for the five year/six year cycles in the first place. As a consequence, the IRS has resorted to putting the entire determination letter program out of bounds for employers adopting certain kinds of plans. This has the potential for problems on several fronts. For example, buyers in M&A transactions have long relied upon IRS determination letters as proof that the seller's plan document is in compliance with the requirements of the law. In addition, plans must be qualified in order for the participants to receive certain bankruptcy protections, and determination letters have commonly been used as evidence of plan qualification. Third, obtaining a determination letter on a pre-approved plan is often a more efficient way to regulate retirement plan language than trying to fix problems after they have been discovered, particularly when the discovery occurs on audit and the penalties are much higher. Plan documentation issues have been on the rise as adoption agreements are increasingly filled out by people who are not experts in employee benefits law. Even the people who ostensibly are made available by the prototype sponsor to help the employer fill out the documentation often lack the expertise of the personnel at the home office of the prototype sponsor charged with the administration of the plan. In any event, the end result of all of the foregoing changes is as follows:

1. Determination letter applications filed on Form 5307 on or after May 1, 2012 will be accepted only from adopters of volume submitter plans that have modified the terms of the pre-approved plan, but only if the modifications are not so extensive as to cause the plan to be treated as individually designed.

2. Form 5307 applications will not be accepted from adopters of volume submitter plans that have not made any changes to the pre-approved plan document or

from any adopters of master and prototype plans. All of these adopters may only rely on the advisory or opinion letter issued with respect to these plans.

3. Individually designed plans, and volume submitter plans that have been modified to such an extent as to cause the plan to be treated as individually designed, must apply for a determination using the lengthier Form 5300 (and pay the higher user fee).

4. Under Rev. Proc. 2012-6, the only other circumstances under which an employer may be able to obtain a determination letter as an adopter of a pre-approved plan by filing Form 5300 is as follows:

- the application also requests a determination regarding affiliated service group or leased employee status, or a partial plan termination;
- the plan is a multiple employer plan;
- a determination letter is required by the IRS (e.g., in connection with a request for a funding waiver);
- the employer has added language to a master or a prototype plan to satisfy the requirements of Sections 415 and 416 because of the required aggregation of plans; or
- the plan is a pension plan with a normal retirement age earlier than age 62.

Note that in the foregoing circumstances the use of Form 5300 does not mean that the plan must be restated for changes in qualification requirements included in the Cumulative List in effect when the application is filed. The plan will instead be reviewed on the basis of the Cumulative List that was considered in issuing the opinion or advisory letter for the plan. The employer must indicate in its cover letter the reason for using Form 5300 and must include with the application a copy of the opinion or advisory letter issued with respect to the prototype or volume submitter plan. The proper user fee must be paid as well, which will be more than for Form 5307.

C. User Fees. The user fees for obtaining a determination letter are as follows:

New User Fees Per Revenue Procedure 2011-8	
Form 5300:	$2,500
Form 5307:	$300
Form 5310:	$2,000
Multiple employer plans (Form 5300):	
(1) 2 to 10 forms 5300 submitted	$3,000
(2) 11 to 99 Forms 5300 submitted	$3,000
(3) 100 to 499 forms 5300 submitted	$15,000
(4) Over 499 Forms 5300 submitted	$15,000
Multiple employer plans (Form 5310):	
(1) 2 to 10 forms 5300 submitted	$3,000
(2) 11 to 99 Forms 5300 submitted	$3,000
(3) 100 to 499 forms 5300 submitted	$15,000
(4) Over 499 Forms 5300 submitted	$15,000
Volume Submitter	

Specimen plan (non-mass) with no/one adoption agreement; Per each additional adoption agreement	$12,000 $9,500
Mass submitter specimen plan with no/one adoption agreement; Per each additional adoption agreement	$12,000 $1,000
Specimen plan identical to mass submitter specimen plan	$300
Assumption of sponsorship of an approved specimen plan per basic plan document	$300
Master & Prototype (M&P)	
Mass submitter – per basic plan document with one adoption agreement; Per each additional adoption agreement	$12,000 $1,000
Sponsor's identical adoption of mass submitter basic plan document – Per adoption agreement	$300
Sponsor's minor modification of mass submitter basic plan document – Per adoption agreement	$1,000
Non-mass submitter – per basic plan document with one adoption agreement; Per each additional adoption agreement	$12,000 $9,500
Advisory letter for additional optional provisions – per mass submitter basic plan document	$1,000
Assumption of sponsorship of an approved M&P plan – Per basic plan document	$300
Mass submitter/non-mass submitter sponsor per trust document In excess of 10	$1,000

D. Final Service Provider Fee Regulations. The Department of Labor has issued its final regulations for service provider fee disclosures under ERISA § 408(b)(2). Covered service providers, e.g., registered investment advisors, certain broker-dealers, third party administrators, and other service providers receiving $1,000 or more in direct or indirect compensation from plan assets, must make initial disclosures to plan fiduciaries of covered plans by July 1, 2012. Those plan fiduciaries must then make disclosures to plan participants. The first annual plan, expense and investment disclosures to participants must be made by August 30, 2012 (later for plan years beginning in August, September or October). The first quarterly expense disclosure to participants is due November 14, 2012. Plan fiduciaries can request additional information from covered service providers if necessary to complete a participant disclosure or Form 5500. A covered service provider must provide that information "reasonably in advance" of the date that the plan fiduciary indicates is the filing deadline. The final regulations do not require a summary disclosure. However, the DOL has provided a model summary disclosure in case a plan would like to use it. The DOL has also indicated that it intends to issue proposed regulations possibly requiring a summary. The regulations allow covered service providers to cure an error or omission in making a disclosure, which includes corrections to change notices. There is an exception to these disclosure requirements for certain 403(b) plans where the account was issued before 2009 and the employer did not have an obligation to make contributions to the account after 2008. Those accounts are not considered to be part of a covered plan, and vendors servicing those accounts are not covered service providers. Therefore, no

disclosures are required to be made with respect to those accounts. The following table summarizes the participant disclosure deadlines:

Summary: Timing Rules for Required Participant Fee Disclosures under the New Rules	
Disclosure Deadlines	**Type of Disclosure**
First Disclosures Required in 2012	
August 30, 2012	First Initial Notices due for calendar year plans and for plans with non-calendar year plan years beginning between November 1, 2011 and July 1, 2012
60 days following the first day of the 2012 plan year	First Initial Notices due for non-calendar year plans whose 2012 plan year begins after July 1, 2012 and before November 1, 2012
November 14, 2012	
45 days after the end of the first quart in which the Initial Notices are required to be made	First Quarterly Notices due for plans whose 2012 plan year begins after July 1, 2012 and before November 1, 2012
Subsequent and Ongoing Disclosure Requirements	
On or before eligibility date to direct plan investments	Initial Notice (includes plan-related information and a comparative chart of investment-related information)
Every 12 months	Annual Notice (includes plan-related information and a comparative chart of investment-related information
30 to 90 days before the effective date of any change to plan-related information provided in Initial Notice or Annual Notice	Updating Notice (includes plan-related information)
Every 3 months	Quarterly Notice (actual administrative and individual expenses charged to individual accounts)
Subsequent to investment	Certain investment information relating to voting and tender rights
Upon participant/beneficiary request	Certain investment information including prospectuses and financial statements

E. Reporting 2010 Roth IRA Rollovers and Conversions. The IRS has posted guidance on its website concerning how taxpayers should report 2010 Roth IRA rollovers and conversions on their 2011 income tax returns. During 2010, a taxpayer may have rolled over eligible distributions from a retirement plan to a Roth IRA, converted amounts from a non-Roth IRA to a Roth IRA, or made an in-plan Roth rollover. If so, the taxpayer must report one-half of the taxable amount of these 2010 rollovers and conversions on their 2011 tax return, unless the taxpayer elected to include the taxable amount in income for 2010, recharacterized the 2010 rollover or conversion to a Roth IRA, or received a distribution in 2010 or 2011 of any of the taxable amount (in which case, the taxpayer would need to report that amount on the 2011 tax return). The guidance provides detailed information concerning how to complete individual income tax returns for taxpayers who took advantage of the ability in 2010 to do a conversion or rollover to a Roth IRA and report one-half of the income in 2011 and the other one-half in 2012.

F. Misclassified Independent Contractors. Last year the IRS created the Voluntary Classification Settlement Program ("VCSP") which allows employers to voluntarily reclassify workers as employees for future tax periods. In new FAQs, the IRS indicates that it will not share information about the VCSP applications with the Department of Labor or state agencies. Also, an employer who is contacted by the IRS regarding an SS-8 determination letter is still eligible for VCSP, but an audit of a parent, subsidiary or another member of the employer's consolidated group is treated as an audit of the employer. Accordingly, the employer would be ineligible for VSCP. In addition, the FAQs indicate that signing a closing agreement under VCSP is not an admission of any liability for prior years, and that the rejection of a VCSP application will not automatically trigger a federal audit. The FAQs are available at http://www.irs.gov/businesses/small/article/0,,id=246014,00.html.

G. Guidance Promoting Annuity Options Under Qualified Plans. The IRS has issued two sets of proposed regulations and two revenue rulings intended to promote annuity options under qualified plans, IRAs, 403(b) plans, and governmental 457 plans. REG-115809-11, 77 Fed. Reg. 5443 (February 3, 2012); REG-110980-10, 77 Fed. Reg. 5454 (February 3, 2012); Rev. Rul. 2012-3; Rev. Rul. 2012-4. Under current regulations, if a participant elects both a partial annuity and lump sum payment, statutory actuarial assumptions must be used to calculate both forms of distribution. If the new regulations become final, plans would only be required to use the statutory assumptions to calculate lump sum payments. They could use the plan's regular conversion factor to calculate the partial annuity. The regulations would also modify the required minimum distribution rules to allow participants to use retirement plan account balances to purchase longevity annuities. A longevity annuity is an annuity with an income stream that begins at an advanced age, such as age 80. Rev. Rul. 2012-3 states that when the participant invests in a deferred annuity, the participant's account is not subject to the QPSA requirement until the participant affirmatively elects to commence an immediate annuity distribution. Finally, Rev. Rul. 2012-4 allows participants receiving a lump sum distribution from a defined contribution plan to transfer all or a portion of that lump sum payment to their employer's defined benefit plan (if permitted under the terms of the plan), so that it could then be payable as an annuity under that plan.

H. ERISA § 404(c) Protection Not Applicable to Investment Selection. ERISA § 404(c) provides that fiduciaries are not responsible for losses resulting from a participant's investment decisions if the plan meets certain requirements. While the DOL has long taken the position that ERISA § 404(c) protection is not available with respect to a fiduciary's selection of the investment alternatives made available to participants, there is

some disagreement on this point among the federal circuit courts. In *PFEIL v. State Street Bank & Trust Co.*, 2012 WL 555481 (6th Cir. 2012), the Sixth Circuit agreed with the DOL's position. The court noted that the fiduciary had a fundamental duty to select and maintain only prudent investment options in the plan. The fact that participants make their own investment decisions does not relieve fiduciaries of the obligation to monitor the prudence of the investments offered. The Sixth Circuit rejected the Fifth Circuit's contrary view that even when a fiduciary's investment selection may have been imprudent, the fiduciary may rely on ERISA § 404(c) in arguing that the participant's investment decision was the cause of the participant's loss.

I. 409A Analysis Used to Determine if "Retirement" Occurs for Pension Plan Purposes. A multi-employer pension plan, in an effort to permit employees to "retire" under an early retirement benefit before that benefit was eliminated, proposed to let eligible participants "retire" and then immediately return to work. In PLR 201147038, the IRS looked to § 409A in concluding that these employees were not legitimately retired. Although § 409A applies to non-qualified plans, the IRS states that its definitions regarding termination and separation from service were consistent with the definition of "severance of service date" under the elapsed time method of crediting service. It also cited a prior Revenue Ruling that concluded an employee is not separated from service if the employee continues on the same job for a different employer post-corporate transaction.

J. IRS Interim 403(b) Document Audit Relief. Monika Templeman, Director of Employee Plans Examinations for the IRS's TE/GE Division, announced in February an interim program to address an audit problem related to the IRS's delay in updating the EPCRS program to reflect 403(b) document changes, and stalled 403(b) prototype program. This interim program, according to IRS staff, will not be provided in formal, published guidance, but will be implemented by the field staff during audit until such time as EPCRS and the 403(b) prototype program are finalized. If an employer is found not to have adopted a formal 403(b) plan document in a timely manner, the IRS may choose to enter into a type of agreement where sanctions more resembling those available under the Voluntary Correction Program ("VCP") will apply, rather than those under the more expensive Closing Agreement Program ("CAP"). If a "document error" (as that term is used under EPCRS) has been found, the employer may be given the option of amending the plan prospectively and fixing the past error as an operational error (either as a self-correction, where applicable, or using the VCP structure); or to instead commit to adopting a prototype program (when issued) and follow the rules for their remedial amendment under that program. The IRS will follow-up with the employer should the "prototype choice" be selected, so serious thought should be given to these alternatives before making a choice. What the IRS is unable to do under favorable terms due to the legal structure of the audit program is to permit a retroactive amendment of the plan on audit.

K. Faulty Summary Plan Description. In *Skinner v. Northrop Grumman Retirement Plan B*, No. 10-55161 (9th Cir. March 16, 2012), two participants claimed additional pension benefits because the summary plan description ("SPD") did not adequately disclose an "annuity equivalent offset" that was used in calculating their pensions. Despite having previously given credence to this theory, the Ninth Circuit held the case when it came back a second time until after the Supreme Court decided *CIGNA Corp. v. Amara*, 131 S.C. 1866 (2011). In light of *Amara*, the Ninth Circuit found that the plaintiff's claim for recovery based on the SPD failed as a matter of law. It then went on to consider whether the plaintiffs were entitled to equitable relief under ERISA § 502(a). The

court did not find sufficient evidence to justify an equitable remedy based on estoppel, reformation or surcharge and affirmed summary judgment to the defendants.

L. IRC Section 415(b) Limits. The American Academy of Actuaries ("AAA") has written to the Department of Treasury and the IRS expressing concern with a position apparently taken by the IRS with respect to Section 415(b). Section 415(b) imposes a dollar limit on benefits payable from qualified defined benefit plans. In 2012, the limit is $200,000 a year for a single life annuity. Section 415(b)(2)(C) provides that the limit is reduced for benefits that begin before age 62, and Section 415(b)(2)(B) provides that there is no adjustment for form of payment if the benefit is paid as a QJSA. It has been understood that, using 2012 limits as an example, a $200,000 benefit could be paid beginning at age 62 as a qualified joint and 100 percent (or any lesser percentage at least equal to 50 percent) survivor annuity. For example, assume that a participant's accrued benefit under the plan formula, before applying the Section 415 limits, is $300,000, payable at the plan's normal retirement age of 65. The plan pays 80 percent of the accrued benefit at age 62, and pays a 100 percent QJSA using an optional form factor of 0.9. The plan's pre-limit accrued benefit payable at age 62 as a 100 percent QJSA is $300,000 x .8 x .9 = $216,000. Since the maximum benefit payable at age 62 is a 100 percent QJSA under Section 415(b) is $200,000, the accrued benefit payable at age 62 as a 100 percent QJSA has been understood to be $200,000. Based on informal discussions between AAA and IRS officials, it appears that the IRS interprets the regulation (specifically Treas. Reg. §1.415(b)-1(a), which limits the benefit that can accrue to the Section 415 limit) to mean that the benefit payable at age 62 is $200,000 x .8 x .9 = $144,000. IRS representatives indicated that this was an intentional change promulgated in the 2007 § 415 regulations. AAA disagrees and has provided statutory and regulatory support for its position. It also noted in its letter that plan formulas can easily be changed to avoid the IRS' interpretation.

M. Failure to Monitor 401(k) Fees Violates Fiduciary Duties. In the first class action over 401(k) fees to be tried and decided on its merits, a Missouri federal district court has ruled that manufacturer ABB Inc. breached its fiduciary duties under ERISA, and was required to pay $35.2 million to the plaintiff class, for (i) failing to monitor the record keeping fees and revenue-sharing payments made to the plan's trust company, (ii) failing to negotiate rebates to offset or reduce the cost of providing administrative services to plan participants, and (iii) replacing an actively balanced mutual fund with the trust company's target date fund that generated more in revenue sharing for the trust company. *Tussey v. ABB, Inc.*, 2012 WL 1113291 (W.D. Mo. 2012).

N. Corporate-Owned Life Insurance Policies. Section 101(j)(1) provides that, in the case of an employer-owned life insurance contract, the amount of the death benefits excluded from gross income may not exceed the sum of the premiums and other amounts paid for the contract. Section 101(j)(2) provides exceptions to the general rule based either on (i) the insured's status as an employee within 12 months of death or as a highly compensated employee or highly compensated individual, or (ii) the extent to which death benefits are paid to a family member, trust, or estate of the insured employee, or used to purchase an equity interest in the applicable policy holder from a family member, trust or estate. The exceptions provided by Section 101(j)(2) apply only if the notice and consent requirements of Section 101(j)(4) are satisfied. The IRS ruled in PLR 201217017 that corporate-owned life insurance policies purchased by a closely held corporation on the lives of its shareholders satisfied the notification and consent requirements of Section 101(j)(4), because the shareholders' signatures on agreements disclosing the amount of the policies and other pertinent information provided their consent.

O. HOP Energy, LLC v. Local 553 Pension Fund, No. 10-3889-cv (2nd Cir., May 3, 2012). On May 3, 2012, the U.S. Court of Appeals for the Second Circuit held that an employer that stopped contributing to a multi-employer pension fund after it sold the assets of one of its divisions, cannot use the Multiemployer Pension Plan Amendments Act sale of assets exemption to avoid withdrawal liability under ERISA when the purchaser did not assume substantially the same post-sale obligation to contribute as the seller had pre-sale.

P. *Shelter Distrib., Inc. v. Gen. Drivers, Warehousemen & Helpers Local Union No. 89,* 6TH Cir. 2012. The U.S. Court of Appeals for the Sixth Circuit has held that a provision in a collective bargaining agreement requiring the union to indemnify the employer for any withdrawal liability resulting from the employer withdrawing from a multi-employer plan was enforceable. The union had argued that this provision in the collective bargaining agreement violated a prohibition in ERISA against an agreement relieving a fiduciary from liability for breach of a fiduciary duty. The Sixth Circuit disagreed, noting that nothing in the collective bargaining agreement relieved the employer from the withdrawal liability. Instead, the indemnification provision was akin to a fiduciary contracting for insurance, which is expressly permitted under ERISA.

Q. Rollovers as Business Start-Ups ("ROBS"). ROBS is a qualified plan arrangement marketed to prospective business owners to access accumulated tax-deferred retirement funds without paying applicable distribution taxes in order to cover new business start-up costs. While not considered to be an abusive tax avoidance transaction, ROBS are questionable in the view of the IRS because they serve solely to benefit one individual's exchange of tax-deferred assets for currently available funds. This is accomplished by using a retirement plan and its investment in employer stock as a means to avoid distribution taxes otherwise assessable on this exchange. The Employee Plans Compliance Unit ROBS project began in December, 2009 and ended in September, 2010. Beginning in 2010, compliance contact letters were sent to a sample of ROBS plan sponsors identified as being non-filers of the Form 5500 Series return, but having received a favorable determination letter from EP Rulings and Agreements regarding the form of the plan. This project has now been completed and the IRS has determined that many plan sponsors have not been filing the Form 5500 Series return. The primary reason for the sponsors being non-filers was because they and their advisors were incorrectly interpreting an exemption to the Form 5500 Series filing requirement which does not apply to ROBS plans. The filing exemption only applies if assets are less than a specified dollar amount ($250,000) and the plan provides deferred compensation solely for an individual or an individual and his or her spouse who wholly own a trade or business whether incorporated or unincorporated. However, in a ROBS arrangement, the plan, rather than the individual, owns the trade or business. Therefore, this filing exemption does not apply and the annual Form 5500 return is still required.

R. IRS Issues Q&A Guidance on Notice Requirements for Single-Employer Defined Benefit Plans. The IRS has issued Question-Answer Guidance in Notice 2012-46 on the requirements of ERISA Section 101(j), under which notice must be provided to participants and beneficiaries regarding certain limitations on benefits provided under single-employer defined benefit plans. Section 101(j) of ERISA requires the plan administrator of a single-employer defined benefit plan to provide a written notice to plan participants and beneficiaries, generally within 30 days after the plan becomes subject to the benefit limitations set forth in ERISA Section 206(g)(1) or (3) which relate to unpredictable contingent event benefits and prohibited payments. More specific notice

rules apply in the case of a plan that becomes subject to the benefit limitations of ERISA Section 206(g)(4), which relate to the cessation of benefit accruals. In the case of Section 206(g)(4), the notice generally must be provided within 30 days after the earlier of the valuation year for the plan year for which the plan's adjusted funding target attainment percentage (AFTAP) is less than 60% or the date that percentage is presumed to be less than 60% under the rules of Section 706(g)(7) of ERISA. Section 502(c)(4) of ERISA provides that the Secretary of Labor may assess a civil penalty of not more than $1,000 a day for each violation by any person of the notice requirements under Section 101(j) of ERISA.

S. Fiduciaries Must Monitor Self-Directed Brokerage Accounts. DOL Field Assistance Bulletin No. 2012-02 provides guidance relating to the new Code Section 404(a)(5) Participant Disclosure Rule. Question No. 30 and its related answer apply to self-directed brokerage accounts ("SDBA"). The question posed is whether an investment platform offered by a plan sponsor would be considered a designated investment alternative ("DIA"). The platform described had many investments from multiple organizations, none of which were DIAs themselves. In the response, the DOL stated:

- the platform itself is not a DIA.
- the failure to designate a manageable number of investment alternatives raises questions about whether the plan fiduciary has fulfilled its fiduciary obligations with respect to providing sufficient information related to investment alternatives.
- plan fiduciaries have a general duty of prudence to monitor a plan's investment menu.
- if a significant number of participants and beneficiaries (at least 5, or at least 1% for plans with more than 500 participants and beneficiaries) choose a non-designated investment alternative through a SDBA or similar arrangement, then the plan sponsor should examine these investments and determine whether they should be designated.

The DOL response raises several concerns, including: (i) many recordkeeping systems are not equipped to track this data, (ii) many plan administrators were surprised to learn that there was a fiduciary duty to monitor the SDBA, and (iii) it raises the issue as to whether having a SDBA is worth the expense and potential liability.

T. FAB 2012-02 Q&A-30 on Brokerage Windows Replaced. The DOL subsequently withdrew Q&A-30 from Field Assistance Bulletin 2012-02, replacing the FAB with FAB 2012-02R that contains new Q&A-39, which does not include the former Q&A-30's requirement that the plan provide disclosure of costs for investments through brokerage windows that were not designated as "designated investment alternatives" that were chosen in fact by a specified minimum number of participants.

U. Release-of-Claims Provisions May Require Section 409A Amendments Before Year-End. Section 409A of the Internal Revenue Code applies to many employment, severance and other similar arrangements that provide for post-termination severance or other compensation payments. These agreements often condition severance payments upon an employee's execution of a release-of-claims. For example, they often provide that severance payments will be made, or commence, only after an employee's execution of a release-of-claims in favor of the employer. Pursuant to federal employment laws the employees will be provided with a minimum period (e.g., 45 days) following

termination of employment to consider a release before signing it, and a minimum period (e.g., seven days) following execution of the release in which to revoke it. The IRS has expressed concern that these provisions violate Section 409A if they give an employee an indirect election as to when to receive or start receiving severance payments. For example, the release provisions may permit an employee to delay the payment or commencement of payment of severance benefits until the calendar year following the year of termination, depending on when the employee signs the release. In Notice 2010-6 and Notice 2010-80 the IRS provided employers with guidance on how to address this problem. For example, agreements providing for severance payments to be made within a specified period following termination of employment and that are conditioned on an employee signing and not revoking a release should be amended to either provide for payment on the last day of the period or provide that if the period spans two taxable years the payment will automatically be made in the later of the two years, regardless of the year in which the release is signed. In contrast, agreements providing for severance payments to be made following an employee's execution and non-revocation of a release that do not have a specified payment period should be amended to either provide for payment either 60 or 90 days following the date of termination or provide for payment during a specified period not exceeding 90 days following the termination date, except that if the period spans two taxable years, the payment will automatically be made in the later of the two years regardless of when the release is signed. For agreements existing on December 31, 2010, with non-compliant release provisions, employers have been able to rely on a transition period under which no document or operational failure will be deemed to occur if either the payments were completed by March 31, 2011, or for payments made after March 2011, where the payments for the release provision span two tax years, the payments are made in the later of the two years (or, in the earlier of the two years, are treated as an "operational failure" and corrected under Section 409A's operational correction program). However, this transition rule will expire on December 31, 2012, meaning that all affected agreements must be amended to bring them into compliance with these rules before the end of the year. If a bad release provision is not fixed before the end of this year, then it can only be fixed under the IRS' document correction program. Covered agreements entered into after December 31, 2010 are not eligible for this transition relief, and can only be corrected through the Section 409A document correction program.

V. Terminated Executives Entitled to Equity Award Payments. In *Schaffart v. ONEOK, Inc.*, Case No. 10-3861(8th Cir., July 5, 2012), the 8th Circuit Court of Appeals found that a company's former executives were entitled to prorated payments under performance share and restricted stock plans, despite the company's determination that the awards were forfeited when the executives terminated employment. In the plans, the term "Retirement" was not defined, and had not been applied consistently by the company. In making its decision, the court chose not to defer to the company's determination, because it was made by a person who lacked authority under the plans to make award decisions. Instead, the court itself interpreted the plan terms in favor of the former executives. It also found that the former executives were entitled to an award of attorneys' fees under state wage and hour laws.

W. Pension Funding Stabilization. Congress reauthorized the Highway Trust Fund to keep most highway taxes at their current levels through September 2014, while modifying the code to stabilize pension funding and use the revenue from that provision to help pay for lower student loan interest rates. The Moving Ahead for Progress in the 21st Century Act (S. 1813) addresses this issue effectively in the short-term by basing pension plan interest rates on historical averages. Specifically, in 2012, the interest rates

determined under prior law, which were based on the two-year average of interest rates, would be adjusted so that they are within 10% of the 25-year average of interest rates. For example, assume that under current law, a pension interest rate for a year is 5.5%, based on an average of interest rates for the prior two years. Assume further that the 25-year average for that interest rate is 7%. In that case, the 10% corridor around the 25-year average would be from 6.3% to 7.7%. Since 5.5% is not within that corridor, the pension interest rate would be deemed to be 6.3%, the closest number within the corridor. This process adjusts aberrational interest rates so that they better reflect historical norms. The 10% corridor is increased by 5% each year until it hits 30% for 2016 and subsequent years. At least in 2012 and 2013, this law effectively helps compensate for the artificiality of today's low rates. It is estimated to raise almost $9.5 billion over 10 years. The IRS subsequently issued Notice 2012-55 providing guidance on the 25-year average segment rates. IRS Notice 2012-61 was then issued providing guidance on the special rules relating to pension funding stabilization for single employer defined benefit pension plans.

X. IRS Discontinues Letter-Forwarding to Help Locate Retirement Plan Participants. Revenue Procedure 94-22 allowed an individual, company, or organization that controls assets that may be due a taxpayer, including Plan Administrators, sponsors of qualified retirement plans, or QTAs of abandoned plans under the Department of Labor's Abandoned Plan Program attempting to locate missing plan participants, to make a written request to the Service to use its letter forwarding program. The IRS announced in Revenue Procedure 2012-35 that the Service will no longer provide letter-forwarding services to locate a taxpayer that may be owed assets from an individual, company, or organization. The letter-forwarding program is now limited to situations in which a person is trying to locate a taxpayer to convey a message for a humane purpose as defined in Section 4 or in an emergency situation. Letter-forwarding requests that do not serve a humane purpose, such as requests that merely provide a financial benefit, will not be processed. This revenue procedure applies to requests postmarked on and after August 31, 2012.

Y. Sixth Circuit Affirms Decision Finding Entities With Any Control Over Funds Are Fiduciaries. In *Guyan International Inc. v. Professional Benefits Administrators Inc*. (6th Cir. No. 11-3126, August 20, 2012), the Court specifically rejected the third-party administrator's argument that it could not be a fiduciary, because it lacked discretionary authority over plan assets, explaining that it merely has to exercise any authority or control over plan assets to be a fiduciary. It also explained that any language in a contract purporting to limit its fiduciary status did not override its functional status as a fiduciary. Thus, because the third-party administrator had the power to write checks on the plan account and exercised that power, it was an ERISA fiduciary to the extent that it did so.

Z. Circuits Split as to the FICA Tax Treatment of Severance Pay. The U.S. Court of Appeals for the Sixth Circuit has issued its decision in *United States v. Quality Stores, Inc.*, No. 10-1563 (6th Cir. Sept. 7, 2012), which affirms the decisions of the bankruptcy and district courts for the Western District of Michigan. The court held that payments made by an employer to its employees upon involuntary termination due to business cessation did not constitute wages for purposes of the Federal Insurance Contributions Act ("FICA"). In so doing, the Sixth Circuit expressly noted that it did not agree with the Federal Circuit's approval of the IRS's position that payments falling within the statutory definition of supplemental unemployment compensation benefits ("SUB pay") can still be treated as dismissal pay subject to FICA taxes in *CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008).

AA. Employer Entitled To Make "Reasonable Modifications" To Retiree Health Care Benefits. An employer was entitled to make "reasonable modifications" to its retiree health care benefits, the Sixth Circuit ruled, reversing a district court's grant of summary judgment to the retirees finding that the employer lacked the ability to modify any benefits except with the approval of the union that once represented them. The Sixth Circuit majority concluded that whatever else vesting in the health care context means, it does not mean that beneficiaries receive a bundle of services fixed once and for all. Judge Bernice Donald filed a separate dissenting opinion. The case was *Reese v. CNH America, LLC* (Nos. 11-1359, 11-1857 and 11-1969).

IV. HEALTH CARE

A. Affordable Care Act Tax Provisions - Summary.

1. Small Business Health Care Tax Credit. This new credit helps small businesses and small tax-exempt organizations afford the cost of covering their employees and is specifically targeted for those with low- and moderate-income workers. In general, the credit is available to small employers that pay at least half the cost of single coverage for their employees.

2. Changes to Flexible Spending Arrangements. Effective Jan. 1, 2011, the cost of an over-the-counter medicine or drug cannot be reimbursed from Flexible Spending Arrangements or health reimbursement arrangements unless a prescription is obtained.

3. Proposed Regulations Issued on Medical Device Excise Tax. On February 3, 2012, the IRS and the Treasury Department issued proposed regulations on the new 2.3-percent medical device excise tax (IRC §4191) that manufacturers and importers will pay on their sales of taxable medical devices starting in 2013.

4. Health Insurance Premium Tax Credit. Starting in 2014, individuals and families can take a new premium tax credit to help them afford health insurance coverage purchased through an Affordable Insurance Exchange.

5. Health Coverage for Older Children. Health coverage for an employee's children under 27 years of age is now generally tax-free to the employee.

6. Excise Tax on Indoor Tanning Services — First Quarterly Payment Was Due Nov. 1, 2010. A 10-percent excise tax on indoor UV tanning services went into effect on July 1, 2010.

7. Employer-Provided Health Coverage — Not Taxable; Reporting is Voluntary for All Employers for 2011 and Small Employers for 2012. Starting in tax year 2011, the Affordable Care Act requires employers to report the cost of coverage under an employer-sponsored group health plan.

8. Adoption Credit. The Affordable Care Act raises the maximum adoption credit to $13,360 per child, up from $13,170 in 2010 and $12,150 in 2009. The adoption tax credit is refundable for tax year 2011, meaning that eligible taxpayers can get it even if they owe no tax for that year.

9. Medicare Shared Savings Program. The Affordable Care Act establishes a Medicare shared savings program (MSSP) which encourages Accountable Care Organizations (ACOs) to facilitate cooperation among providers to improve the quality of care provided to Medicare beneficiaries and reduce unnecessary costs.

10. Qualified Therapeutic Discovery Project Program. This program was designed to provide tax credits and grants to small firms that show significant potential to produce new and cost-saving therapies, support U.S. jobs and increase U.S. competitiveness.

11. Group Health Plan Requirements. The Affordable Care Act establishes a number of new requirements for group health plans.

12. Tax-Exempt 501(c)(29) Qualified Nonprofit Health Insurance Issuers. The Affordable Care Act requires the Department of Health and Human Services (HHS) to establish the Consumer Operated and Oriented Plan program (CO-OP program). IRS Notice 2011-23 outlined the requirements for tax exemption under section 501(c)(29.

13. Medicare Part D Coverage Gap "donut hole" Rebate. The Affordable Care Act provides a one-time $250 rebate in 2010 to assist Medicare Part D recipients who have reached their Medicare drug plan's coverage gap.

14. Additional Requirements for Tax-Exempt Hospitals. The Affordable Care Act added new requirements that tax-exempt hospitals must meet to maintain their tax-exempt status.

15. Annual Fee on Branded Prescription Pharmaceutical Manufacturers and Importers. The Affordable Care Act created an annual fee payable beginning in 2011 by certain manufacturers and importers of brand name pharmaceuticals.

16. Modification of Section 833 Treatment of Certain Health Organizations. The Affordable Care Act amended section 833 of the Code, which provides special rules for the taxation of Blue Cross and Blue Shield organizations and certain other organizations that provide health insurance.

17. Medical Loss Ratio (MLR). Beginning in 2011, insurance companies are required to spend a specified percentage of premium dollars on medical care and quality improvement activities, meeting a medical loss ratio (MLR) standard.

18. Limitation on Deduction for Compensation Paid by Certain Health Insurance Providers. The Affordable Care Act amended section 162(m) of the Code to limit the compensation deduction available to certain health insurance providers.

19. Employer Shared Responsibility Payment. Starting in 2014, certain employers must offer health coverage to their full-time employees or a shared responsibility payment may apply.

20. Patient-Centered Outcomes Research Institute. The Affordable Care Act establishes the Patient-Centered Outcomes Research Institute. Funded by the Patient-Centered Outcomes Research Trust Fund, the institute will assist patients, clinicians,

purchasers and policy-makers in making informed health decisions by advancing clinical effectiveness research.

B. Reporting Excise Taxes for Health Plan Compliance. For plan years beginning on or after January 1, 2010, sponsors of group health plans are required to self-report and pay excise taxes for failure to comply with COBRA and various other federal group health plan mandates, which generally include the following:

- Health Insurance Portability And Accountability Act ("HIPAA") non-discrimination and portability requirements
- Newborns and Mothers' Health Protection Act ("NMHPA")
- Genetic Information Nondiscrimination Act ("GINA")
- Mental Health Parity and Addiction Equity Act ("MHPAEA")
- Michelle's Law
- Children's Health Insurance Program Reauthorization Act ("CHIPRA")
- Health Savings Account employer comparable contribution rules
- Archer MSA comparable employer contribution rules

The excise tax for noncompliance with the rules relating to COBRA, HIPAA, GINA, MHPAEA, NMHPA, CHIPRA and Michelle's Law is generally $100 per individual per day for each individual to whom the violation relates for each day of noncompliance. However, this excise tax is subject to various limits and special rules. IRS Form 8928 with the applicable excise tax must generally be filed by the due date for filing the plan sponsor's federal income tax return (without extensions) for the year in which the failure occurs. The excise tax for noncompliance with the rules relating to HSA and Archer MSA comparable employer contributions is generally 35 percent of the aggregate employer contributions made to all HSAs or Archer MSAs during the applicable calendar year. Employers who fail to make these contributions must file Form 8928 on or before the 15th day of the fourth month following the calendar year in which the noncomparable contributions were made (i.e., April 15th). The failure to file Form 8928 and pay excise taxes may result in penalties and interest. However, for certain of these requirements there may be relief for inadvertent errors, and there is a 30 day grace period where the failure was due to "reasonable cause" and not "willful neglect." Form 8928 has a separate line to report that the failure was not discovered despite due diligence, but was corrected within the correction period.

C. Health Plan Participant Fee. For plan years ending after September 30, 2012, the Patient Protection and Affordable Care Act ("PPACA") requires a fee to be paid by the issuer of a policy for fully insured accident or health coverage and by the plan sponsor in the case of a self-funded accident or health plan. The purpose of the fee is to fund a non-profit corporation, the Patient Centered Outcomes Research Institute that was created by PPACA to research the risks and benefits of various medical procedures and drugs and to review ways to diagnose, treat and prevent illness. The fee will be due for seven years, with the amount increasing over that time. The fee is $1 times the average number of lives covered under the plan or policy in the case of plan or policy years ending after September 30, 2012 and before October 1, 2013, but increasing to $2 times the average number of covered lives for plan or policy years ending after September 30, 2013 and before October 1, 2014. Thereafter, the fee is adjusted for projected increases in national health care expenditures. The fee applies to grandfathered plans, but not to

excepted benefits for purposes of the HIPAA portability rules, e.g., most health FSAs, certain dental and vision plans, specified illness coverage, and coverage only for accidents.

D. Form W-2 Reporting on the Cost of Health Care Coverage. The Patient Protection and Affordable Care Act amended the Internal Revenue Code to require employers to report on Form W-2 the aggregate cost of employer sponsored health care coverage for most types of plans with respect to 2012 and beyond. Notice 2012-9 restates and amends guidance previously issued in Notice 2011-28 for employers and issuers regarding how to value and report coverage. In 2010, the IRS had granted employers relief from this reporting requirement through the end of 2011, and indicated that the penalty provisions would generally apply only to calendar years 2012 and beyond. Notice 2011-28 provided information for employers voluntarily choosing to report the cost of employer-sponsored health care coverage on 2011 Forms W-2 (generally issued in early 2012) and created a temporary exception for certain plans, including plans of smaller employers that file fewer than 250 Forms W-2 for the previous calendar year, until calendar year 2013. Thus, those employers would not need to report health care coverage until they issue W-2s in early 2014. COBRA rates are generally used to determine "aggregate cost." However, there are a variety of methods and special rules that may apply. The following table may be helpful in determining whether to report:

To report? Or not to report?			
Type of Coverage	**Yes**	**No**	**Optional**
Medical or Prescription Drug Coverage	X		
Stand-Alone Dental or Vision Coverage			X
Other Dental or Vision Coverage	X		
Health Reimbursement Arrangement			X
Employee Health FSA Contributions		X	
Employer Health FSA Contributions allocated specifically to Health FSA	X		
Employer Health FSA Contributions to the extent Employee's FSA amount exceeds Employee's contributions for tax-free benefits	X		
Other Employer Health FSA Contributions		X	
Multiemployer Plans (collectively bargained)			X
Self-Funded Church Plan (COBRA Exempt)			X
Health Savings Account Contribution*		X	
Archer Medical Savings Account Contribution*		X	
Hospital Indemnity Insurance or Coverage for Specified Illness-paid for by employee on after-tax basis		X	
Hospital Indemnity Insurance or Coverage for Specified Illness – paid for by employer or by employee on pre-tax basis	X		
Taxable Coverage for Domestic Partner or Child Over Age 27	X		
Indian Tribal Plan		X	
Third-Party Sick Pay Provider			X
Employee Assistance Plan providing "medical care" (e.g., counseling) for which a COBRA premium is charged	X		
Employee Assistance Plan providing "medical care" for which no COBRA premium is charged			X
Employee Assistance Plan providing no "medical care"		X	
Wellness Program providing "medical care" (e.g. biometric screening) for which a COBRA premium is charged	X		
Wellness Program providing "medical care" for which no COBRA premium is charged			X
Wellness Program providing no "medical care"		X	

To report? Or not to report?			
Type of Coverage	**Yes**	**No**	**Optional**
On-Site Clinic Providing "medical care" (e.g., by treating dependents) for which a COBRA premium is charged	X		
On-Site Clinic providing "medical care" for which no COBRA premium is charged			X
On-Site Clinic providing no "medical care"		X	
Taxable Income Attributable to Discriminatory Health Coverage**		X	
Taxable Income Attributable to S Corporation's Payment of Premiums on Behalf of 2% of Greater Shareholder**		X	
Employer Required to File Fewer than 250 W-2s for Prior Calendar Year			X
Governmental Plan (other than military)	X		
Governmental Plan (military)		X	
Long-Term Care Insurance		X	
Life Insurance		X	
Accidental Death & Dismemberment Insurance		X	
Disability Income Insurance		X	
Worker's Compensation Insurance		X	
W-2 Furnished During Calendar year in Which Employee Terminates Employment (at Employee's Request)			X
**** But report in Box 12 Using Code W***			
***** But report in Box 1***			

E. Medicare Tax on Net Investment Income. Effective January 1, 2013, a new 3.8 percent tax will apply to the "unearned" income of "high income" taxpayers. Another 0.9 percent tax will apply to the "earned" income of many of these same individuals. The revenues generated from this tax will be allocated to the Medicare trust fund that is part of the social security system. Those whose tax filing status is "single" will be subject to the new unearned income taxes if they have adjusted gross income ("AGI") of more than $200,000. Married couples filing a joint return with AGI of more than $250,000 will also be subject to the new tax. The AGI threshold for married couples filing separate returns is $125,000. Unearned income includes capital gains, rents, dividends and interest income. The portion of the unearned income that is subject to the new Medicare tax is the amount of income derived from those sources, reduced by any expenses associated with earning that income. Thus, in the case of rents, the taxable amount would be the gross rents minus all expenses (including depreciation) incurred in operating the rental property. In order to determine the amount of tax, a taxpayer will need to determine the lesser of his or her net investment income or the excess of AGI over the $200,000/$250,000 AGI thresholds. Thus, if net investment income is the smaller amount, then the 3.8 percent tax is applied only to the net investment income amount. If the excess over the thresholds is the smaller amount, then the 3.8 percent tax would apply only to the excess amount. Note that the 3.8 percent tax would apply to any part of the gain on the sale of a principal residence that exceeds the $250,000/$500,000 primary home exclusion if the seller has AGI above the $200,000/$250,000 AGI thresholds. If the ownership and operation of real estate you own is your sole occupation, then those activities constitute a trade or business and the income derived from them would not be subject to the new 3.8 percent tax, but it could be subject to the 0.9 percent tax on earned income. The IRS has issued Frequently Asked Questions (FAQs) to help employers implement the new 0.9 tax, which can be found on the IRS' website at http://www.irs.gov/businesses/small/article/0,,id=258201,00.html.

F. Summary of Benefits and Coverage. The Patient Protection and Affordable Care Act requires group health plans and health plan issuers to provide a

summary of benefits and coverage ("SBC") that "accurately describes the benefits and coverage under the applicable plan and coverage." The requirement applies to insured and self-funded group health plans, including grandfathered plans, as well as to individual health insurance coverage. The SBC must follow a uniform format which includes standard definitions of medical and health coverage terms, a description of coverage, cost sharing arrangements (e.g., deductibles, co-insurance and co-payments), and information regarding any exceptions, reductions or limitations under the coverage. These rules will apply to open enrollment that begins on or after September 23, 2012.

G. Self-Funded Plan Can Convert to Insured Without Loss of Grandfathered Status. The Department of Health and Human Services ("HHS") has released additional guidance on waivers from the annual limit restrictions under the Affordable Care Act ("ACA"). The annual limit restrictions under ACA provide that as of January 1, 2014, health plans or insurers offering group or individual coverage cannot impose any lifetime or annual dollar limits on "essential" health benefits. Previous HHS guidance allowed group health plans to obtain a waiver. The waiver program was closed in September, 2011. A group health plan that has a waiver is allowed to move to another insurer with a waiver without losing its grandfathered status. Grandfathered plans can impose annual limits of $1,250,000 for plan years beginning after September 22, 2011, and $2 million for plan years beginning after September 22, 2012, and before January 1, 2014. A recent Q&A release clarifies that a self-insured plan that has an annual limit waiver can move to an insured arrangement without losing its waiver or grandfathered status. The same requirements that apply to a move among insurers also apply to a self-insured to insured move, including:

- the plan sponsor must have been offering the group health coverage (for which it obtained from HHS a waiver of the annual limits requirement) to its employees before September 23, 2010;
- the issuer from which the group health plan is obtaining the insured policy must have obtained a waiver from HHS for the newly purchased policy;
- the annual limits of the new policy may not be lower than the annual limits of the previous policy, except in very limited situations where comparable coverage is not available; and
- the health insurance issuer must obtain from the plan sponsor an attestation that the criteria outlined above are satisfied, and the attestation must be accompanied by documentation outlining the terms of the prior coverage. Issuers have to retain this information in accordance with the data retention requirements under HHS regulations.

H. Affordable Insurance Exchanges. On March 12, 2012, the U.S. Department of Health and Human Services ("HHS") published a final rule on Affordable Health Insurance Exchanges ("Exchanges") which combine policies from two Notices of Proposed Rulemaking published last summer. Starting in 2014, one-stop marketplaces called Exchanges will be operational, enabling consumers and small businesses to choose a private health insurance plan. The final rule offers a framework to assist states in setting up the Exchanges. The final rule includes standards for:

- the establishment and operation of an Exchange;
- health insurance plans that participate in an Exchange;

- determinations of the individual's eligibility to enroll in Exchange Health plans and in insurance affordability programs;
- enrollment in health plans through Exchanges; and
- employer eligibility for and participation in the small business health options program ("SHOP").

I. $2,500 Health HSA Limit. In Notice 2012-40, the IRS provided guidance on the $2,500 limit on salary reduction contributions to health flexible spending arrangements. The $2,500 limit is a new requirement that was added by the Patient Protection and Affordable Care Act. The limit applies for plan years that begin after December 31, 2012. The guidance specifies that the $2,500 limit applies on a plan year basis, not on an employer's or employee's taxable year basis. The limit applies only to employee salary reductions under health FSAs. For example, if an employer provides $1,000 in non-elective contributions that the employee may use for any qualified benefit offered under a cafeteria plan, but that cannot be taken by the employee in cash, then the $1,000 will not count against the $2,500 limit on the employee's salary reduction contributions. On the other hand, if the employee's $1,000 contribution can be taken by the employee in cash, then it will count against the limit. The guidance gives plan sponsors until December 31, 2014 to amend their cafeteria plans to set forth the $2,500 limit (or a lower limit chosen by the sponsor), provided that the plan is operated in accordance with the limit for plan years beginning after December 31, 2012.

J. HIPAA Settlement Regarding Email and Texting. The Department of Health and Human Services earlier this year announced a HIPAA privacy and security settlement executed by its Office for Civil Rights ("OCR"). The covered entity, a small cardiothoracic surgery practice, reportedly posted protected health information ("PHI") on an internet-based, publically assessable calendar, and transmitted PHI from an internet-based email account to work force members' personal internet-based email accounts. OCR alleged that the covered entity failed to appropriately train its work force; adopt appropriate administrative and technical safeguards to protect the privacy and security of PHI; identify a security official; conduct an accurate and thorough security risk assessment; and obtain business associate agreements from the calendar and email providers. The settlement agreement requires the covered entity to pay $100,000 to OCR and comply with a corrective action plan.

K. Supreme Court Upholds Health Insurance Mandate Under Taxing Power. In one of its most noteworthy opinions in recent years, the U.S. Supreme Court ruled, in a 5-4 decision issued on June 28, 2012, that the individual mandate under the 2010 health care legislation is constitutional, but certain Medicaid expansion provisions are unconstitutional.

1. Background. The constitutionality of the Patient Protection and Affordable Care Act (the "Act"), was challenged by a variety of plaintiffs, including 26 states. The plaintiffs argued that the Constitution does not grant Congress the power to require private citizens to buy a private product from a private enterprise. They also argued that the Act unconstitutionally coerced states to expand Medicaid by threatening to withhold all federal Medicaid grants for non-compliance. The administration responded that Congress had the authority to establish the individual mandate under the power to regulate commerce (the "Commerce Clause") and the power to "lay and collect taxes" (the "Tax and Spend Clause") set forth in Article I of the U.S. Constitution. The administration further agued that the Medicaid expansion provisions were mere modifications of the existing program that

offered financial inducements to comply with the new law. The lower courts generally divided along four lines: (i) the individual mandate, along with the entire Act, was constitutional; (ii) the individual mandate was unconstitutional, but severable from the rest of the Act; (iii) both the individual mandate and the entire law was unconstitutional; and (iv) the issue was not ripe for review because of the Anti-Injunction Act, which prohibits taxpayers from preemptively seeking to stop the government from assessing any tax before it is imposed.

2. Supreme Court's Ruling. There were four separate opinions on the various issues, with Chief Justice Roberts writing for the Court. The Court upheld the individual mandate as constitutional on the basis that it is within Congress' authority under the Tax and Spend Clause. According to the Court, "The Federal Government does not have the power to order people to buy health insurance . . . [but it] does have the power to impose a tax on those without health insurance." In writing the decision for the Court, Chief Justice Roberts wrote that the individual mandate exceeded Congress' authority under the Commerce Clause, noting that the Commerce Clause does not authorize Congress to order individuals to engage in commercial activity. However, the Chief Justice said that Court should resort to "every reasonable construction . . . in order to save a statute from unconstitutionality." The Tax and Spend Clause, which grants Congress broad powers to assess and collect taxes, provided a basis for a reasonable construction that would permit the Court to find the Act constitutional. The Court held that the Act's Medicaid eligibility expansion provisions were unconstitutional because the government cannot coerce states to expand Medicaid by threatening to withhold existing federal Medicaid funds. Thus, even non-participating states must still receive existing Medicaid funding. Nevertheless, the Court found that the unconstitutional part of the Medicaid provisions could be severed and remedied, leaving in effect the remainder of the Act.

3. What's ahead. Although the Act was deemed largely constitutional, issues concerning the implementation and administration of the Act's various coverage mandates may still be litigated. For example, dozens of Catholic dioceses and schools have filed lawsuits in a number of states charging the Act's contraception coverage requirement violates their rights under the First Amendment to the U.S. Constitution. Separately, employers and plan sponsors could face litigation over whether the Act's coverage mandates have been properly implemented and administered. All of this is in addition to potential legislative challenges, particularly if a new administration takes office after the November election. In the meantime, individuals and employers must nevertheless plan for the Act's various reforms and mandates as they come into effect.

4. Make Sure All Current Requirements Have Been Implemented. The U.S. Department of Labor ("DOL") has begun random audits of employers to verify compliance with the initial requirements of Health Care Reform. Employers are being asked to produce documents to show that health plans have been amended for the insurance market reforms that have already taken effect, including coverage of dependent children until age 26, elimination of lifetime limits on the dollar value of essential health benefits, and the "restricted" annual limits that are still permissible on the dollar value of essential health benefits. Generally, for plan years beginning on or after September 23, 2010, group health care coverage can no longer have lifetime dollar limits on "essential health benefits." Group coverage may have restricted annual limits on essential health benefits for plan years beginning before January 1, 2014. No lifetime or annual dollar limits are permitted after 2014. If a plan is not grandfathered, then employers are being asked to demonstrate that the plan was amended to comply with the additional insurance market

reforms applicable to non-grandfathered plans. The DOL is requesting employers to supply copies of the notices that were provided to participants implementing the insurance market reforms. If a health plan is grandfathered, then the participant notices regarding grandfathered plan status must also be produced.

5. Additional Plan Changes and Participant Notices. Additional changes will be taking effect over the next few years. For example, non-grandfathered plans must offer contraceptive drugs and devices to female participants on a first dollar basis with no participant cost-sharing, effective as of the first day of the first plan year beginning on or after August 1, 2012. An exception is available for religious employers. Annual medical flexible spending account ("FSA") employee pre-tax contributions must be capped at $2,500 per participant. The IRS recently issued a notice to clarify that this is a plan year limit, and not a calendar year limit, and that it begins to apply as of the first day of the first plan year beginning on or after January 1, 2013. Generally, employer non-elective contributions (i.e., flex credits) do not count toward the $2,500 limit. However, if an employer provides flex credits that employees can elect to receive as cash, or as a taxable benefit, then those flex credits will be treated as salary reduction contributions and will count toward the limit. The most significant new participant notice is the summary of benefits and coverage ("SBC"). The purpose of the SBC is to provide certain information in a prescribed format to participants in an employer's health plan so they can compare the information to other plans for which they may be eligible, including the new coverages available on the state health insurance exchanges. The SBC must be provided to participants at open enrollment, effective with open enrollment periods beginning on or after September 23, 2012. In addition, newly eligible employees must be provided with an SBC effective as of the first day of the first plan year beginning on or after September 23, 2012. Most employers will be looking to the insurer or third party administrator of their group health plan for assistance in preparing and providing the SBC. New guidance allows the SBC to be distributed in electronic form in many situations.

6. New Reporting Requirements. Effective for 2012 and later years, employers must include the aggregate cost of employer-sponsored health benefits on the W-2 statements issued to employees. This new reporting requirement initially applies to W-2s issued in January, 2013. It is not applicable to employers with fewer than 250 individuals to whom the employer must issue a W-2. Since the cost is based on the coverage tier in which an employee is enrolled, and the cost must account for any changes in the employee's coverage during the year, employers should be developing systems to track an employee's health benefit coverage elections, so that this information can be captured when preparing W-2s in January 2013. Employers will also need to comply with other new reporting requirements in the near future. For example, non-grandfathered health plans must submit an annual report to the U.S. Department of Health & Human Services ("HHS") addressing whether the plan's benefits satisfy various criteria relating to cost and quality of care in areas such as case management, discharge planning and wellness. The reports will be due as of a future date which will be established in yet-to-be issued regulations.

7. New Taxes and Penalties. There are many new taxes and penalties intended to help finance health care reform. For example, beginning July 31, 2013, insurers and employers will be required to pay a new premium tax to finance comparative clinical effectiveness research. For the first year, the fee is $1.00 multiplied by the average number of covered lives (employees and dependents) enrolled in the employer's health plan. The multiplier increases to $2.00 for subsequent years and the tax sunsets for plan

years ending after October 1, 2019. Higher income taxpayers with wages in excess of $200,000 if single, or $250,000 if married and filing jointly, will be subject to an additional .9 percent Medicare hospital insurance payroll tax on wages in excess of these thresholds beginning next year. In addition, these individuals will be subject to a 3.8 percent tax on their net investment income. Under Health Care Reform, a new temporary reinsurance program is established for insurers in the individual market. The purpose of the program is to transfer insurer risk in the individual market to the group market over a three-year period beginning in 2014. Approximately $25 billion must be raised to finance the program, and it will be collected through a per capita contribution fee levied against employer group health plans (both fully-insured and self-funded). Guidance is expected to be issued later this fall regarding the amount of the fee.

8. State Exchanges, The Individual Mandate and Employer "Pay-or-Play" Penalty. The centerpiece of Health Care Reform is the establishment of the state health insurance exchanges, along with the individual mandate and the employer "pay-or-play" penalty. These elements of health care reform take effect in 2014. At that time, employers with 50 or more full-time employees must offer health care coverage to full-time employees and their dependents or pay a $2,000 per full-time employee penalty (disregarding the first 30 full-time employees). If the employer offers a health plan, but has at least one full-time employee who is enrolled in health coverage through a state exchange, and the employee is considered to be "low income" and receives the premium credit, then the employer must pay a penalty of $3,000 per each such individual. The $3,000 penalty is capped at $2,000 multiplied by all of the employer's full-time employees (disregarding the first 30), if that amount is less. However, low income individuals who are eligible for employer-provided health coverage can only qualify for the premium credit if the employer's health coverage is not "valuable" enough or isn't "affordable." An employer's health plan is not "valuable" enough if it does not provide "minimum essential coverage," which means that it covers at least 60 percent of the average employees' eligible expenses. The IRS has issued guidance to help employers determine if their coverage is "valuable" enough. The vast majority of employer health plans are expected to satisfy this requirement. An employer's health plan is not "affordable" for purposes of the $3,000 penalty if the employee's premium for single coverage under the lowest cost health option exceeds 9.5 percent of the employee's wages for that year. For this purpose, an employee's wages are defined as wages for purposes of Box 1 on Form W-2. Interestingly, the Supreme Court's decision holding the Medicaid expansion provisions unconstitutional may have an adverse effect on employers' liability under the Act's "pay-or-play" mandate. The Medicaid expansion provisions would have expanded eligibility from incomes below 100 percent of the federal poverty level to incomes below 133 percent of the federal poverty level (in effect, 138 percent of the federal poverty limit due to an additional 5 percent income disregard provided under the Act). If states do not expand Medicaid coverage, as they are not required to do so under the Supreme Court's decision, then individuals who would have been eligible for Medicaid will now likely seek coverage under the public health insurance exchanges. In addition, these individuals could be eligible for federal subsidies for exchange-based coverage. For example, an individual with income at 120 percent of the federal poverty level will not be eligible for Medicaid if his or her state declines to participate in the Act's Medicaid expansion. Such an individual may put his or her employer at risk of a shared responsibility under the "pay-or-play" mandate if the employer's plan fails the quality and affordability standards discussed above and the individual enrolls in coverage through a public health insurance exchange.

L. Proposed Regulations Provide Guidance on the new Section 501(r) Requirements for Charitable Hospital Organizations. The IRS has issued proposed regulations on the new section 501(r) requirements for charitable hospital organizations (REG-130266-11). Section 501(r) generally requires nonprofit hospitals to meet four new requirements:

1. Conduct a periodic community health needs assessment (CHNA");
2. Provide written financial assistance and emergency care policies;
3. Establish limitations on charges for emergency or medically necessary care; and
4. Set policies and procedures related to billing and collections actions.

In addition to risking the loss of it tax-exemption, hospitals that fail to comply can be subject to penalties. For example, there is a $50,000 excise tax for each year that a nonprofit hospital is not in compliance with the CHNA requirement. The proposed regulations provide that -- except for the CHNA requirements in Section 501(r)(3) -- Code section 501(r) itself applies to tax years beginning after March 23, 2010. The Section 501(r)(3) requirements apply to tax years beginning after March 23, 2012. The regulations under Section 501(r)(4) through 501(r)(6), which deal with the items listed in nos. 2-3 above, are proposed to apply for tax years beginning on or after the date these rules are published in the *Federal Register* as final or temporary regs. Comments and public hearing requests are due by September 24.

M. HIPAA Privacy and Security Audit Program. The American Recovery and Reinvestment Act ("ARRA") of 2009, and Section 13411 of the HITECH Act, requires the Department of Health and Human Services ("HHS") to provide periodic audits to ensure that covered entities and business associates are complying with the HIPPA Privacy and Security Rules and Breach Notification standards. To implement this mandate, HHS's Office of Civil Rights ("OCR") piloted a program to perform 115 audits of covered entities to assess privacy and security compliance. Audits conducted during the pilot phase began November 2011 and will conclude in December 2012. OCR has posted on its website a comprehensive audit protocol. The audit protocol covers three aspects of HIPAA's requirements regarding the safeguarding of protected health information ("PHI"). First, the audit protocol covers the following seven requirement of HIPAA's Privacy Rule: (i) notice of privacy practices for PHI, (ii) rights to request privacy protection for PHI, (iii) access of individuals to PHI, (iv) administrative requirements, (v) uses and disclosures of PHI, (vi) amendment of PHI, and (vii) accounting of disclosures. Second, the audit protocol requires investigation into the covered entities' compliance with HIPAA's Security Rule for administrative, physical and technical safeguards. Third, the audit protocol will examine compliance with HIPAA's Breach Notification Rules.

N. Long Awaited Guidance under Affordable Care Act's Employer Shared Responsibility Rules and 90-Day Waiting Period Limit. The Patient Protection and Affordable Care Act (the "Act") imposes new obligations - referred to as "employer shared responsibility" standards (a/k/a "pay-or-play" requirements) - on employers with 50 or more full-time equivalent employees. These rules are set forth in new Code § 4980H. Generally, employers with 50 or more full-time employees must offer group health coverage that satisfies certain requirements or pay a penalty. The pay or play penalty takes effect in 2014. The legislation defines full-time employee for this purpose as an individual who works, on average, at least 30 hours per week. Notice 2012-58 provides a safe harbor for ongoing employees under which the employer determines each ongoing employee's full-time status

by looking back at a standard measurement period (SMP), chosen by the employer, that is at least three consecutive calendar months and no more than twelve consecutive calendar months. The employer must treat employees who averaged at least 30 hours each week during the SMP as full-time employees during a subsequent "stability period," regardless of the employee's number of hours of service during the stability period and provided that the employee continues to be an employee. The stability period must be at least six consecutive calendar months, it must be no shorter in duration than the SMP, and it must begin after the SMP. The employer need not treat employees who did not work full-time during the SMP as full-time employees during the following stability period. Also, an employer can structure its SMP to end before the stability period begins in order to provide an administrative period of up to 90 days during which the employer can determine which ongoing employees are eligible for coverage and to notify and enroll employees. For employees that are reasonably expected as of their start date to work full-time, an employer that offers group health plan coverage at (or before the end of) their first three calendar months of employment will not be subject to an assessment penalty for not offering the employee coverage during this three-month period. The Notice provides a separate safe harbor for new variable and seasonal employees for employer health plans under which employees are offered coverage only if they are determined to be full-time employees. The employer may use a measurement period similar in concept to the SMP, called the initial measurement period (IMP). However, the IMP, together with any administrative period, generally cannot extend more than 13 months (plus a fraction of a month) from the employee's start date. For employees determined to be full-time employees during the IMP, the stability period must be at least six consecutive calendar months, it must not be shorter in duration than the IMP, and it must begin after the IMP. Additional rules address the treatment of new employees who become ongoing employees and the definitions of seasonal (for example, a camp counselor) and variable (for example, a retail worker) employees. Most of these safe harbors are available at least through 2014. The Act also imposes new requirements on health insurance issuers in the individual and group markets and group health plans maintained by all employers irrespective of size. These requirements include a limit of 90 days on the maximum length of waiting periods that plans may impose. The 90-day waiting period limitation appears in Public Health Service Act § 2708. It is also incorporated by reference into both the Employee Retirement Income Security Act and the Internal Revenue Code. As a result, the limitation applies to health insurance issuers and to group health plans in the public and private sectors, including church-sponsored plans. Notice 2012-59 provides temporary guidance regarding the 90-day limit on waiting periods.

O. Funds Transferred by Employer to TPA of Self-Insured Health Plan Were ERISA Plan Assets, Making TPA Liable as an ERISA Fiduciary for Deducting Undisclosed Fees. According to the DOL, the question of whether a plan has been given a beneficial ownership interest in particular funds (such that they become plan assets) is determined by formal contracts and other legal instruments, as well as the actions and representations of the parties involved -- particularly the employer. Based on these principles, service contracts often provide that employer funds do not become plan assets simply because they are transferred to a TPA. The decision in this case may ultimately be appealed, of course, yet this is not the first case to hold that TPA-held funds are plan assets. *Borroughs Corp. v. Blue Cross Blue Shield of Michigan*, 2012 WL 3887438 (E.D. Mich. 2012).

P. Sixth Circuit Allows Reasonable Modifications of Retiree Health Benefits.

In this case, the employer and labor union entered a collective bargaining agreement which stated the employer would provide healthcare benefits for retirees and their eligible surviving spouses. The issue was whether the lifetime healthcare benefits had vested and, if so, whether, and to what extent, the employer could modify the benefits. The court reiterated its 2009 ruling in the same case that an employer could unilaterally modify a retiree health plan, as long as the modifications were reasonable. The Court listed three considerations for the district court to examine in making its reasonableness determination: (i) Does the modified plan provide benefits 'reasonably commensurate' with the old plan? (ii) Are the proposed changes 'reasonable in light of changes in health care?' and (iii) Are the benefits 'roughly consistent with the kinds of benefits provided to current employees? *Reese v. CNH Am. LLC*, 11-1359, 2012 WL 4009695 (6th Cir. Sept. 13, 2012).

V. ESTATE PLANNING

A. Changing Estate, Gift and GST Tax Laws. The following table summarizes the estate, gift and GST tax landscape for the period from 2009 through 2013 under current law.

	2009	2010	2011	2012	2013
Estate Tax					
Exclusion	3,500,000	5,000,000	5,000,000	5,120,000	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	5,120,000	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	5,120,000	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.

B. Alternate Valuation Date. The IRS has issued new proposed regulations regarding the alternate valuation date. Reg-112196-07, 76 Fed. Reg. 71491 (Nov. 18, 2011). Generally, the date for valuing a decedent's estate is the date of death, unless the executor elects the alternate valuation date. The alternate valuation date is the date that is six months after the date of death or, if earlier, the date that any of the decedent's property is sold, exchanged or otherwise disposed of. The new proposed regulations expand the list of examples as to what constitutes a distribution, sale, exchange or disposition. For example, an exchange or disposition can result from an exchange of an interest in a corporation, partnership or other entity for a different interest in the same entity or in an acquiring or resulting entity (e.g., through a merger). There are a couple of exceptions where the fair market value of the exchanged interest equals the fair market value of the interest received, and where distribution from an entity or trust has the same fair market value as the amount distributed plus the fair market value of the remaining interest in the entity immediately after the distribution. The new proposed regulations include an "aggregation rule" pursuant to which the value of a portion of property that has been disposed of during the six month period is determined by multiplying the total value of the property as of the date of disposition by the fraction disposed. Also, if the decedent's gross estate includes an annuity, unitrust or similar interest pursuant to Section 2036 of the Code, then the value of each payment or distribution during the six month alternate valuation period must be determined as of the date of distribution and added to the value of the property generating the annuity, unitrust or other payment determined as of the alternate valuation date. The result is then used to calculate the amount includable in the decedent's gross estate.

C. Right to Substitute Assets Is Not An Incident of Ownership In A Life Insurance Policy. In Rev. Rul. 2011-28, the IRS applied the holding in Rev. Rul. 2008-22 to conclude that the right on the part of the grantor of a trust to substitute assets of equivalent value would not be treated as an incident of ownership in a life insurance policy

on the grantor's life held by the trust. However, the IRS indicated that the trustee must have a fiduciary obligation to satisfy itself that the properties acquired and substituted by the grantor have equivalent value. In addition, the substitution power cannot be exercised in a manner that shifts benefits among the trust beneficiaries. For example, the second test can be met when the trustee has the power to reinvest the trust corpus and a duty to treat the trust beneficiaries impartially. Alternatively, it can be met if the substitution does not impact the respective interests of the beneficiaries, such as when the trust is administered as a unitrust or distributions are all discretionary. Thus, if the grantor retains the power to substitute trust assets, such as an insurance policy, and the foregoing requirements are satisfied, then the trust will be treated as a wholly-owned grantor trust for income tax purposes, but the insurance policy will not be included in the grantor's gross estate under Section 2042.

D. Value of Property Subject to a Retained Interest. The IRS has issued final regulations regarding the estate tax treatment of retained interests, such as a GRAT. T. D. 9555, 76 Fed. Reg. 69126 (Nov. 8, 2011). For example, where the decedent and another individual are joint beneficiaries, the grantor's estate includes the value of one-half of the trust property, plus the value of the other half of the trust property reduced by the value, as of the grantor's death, of the present value of the survivor's interest. Where the grantor's beneficial interest succeeds another individual's interest, then the grantor's estate includes the value of the trust fund necessary to produce the grantor's annuity or unitrust payment had he survived the current recipient, less the present value of the current recipient's remaining annuity or unitrust interests, provided that this amount cannot be less than the amount of principal required to produce the annuity or unitrust payment that the grantor was entitled to receive in the year of death. If the decedent is entitled to increasing payments, such as in the case of a "backloaded" GRAT, then the grantor's estate includes the value of the trust fund necessary to produce the annuity or unitrust payments for the year of death, plus the value of the trust fund necessary to produce the incremental amount resulting from the increased annuity in each of the future years, discounted to reflect the delay in the decedent's receiving this additional amount. Finally, in order to avoid double inclusion, the regulations indicate that any amounts payable to the grantor's estate after death will not be included under Section 2033 if the value of the trust property is included by virtue of Section 2036.

E. Avoiding Late Filing and Payment Penalties by Reliance on Advice of Counsel. In *Estate of Liftin v. U.S.*, 2011 WL 5395546 (Ct. Fed. Cl. Nov. 8, 2011), the Court of Federal Claims denied the IRS' motion for judgment on the pleadings because the estate had alleged sufficient facts to show reasonable reliance on the advice of counsel regarding an estate tax return that was filed late. The estate had timely filed for a six month extension to file and made a payment of approximately $870,000. The decedent's surviving spouse was interested in applying for U.S. citizenship in order to allow the estate to take advantage of the marital deduction. She consulted with an estate attorney who advised her that the estate could file its return after the due date and preserve the marital deduction without triggering any penalties. The estate filed the return almost two years after the extended deadline showing an overpayment of approximately $200,000. The IRS issued a Notice of Adjustment reflecting penalties of approximately $170,000. In order to avoid a late filing penalty, a taxpayer must show that the failure was due to reasonable cause and that the taxpayer exercised ordinary business care and prudence, but was unable to timely file the return. Because the surviving spouse had consulted with an attorney on multiple occasions regarding the potential for penalties, the court held that the estate may be able to prove facts that show its failure to file on time was due to reasonable cause.

F. Portability. Under the tax bill signed on December 17, 2010, a deceased spouse's unused federal estate tax exclusion may be transferred to his or her surviving spouse, provided that the deceased spouse's executor files an estate tax return on IRS Form 706. This is known as "portability." Absent a change in current law, it only applies to decedents dying in 2011 or 2012. For some persons passing away in 2011, an estate tax return may not have been filed because the estate was under the $5 million exclusion amount, and the IRS may have not yet issued guidance on qualifying for portability. Notice 2012-21 allows a period of up to 15 months to obtain a six month extension by filing Form 4768. This election is available to the estate of a decedent (i) whose date of death was after December 31, 2010, and before July 1, 2011, (ii) who is survived by a spouse, and (iii) whose gross estate does not exceed the $5 million estate tax exclusion for 2011.

G. FLP Assets Includable in Gross Estate. The tax court held that assets owned by a family limited partnership were includable in the decedent's estate under Section 2036 in *Liljestrand v. Commr.*, T. C. Memo 2011-259 (Nov. 2, 2011). The holding was based on a finding that there was no legitimate, significant non-tax reason for the family limited partnership, and that the decedent had disregarded partnership formalities. The estate claimed that the partnership was created to secure the decedent's son's employment as manager of the property, and to avoid partition of the property under Hawaii law. However, the decedent's son was already guaranteed long-term employment as property manager by virtue of his position as trustee, and most of the real estate was located outside of Hawaii anyway. Moreover, the partnership did not open a bank account until two years after the partnership was formed, the decedent reported real estate income and expenses on his individual income tax returns in the interim, disproportionate distributions from the partnership were made to cover the decedent's personal expenses and those of his children, and the partnership refinanced some of the property and used the proceeds to pay for the decedent's federal estate tax liability.

H. FLP Assets Not Includable in Gross Estate. The tax court found that there were legitimate non-tax reasons for creating a family limited partnership in *Estate of Stone v. Commr*, T. C., No. 23290-09, T. C. Memo. 2012-48, 2/22/12. In this case, the decedent transferred Tennessee lakefront property with a value of $1.6 million to a family limited partnership. The IRS claimed that there was no legitimate non-tax reason for the family limited partnership and included the property in the decedent's estate under Section 2036. The court indicated that a family limited partnership transaction qualifies for the bona fide sale for adequate and full consideration exception under Section 2036 when there is a legitimate and significant non-tax reason for creating the partnership and the transferors receive partnership interests proportionate to the value of the property transferred. The court concluded that there was a legitimate and significant non-tax reason for the partnership, because the decedent wanted the property to become a family asset and the family hoped to one day develop and sell homes near the lake.

I. Incomplete Gift. In CCA 201208026, the IRS concluded that a completed gift had been made, but that it was not a gift of a present interest. As a result, the transfer did not qualify for the annual gift tax exclusion. The transfer involved a gift to a trust. The taxpayer argued that it was an incomplete gift, because of a testamentary power of appointment retained by the donor. The IRS concluded that the testamentary power of appointment related to the remainder of the trust, not the preceding beneficial term interest. On the other hand, there were certain impediments to the beneficiaries being able to enforce their withdrawal rights in state court. Consequently, the withdrawal rights were illusory and no annual exclusion was allowable.

J. Tax Consequences of Trust Reformation. In PLR 20120008, the IRS ruled that the reformation and modification of a residuary trust did not result in a gift under Section 2514 and will not cause the trust assets to be includable in the beneficiary's gross estate. It also ruled that the trust will have a zero inclusion ratio for generation-skipping transfer tax purposes. The purpose of the reformation was to correct a scrivener's error, not to alter or modify the trust instrument.

K. Family Limited Partnership Assets Includable in Gross Estate Do Not Increase Marital Deduction. In *Estate of Clyde W. Turner, Sr., et al. v. Commr.*, 138 T.C. No. 14 (2012), the Tax Court found that assets transferred to a family limited partnership were includable in the decedent's estate because there was no significant non-tax purpose to the partnership and the decedent retained an interest in the transferred assets. The estate argued that the marital bequest formula clause, which required the estate to transfer enough property to the surviving spouse to eliminate estate tax, required an increase in the marital deduction to account for the additional assets that were included in the gross estate. The Tax Court disagreed. Under Section 2056(a), an estate may deduct from the value of the gross estate the value of property that passes, or has passed, from a decedent to a surviving spouse. Accordingly, the marital deduction could not include the amount of the gifts of limited partnership interests that the decedent gave to those other than his wife, because they did not pass to the surviving spouse.

L. IRS Acquiesces But Only in Result in Marital Deduction Case. The decedent owned shares of non-publicly-traded stock held in a revocable trust, which provided that if the trustee sold the stock for more than the decedent's cost basis during the surviving spouse's lifetime, the trustee would distribute a certain amount to 23 named beneficiaries. After the decedent died, the stock was transferred to a marital trust for which a QTIP election was made. The IRS denied the marital deduction, but the district court determined that, based on the date-of-death value of the stock, the contingent bequests were effectively extinguished, and the possibility of a transfer to the contingent beneficiaries was "so remote that it is negligible." In AOD 2012-01, the IRS wrote that the district court erred as a matter of law because the test for the marital deduction under Section 2056(b)(7)(B)(ii)(II) is a bright-line test. However, the IRS concluded that the district court's finding that the stock had negligible value rendered the legal error irrelevant.

M. Future of Inherited IRAs in Doubt. Senate Finance Committee Chair Max Baucus, D-Mont., added a proposal to the Highway Investment, Job Creation and Economic Growth Act of 2012 that would limit the payout on inherited IRAs to five years. Certain classes of eligible beneficiaries, including surviving spouses and children below the age of majority, could still receive distributions based on life expectancy. There are also exceptions for disabled and chronically ill individuals. In addition, spouses could still roll over accounts. However, the five year rule would apply once a child reaches the age of majority. Reports of IRAs worth millions of dollars, like Republic Presidential Candidate Mitt Romney's, may have prompted the proposal. Arguably, these accounts are intended to be retirement assets, not assets to be left to the account owner's heirs. However, that distinction is hard for most people to understand. Many people would never have put as much money into their IRAs if it could not be stretched over their children's' life expectancy. The proposal would also frustrate taxpayers who converted traditional IRAs to a Roth IRA based on the assumption that the payout of the account could be stretched over the beneficiary's life expectancy. The proposal was introduced as a stand-alone revenue raiser. Although the JCT scored the proposal as raising $4.6 billion, it may be difficult for the government to collect that amount, because there are other alternatives. For example,

one alternative is a charitable remainder trust. Another alternative is for people to simply put less money into these accounts. Perhaps the most likely candidate to lobby against the proposal is the financial industry. The assets in IRAs and defined contribution plans are reported to total $9.1 trillion, or over 50 percent of all retirement assets.

N. Proposed Regs on Program-Related Investments of Private Foundations. The IRS has issued proposed regulations (REG-144267-11) that provide guidance to private foundations on program-related investments. The regulations include nine additional examples illustrating investments that qualify as program-related investments. Section 4944(a) imposes an excise tax on a private foundation that makes an investment that jeopardizes the carrying out of any of the private foundation's exempt purposes and on foundation managers who knowingly participate in the making of a jeopardizing investment. Additional excise taxes apply under Section 4944(b) to private foundations and foundation managers when investments are not timely removed from jeopardy. Section 4944(c) provides that program-related investments are not treated as jeopardizing investments. Because the existing examples focus on domestic situations principally involving economically disadvantaged individuals and deteriorated urban areas, the Treasury and the IRS determined that it would be beneficial to expand the examples to address activities conducted in a foreign country, situations not involving economically disadvantaged individuals and deteriorated urban areas, investments with potentially high rates of return, credit enhancement arrangements, and a private foundations' acceptance of an equity position in conjunction with making a loan. To illustrate, in one example a foundation makes a below-market-rate loan to a social welfare organization that conducts community art exhibits to help the organization buy new exhibition space. Because the loan advances the foundation's exempt activities, it is considered a program-related investment. Another example involves a business in a developing country that transports solid waste which is harming the environment to recycling centers. The business had obtained funding from a few commercial investors, but was having difficulty finding additional financing. For that reason, a foundation bought shares of the business' common stock on the same terms as the initial investors. Although there could be a high rate of return on the investment if the business succeeds, the investment is a program-related investment because it furthers the foundation's exempt activities.

O. Estate of George H. Wimmer, TC Memo 2012-157. On the basis of the specific facts and circumstances in this case, the tax court found that the limited partners received a substantial present economic benefit sufficient to render the gifts of limited partnership interests present interest gifts on the date of each gift. Accordingly, the gifts qualify for the annual gift tax exclusion under Section 2503(b). The primary purpose of this partnership was to invest in property, stock, bonds, notes, securities and other personal property and real estate. The partnership agreement generally restricted the transfer of partnership interests and limited the instances in which a transferee could become a substitute limited partner. Notwithstanding those restrictions, the partnership agreement contained an exception for transfers to related parties. The partnership agreement called for all partnership profits and all distributions of net cash flow to be allocated to the partners according to their proportional partnership interests. Distributions had to be made in cash pro rata. Wimmer made gifts of limited partnership interests to related parties during the years of 1996 through 2000. He died on March 29, 2004. The tax court said that the gifts could qualify for the annual exclusion if the donees received unrestricted and non-contingent rights to the immediate use, possession or enjoyment of the income from the limited partnership. To show that they did, the tax court said that the estate had to prove that the partnership would generate income, that some portion of the income would flow

steadily to the donees, and that the portion of income could be readily ascertained. The tax court found that the estate was able to carry this burden.

P. "Shark-Fin" Charitable Lead Annuity Trusts. With a charitable lead annuity trust ("CLAT"), a grantor creates and funds an irrevocable trust that pays a qualified charity a guaranteed annuity for a specified period of time. At the end of the annuity term, the CLAT assets can revert to the grantor or pass to other designated beneficiaries. The annuity payments are based on the federally determined, monthly adjusted, Section 7520 rate in effect for the month of the CLAT's creation or for one of the two months prior to creation, if lower. If the present value of the total annuity payments, based on the applicable Section 7520 rate, equals the value of the grantor's contribution to the CLAT, no gift is made upon formation (so-called "zeroing-out"). The ability of a CLAT to back load annuity payments to a charity may increase both the total charitable distributions and the amounts passing to the CLAT's remainder beneficiaries. Prior IRS guidance has indicated that a CLAT can provide for escalating annuity payments, but the IRS has failed to provide specific insight into the extent to which the payments may be back loaded. *See, e.g., PLR* 9112009 and Revenue Procedures 2007-45 and 2007-46. Recently, in PLR 201216045, the IRS reviewed the use of a CLAT formula that annually increased the annuity payments by 120 percent of the prior year's payment for the annuity term. The IRS approved the escalating annuity formula, ruling that it met the requirements of a guaranteed annuity interest as required for the estate to take a charitable tax deduction for the assets contributed to the CLAT. Unfortunately, none of the foregoing revenue procedures or PLRs require specific limitations on variable or increasing annuity payments made by a CLAT. Thus, until the issuance of more specific guidance, there will continue to be uncertainty regarding the limits on back-loading CLAT annuity payments.

Q. Proposed Portability Regs Provide Filing Relief for Small Estates. The IRS has issued temporary and proposed regulations on estate and gift tax portability that allow executors, in some cases, to estimate the value of a gross estate for purposes of filing a return to elect portability. The Tax Relief Act of 2010 included a provision that allows the unused portion of a deceased spouse's estate and gift tax exemption to be transferred to the surviving spouse. Under the new rules a taxpayer's total applicable exclusion amount is now the sum of the basic amount, plus the "Deceased Spousal Unused Exclusion Amount" (DSUEA). The "basic exclusion amount" corresponds to what was previously the entire applicable exclusion ($5,120,000 for 2012, which ties to the unified credit of $1,772,800). The DSUEA is the exclusion amount inherited from a deceased spouse to the extent it was not used. For example, a surviving spouse's exemption could include both a basic exclusion of $5,120,000, and a DSUEA of $5,120,000, resulting in a total exemption of $10,240,000. The carryover of the unused exemption applies for both estate and gift tax purposes, but not generation-skipping taxes. Estates must file a timely estate tax return (even if not otherwise obligated to do so) in order to make a portability election and report the amount of the unused exemption that remains from the decedent as a carryover to the surviving spouse. To prevent abuse (either deliberate or simply by circumstance), the determination of the DSUEA is calculated with respect to the last deceased spouse (who passed away after December 31, 2010, when the rules took effect). Thus, in the event of multiple marriages and a widow/widower with multiple deceased spouses, the deceased spousal unused exclusion amount is only calculated and applied with respect to the most recent deceased spouse, not the cumulative value from all prior spouses. The new portability rules apply to decedents who pass away after 2010 (when the rules took effect) and before 2013 (when the rules lapse). In other words, portability currently applies only to those decedents who pass away in 2011 and 2012.

Under the new temporary and proposed regulations, several changes have been made which are intended to make the rules easier to apply. While the new rules reiterate that it is necessary to file an estate tax return to take advantage of portability, and that the deadline is still the due date for the estate tax return (plus extensions), the Form 706 may now simply include an "estimated value" for property, to the nearest $250,000, if the entire amount is being left to a spouse or charity (such that the value, whatever it would be, is offset by a marital or charitable deduction anyway) and the estate is under the $5,120,000 exemption. This eliminates the need (and cost) to get appraisals for all of the property in the estate. However, the exception applies only if all property is passing to the spouse or charity. If there is a split between multiple parties, such as 50% to the spouse and 50% to children, then an appraisal is needed to ensure the proper split of the total value of the estate. If an estate tax return is filed, the portability election will be assumed to have been made, unless the executor explicitly opts out of portability (although there appears to be little reason to ever do so). The good news is that this means portability will happen automatically when the return is filed, eliminating the risk that the executor files the return but forgets to make a portability election. However, the bad news is that portability only applies if the executor files the estate tax return. As a result, if the executor fails to do so (or chooses not to do so due to cost), the surviving spouse cannot override the executor's decision. According to James Hogan, branch 4 chief, IRS Office of Associate Chief Counsel (Passthroughs and Special Industries), on July 23, 2012, practitioners should not expect a simplified estate tax return for electing portability. The temporary and proposed regulations also clarify that the DSUEA is available to the surviving spouse immediately after the decedent passes away, even if the estate tax return has not yet been filed (as long as it ultimately is filed in a timely manner). In addition, they indicate that if a surviving spouse makes a gift, the gift is deemed to have come first from the DSUEA, thereby preserving the individual's own lifetime estate tax exemption. This is important, because it eliminates the risk of a gift/estate tax "clawback" if a spouse used a DSUEA through gifting and then later "lost" it by remarrying and outliving a second spouse (where the death of the second spouse overwrites the DSUEA from the first deceased spouse). On the other hand, some surviving spouses in the future may begin to take advantage of the favorable ordering rules to proactively gift after inheriting a DSUEA, either to preserve it in case of a future remarriage with a subsequent spouse death, or to even gift when a spouse is on his/her deathbed to preserve the prior DSUEA just before it is overwritten by a more recent deceased spouse.

R. Formula Gifts. A lot of wealth is tied up in hard-to-value assets. Because those assets are not publically traded, their value for gift tax purposes is often subject to dispute between the donor and the IRS. Early attempts to solve this problem by means of a formula gift, such as *Comm'r v. Procter*, 142 F.2d 824 (4th Cir. 1944), were failures. Later cases, such as *Estate of Christiansen v. Comm'r*, 130 T.C. 1 (2008) suggested that the keys to a formula clause being upheld were that the donor did not attempt to undo any part of the transfer, and that the benefit of the increased estate valuation all went to charity. Another case that followed the approach of using a charity is *Petter v. Comm'r*, T.C. Memo 2009-280. A more recent case, *Wandry v. Comm'r*, T.C. Memo 2012-88, indicates that a charity is not necessary. In *Wandry*, the donors each executed gift documents stating, "I hereby assign . . . a sufficient number of my Units [in the family LLC] so that the fair market value of such Units for federal estate tax purposes shall be as follows . . . ." Each donor then listed nine donees and the dollar value of the LLC that each should receive. Each donor then went on to say that if the value that was used in actually transferring the units was determined to be otherwise by the IRS or a court, then the new value would be used to adjust the number of units between the donor and donee accordingly. The tax court,

applying a 4-factor test, held that the gift documents did not allow for the taxpayers to "take property back," as in *Procter*. Instead, they corrected the allocation of LLC units among the taxpayers and the donees because the original appraisal understated the LLC's value. Thus, the clauses at issue were valid formula clauses. Assuming that *Wandry* stands, the donors can gift or sell hard-to-value assets without fear of a large unexpected gift tax. This can be useful both for small interests and closely held entities where the annual exclusion is being used to shelter the gifts, as well as in larger gifts, such as those involving donors attempting to use their entire $5,120,000 million gift tax exemption in 2012.

S. Executor and Trustee Held Individually Liable for Unpaid Gift Taxes. In *United States v. Robert S. MacIntyre, et al.*, No. 4:10-cv-02812, a U.S. District Court granted partial summary judgment against an estate's executor and the trustee of a living trust, holding them individually liable for amounts they distributed without paying gift taxes on an indirect gift and jointly liable for trust funds set aside in violation of the government's priority status. In 1995, J. Howard Marshall, II, made an indirect gift to certain members of his family. He died shortly thereafter. The IRS assessed gift taxes against Marshall's estate. The Marshall estate never paid the tax on the gift. By operation of law, liability for the donor's unpaid gift tax shifted to the donee, Eleanor Pierce Stevens. In April of 2007, Stevens died. E. Pierce Marshall, Jr. ("Marshall") became the sole executor of her estate. Finley L. Hilliard ("Hilliard") was the trustee for the Eleanor Pierce Stevens Living Trust (the "Trust"). Marshall, in his capacity as executor, made distributions from Stevens' estate. Hilliard used trust funds to pay for accounting services and legal fees. The government brought claims against Marshall and Hilliard for personal liability pursuant to 31 U.S.C. § 3713, known as the Federal Priority Statute. This statute requires a claim of the United States government to be paid first when the estate of a deceased debtor is not enough to pay all of the debts. It further provides that a representative of a person or an estate paying any part of a debt of the person or estate before paying the claim of the government is liable to the extent of the payment for the unpaid claims of the government. Further, the burden lies with those who argue that the government's priority does not apply to show that they are not within the provisions of the statute. It is sufficient to show that the fiduciary had "notice of such facts as would put a reasonably prudent person on inquiry as to the existence of the unpaid claim." *Leigh v. Comm'r*, 72 T.C. 1105, 1110 (U.S. Tax Ct. 1979). Marshall and Hilliard also set aside money in the trust for charitable purposes, although the funds had not yet been paid to any charity. The court found that those funds were properly set aside, so that the government could not access them to pay the transferee liability. However, because Marshall and Hilliard put those funds beyond the reach of the government, they became individually liable for doing so.

T. Charitable Deduction Denied Due To Improper Appraisal. In *Mohamed v. Commr.*, T.C. Memo 2012-152 (May 29, 2012), the tax court ruled that the taxpayers were properly denied a charitable contribution deduction for donations of real estate to a charitable remainder unitrust, because they failed to comply with Treas. Reg. § 1.170A-13(c), which is the regulation that sets forth the proper appraisal and documentation requirements for charitable contributions that exceed $5,000 in value. The donor was a licensed real estate broker and a real estate appraiser, and he had essentially prepared the appraisal himself. Treas. Reg. § 1.170A-13(c)(5) provides that an appraisal must be done by a "qualified appraiser" which cannot be either the donor or the donee.

U. Inherited IRA was Exempt from Debtor's Bankruptcy Estate. In *In re Holly Anne Seeling, Debtor* (Bktcy Ct. MA, 5/24/12), the U.S. Bankruptcy Court held that the proceeds from a deceased person's annuity account that were transferred to a debtor's

inherited individual retirement account prior to bankruptcy were exempt from the debtor's bankruptcy estate under Bankruptcy Code § 522(d)(12). This is another in a series of cases, not all of which have reached consistent results. For example, 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).

V. Potential IRS Review of Certain Private Split Dollar Arrangements. The AALU has indicated informally that, based on recent reported comments, the IRS may be undertaking a national review of certain private split-dollar arrangements, including consideration of whether Code §2702 should apply to these transactions. Private split-dollar arrangements (those outside of an employer-employee context) generally are used in estate planning to acquire life insurance on a gift-tax favored basis, particularly when available annual exclusion gifts are insufficient to cover the yearly premiums for the desired coverage. In a typical situation, a client enters into a private split-dollar arrangements with his irrevocable life insurance trust ("ILIT") to split the cost of a life insurance policy insuring the client's (and sometimes his spouse's) life. The client funds the required insurance premiums in exchange for a right to repayment upon termination of the private split-dollar arrangement, which is generally secured by or paid from the policy proceeds. Treas. Reg. §1.61-22 generally provides two mutually exclusive regimes to determine the gift tax treatment of private split-dollar arrangements, depending on the identity of the deemed policy owner. The economic benefit regime applies if the client is the policy owner, and the loan regime applies if the ILIT is the policy owner. Since an ILIT will almost always own the policy subject to a private split-dollar arrangement in order to remove the death benefit from the client's gross estate, it would appear that the loan regime would apply by default. However, a special rule under the regulations states that the deemed owner of the policy will be the client (and thus the economic benefit regime will apply) if the only economic benefit received by the ILIT is current life insurance protection under the policy (commonly referred to as a non-equity private split-dollar arrangement, since the ILIT will have no interest in the policy's cash value). Accordingly, in a typical private split-dollar arrangement subject to the economic benefit regime, the client and the ILIT agree that the client will fund all policy premiums until termination of the split-dollar arrangement. In exchange, the client receives the right to the greater of the policy's cash value or the total premiums paid, which is secured by a restricted collateral assignment of the policy death benefits to the client. Thus, the only benefit received by the ILIT is current life insurance coverage under the policy. Under the regulations, the client is deemed to make an annual gift to the ILIT equal to the term cost for that current life insurance coverage, less any consideration paid by the ILIT for such coverage. Code §2702 provides that, where a transferor makes a transfer in trust for the benefit of family members but retains an interest in the trust, that retained interest has a value of zero for purposes of determining the gift tax value of the transfer, unless the retained interest is a qualified interest (as with the annuity paid from a GRAT) or the trust only holds the transferor's personal residence (as with a QPRT). Application of Code §2702 to a private split-dollar arrangement appears to rely on the assumption that the

client's reimbursement right under the private split-dollar arrangement is actually a retained interest in the ILIT. As this interest is not a qualified interest, the reimbursement right would have a zero value and would not offset any portion of the premium payments that the client makes on behalf of the ILIT. Thus, the client would make a taxable gift of the full value of each such payment, not just the portion equal to the term cost of the current life insurance protection. Given that the regulations have been in effect since 2003, with widespread implementation of private split-dollar arrangements based on those regulations, one wonders if the IRS' current focus has been generated by a specific interest in a fairly recent split dollar planning development known as "discount" or "generational" split dollar. In a common version of a "generational" split dollar arrangement, a client enters into a non-equity private split-dollar arrangement subject to the economic benefit regime with his or her ILIT. The ILIT buys a life insurance policy insuring the client's child or more remote descendant. The client holds a reimbursement right under the private split-dollar arrangement equal to the greater of the policy's cash value or the premiums paid by the client. The private split-dollar arrangement terminates upon the earlier of the insured's death or the mutual agreement of the ILIT and the client. The client has no right to access the policy's cash value during the private split-dollar arrangement term and has no unilateral right to terminate the split-dollar arrangement. Arguably, based on these facts, a bequest of the client's reimbursement right under the private split-dollar arrangement is entitled to a substantial valuation discount, since the client cannot access the policy's value or unilaterally terminate the private split-dollar arrangement and the insured's death is not expected for many years. Code §2702 could be a different approach in analyzing the possible consequences of "generational" split dollar, which would not challenge the discount of the reimbursement right, but would undermine the potential gift tax benefits of the arrangement by subjecting the full value of the client's premium payments to gift tax. Unfortunately, a broad application of the Code §2702 approach could adversely impact all private split-dollar arrangements.

W. Split-Dollar Rollout. In two consolidated cases, *Neff v Commr.* and *Jensen v Commr.*, T.C. Memo. 2012-244 (2012), the tax court found that petitioners realized $710,376 in compensation income resulting from an equity split-dollar rollout. The petitioners were in business together. They acquired six life insurance policies to fund cross-purchase agreements and to provide estate liquidity upon their deaths. Each petitioner owned one policy. Their family limited partnerships each owned two other policies. Each policy was the subject of a split-dollar agreement. The split-dollar agreements obligated the petitioners' management company to pay the premiums, and provided that the management company would be reimbursed upon the earlier to occur of the termination of the life insurance policies, the termination of the split-dollar agreements, or the deaths of the petitioners. The amount that the management company was entitled to be reimbursed was equal to the lesser of the total premiums it had paid or the total cash surrender value of the policies. Based on the advice of their advisors, the petitioners terminated the split-dollar agreements when the final split-dollar regulations were issued. At that time, the management company had paid a total of $842,345 in premiums, and the policies had a total cash surrender value of $877,432. However, upon termination the management company was only paid the present value of $842,345, which amounted to $131,969. This was on the erroneous assumption that the management company was only entitled to be reimbursed upon the deaths of the petitioners. At trial, the petitioners took various positions, e.g., they only acquired "contract rights" and/or the intent was only to "freeze" the split-dollar agreements, but these arguments were disregarded by the court, which found that the petitioners' recognized income in the amount of the difference between

the $842,345 that the management company was entitled to be reimbursed and the $131,969 that was actually paid, which amounted to $710,376.

VI. MERGERS & ACQUISITIONS

A. Step Transaction Doctrine Applied to Contingent Payment Acceleration Provision. In an interesting Delaware case, the court applied the step transaction doctrine to a two-step transfer of assets and found that the steps, taken together, triggered a contingent payment acceleration provision in the merger agreement between the parties. In 2007, GloNav, Inc. ("GloNav") merged with a subsidiary of NXP, B.V. ("NXP"). GloNav became NXP's wholly owned subsidiary, and GloNav's shareholders received cash plus rights to additional payments contingent on the future performance of GloNav's IP assets. The merger agreement provided for acceleration of the contingent payments if NXP transferred all or substantially all of GloNav's assets other than to a subsidiary of NXP. In 2008, NXP and ST Microelectronics formed a joint venture into which NXP contributed its wireless business, including GloNav's IP assets, in exchange for a 20 percent interest. The transaction was accomplished in two steps. First, GloNav transferred its assets to NXP's newly created and wholly owned subsidiary, WH2. NXP then transferred the WH2 shares to the joint venture. NXP contended that the first step avoided acceleration because WH2 was a subsidiary of NXP, and the second step avoided acceleration because neither GloNav stock or assets nor NXP stock or assets were transferred. The court looked at the "end result," "interdependence," and "binding commitment" tests under the Step Transaction Doctrine and found that NXP's two-step transfer satisfied all three tests. The court said that the purpose of the acceleration provision "was to ensure that the stockholders would continue to received their bargained-for contingent payments in the event that NXP sold GloNav," and that application of the Step Transaction Doctrine was therefore appropriate. The case shows the limits on the extent to which a party can rely on the technical structuring of a transaction where a court might find that the parties' intent was otherwise. *Coughlan v. NXP, B.V.*, 2011 WL 5299491 (Del. Ch. Nov. 4, 2011).

B. Purchase Agreement Found to be an Amendment to a Purchaser's Benefit Plans. In *Evans v. Sterling Chemicals, Inc.*, No. 10-20493 (5th Cir. 10/13/11), the Fifth Circuit Court of Appeals held that a provision in an asset purchase agreement, pursuant to which the purchaser agreed to provide post-retirement medical and life insurance coverage to the seller's employees which the purchaser hired in connection with the transaction, constituted an amendment to the purchaser's employee benefit plans. The Fifth Circuit indicated that, as long as the agreement is in writing, it contains a provision directed to an ERISA plan, and the plan amendment formalities are satisfied, the agreement will be considered a valid plan amendment. The amendment procedures in the purchaser's benefit plans specified that the plan could be amended by action of the purchaser's employee benefits plan committee. That did not occur. However, the asset purchase agreement was authorized by the board of directors of the purchaser and executed by the purchaser's chairman. The court determined that the plan amendment formalities were satisfied because, regardless of any action taken by the employee benefits plan committee, the board of directors had the authority under state corporate law to revoke the delegation to the committee and authorize the chairman to amend the plan by signing the asset purchase agreement. Most asset purchase agreements contain provisions indicating that the agreements are not intended to benefit third parties, and it is not clear from the decision whether the asset purchase agreement included such language. However, it is possible that such a provision may not be sufficient to protect the purchaser under the court's decision. It is also important to note that the purchaser had not assumed

the seller's benefit plans. It had only hired the seller's employees. The asset purchase agreement was treated as an amendment to the purchaser's benefit plans as it related to the former employees of the seller that the purchaser hired.

C. Jump Start Our Business Start-Ups ("JOBS") Act. The new JOBS Act aims to facilitate business formation by reforming certain aspects of the laws and rules governing the U.S. capital formation process. Among its other provisions, the JOBS Act exempts emerging growth companies from several executive compensation reporting requirements otherwise required by the Dodd-Frank Act. The JOBS Act will make it easier for emerging growth companies to go public by exempting them from certain federal securities regulations, including certain compensation-related reporting requirements. In general, an "emerging growth company" is a company with annual gross revenues of less than $1 billion during its most recently completed fiscal year.

1. Increases the "Private" Holder Cap from 500 to 2,000. Under current law, issuers are generally required to register a class of securities with the Securities and Exchange Commission ("SEC") if the securities are held of record by 500 people or more. This makes them subject to burdensome reporting obligations applicable to public companies, including the obligation to file detailed quarterly and annual reports with the SEC. The JOBS Act significantly increases the threshold to 2,000 holders of record, provided that not more than 499 of those 2,000 holders of record do not qualify as "accredited investors" under SEC rules. The new rule excludes from these calculations people who obtained equity under the company's equity compensation plans and investors who purchased securities pursuant to the crowd funding exemption discussed below.

2. Elimination of the Prohibition Against General Solicitation and Advertising in Certain Private Offerings. Private companies that sell equity securities to angel, venture or private equity investors have typically relied on an exemption from public registration, Rule 506 of Regulation D, that permits sales of shares to sophisticated investors subject to certain limitations, including that the company not engage in "general solicitation" or advertising of the offering. The JOBS Act expands Rule 506 to permit general solicitation and advertising for private offerings under Rule 506 if all purchasers qualify as "accredited investors" under SEC rules.

3. Crowdfunding. The securities laws will be amended to provide for a new "crowdfunding" exemption from registration, meaning that private companies will be allowed to raise up to $1 million over a twelve month period from an unlimited number of investors, including unsophisticated investors, through "crowdfunding." The key conditions of the "crowd funding" exemption" are as follows:

- The aggregate amount sold to all investors in any twelve-month period in reliance on this exemption cannot exceed $1 million.
- Investors with annual income or net worth of more than $100,000 can invest up to 10 percent of their annual income or net worth, not to exceed an aggregate of $100,000.
- Thresholds are lower for investors with annual income or net worth of less than $100,000. The transaction must be conducted through an intermediary that is registered with the SEC as a "funding portal" or broker and registered with a self-regulatory authority. In addition,

intermediaries must provide disclosures to investors regarding the level of risk of the offering and comply with other SEC regulations.

- Issuers must file with the SEC and provide to investors and intermediaries basic information about the issuer, including its financial statements, its officers, directors, 20% shareholders and the risks related to the offering.

4. Emerging Growth Company. The JOBS Act makes it easier for "emerging growth companies," or "EGCs" (companies with less than $1 billion of revenue), go public by reducing regulatory burdens associated with going public and creating a transitional on-ramp that phases in certain SEC compliance measures over a period of time following an EGCs IPO. EGC status is not available to any issuer that priced its IPO before December 9, 2011. EGCs will benefit from the following IPO procedural changes:

- EGCs will only need to provide two years of audited financials instead of three years, with no selected financial data for prior periods.
- EGCs will be permitted to make pre-filing offers to investors to "test the waters," without being subject to current "gun-jumping" restrictions on pre-offering communications.
- Investment banks will be permitted to publish research reports about an EGC immediately after they become public companies.
- EGCs will be permitted to begin the SEC registration process on a confidential basis.
- For newly public EGCs, the JOBS Act scales back certain governance and disclosure requirements for up to five years.
- Exemption from "say-on-pay" votes.
- More limited executive compensation disclosure.
- Exemption from requirement to hire an independent auditor to attest to the company's internal financial controls.
- Subject to the longer phase-in periods for new or revised financial accounting standards.

5. Raises Limit on Regulation A "Mini Public Offerings" from $5 Million to $50 Million. Regulation A, often called the "Mini Public Offering" exemption, currently allows companies raising less than $5 million to avoid certain disclosure requirements typically associated with an IPO. Companies that file under Regulation A currently do not have to issue the kinds of periodic reports to shareholders that are expected of conventional public companies. Regulation A offerings have only rarely been used by emerging companies to raise capital, in part because of Regulation A's low $5 million threshold and requirement to prepare an offering circular for review by the SEC and distribution to investors. The JOBS Act will extend Regulation A exemptions for companies raising up to $50 million, but will also expand the investor protection provisions for this larger offering exemption, including a requirement to file certain periodic disclosures with the SEC. While the requirement to prepare an offering circular and make periodic disclosures is likely to make entrepreneurs continue to prefer a private offering under Rule 506 of Regulation D, this change in Regulation A might have some appeal as an

alternative for later stage rounds, institutional investors, and in providing experience to a company's management team is readying for an eventual IPO.

D. E&P Cannot Be Allocated Between Parties to an Asset Reorganization. On April 18, 2012, the Treasury Department issued regulations proposing to conform the language in Treas. Reg. § 1.312-11 with its long-standing administrative position that earnings and profits, along with all other tax attributes, must stay in full up at the acquiring corporation that directly acquires the target corporation's assets, unless 100 percent of the target corporation's assets are dropped to a lower-tier subsidiary corporation.

E. Tax-Free "Merger" of a Corporation and Partnership. Private Letter Ruling 201222014 describes a transaction involving a tax-free "merger" of a corporation and a partnership. The members of the limited liability company exchanged their membership interests for stock in Newco. Newco then formed Merger Subsidiary. Merger Subsidiary was merged into Target Corporation. The shareholders of Target Corporation exchanged their stock in Target Corporation for stock in Newco. One of the key issues discussed in the ruling concerned the application of Section 351. Generally, if a new corporation is formed to which the partnership's partners transfer their partnership interests and the old corporation's shareholders transfer their stock in exchange for new corporation's stock, the transaction can be brought within the non-recognition provisions of Section 351. As long as the new corporation is not considered a mere continuation of the old corporation, the provisions of Section 351 will provide the transfer or partners with non-recognition treatment. Under the facts of the ruling, the IRS determined that Newco was not a mere continuation of Target Corporation.

F. IRS Modifies Procedures for Accounting Method Changes Involving Reorganizations and Tax-Free Liquidations. Rev. Proc. 2012-39, 2012-41 IRB modifies the rules for certain automatic and non-automatic changes in method of accounting by taxpayers that engage in a transaction to which Code Sec. 381(a) applies, and that occurs on or after Aug. 31, 2011. Except as otherwise provided in the Code or regulations, Section 446(e) and Treas. Reg. § 1.446-1(e)(2) require a taxpayer to secure the IRS's consent before changing an accounting method for federal income tax purposes. Treas. Reg. § 1.446-1(e)(3)(ii) authorizes the IRS to prescribe administrative procedures setting forth the requirements necessary for a taxpayer to obtain consent. Rev. Proc. 2011-14 provides procedures by which a taxpayer may obtain the IRS's automatic consent. Rev. Proc. 2011-14, Sec. 4.02, describes seven situations where the rules set forth in the Revenue Procedure do not apply. In particular, a taxpayer is precluded from using the automatic consent procedures in Rev. Proc. 2011-14 to change its method of accounting for a tax year in which (i) it engages in a transaction to which Code Sec. 381(a) applies, or (ii) it ceases to engage in the trade or business to which the change in method of accounting relates or terminates its existence. A taxpayer that is precluded from using the automatic consent procedures in Rev. Proc. 2011-14 may request permission to change its method of accounting using the provisions of Rev. Proc. 97-27, if applicable. In T.D. 9534, the IRS issued final regulations on the method of accounting, or combination of methods of accounting, that an acquiring corporation must use following a distribution or transfer to which Section 381(a) and Section 381(c)(4) or Section 381(c)(5) apply, and how to implement any associated change in method of accounting. The regulations apply to corporate reorganizations or tax-free liquidations described in Code Sec. 381(a) that occur on or after Aug. 31, 2011. Under these regulations, any party to a Code Sec. 381 transaction may ask permission from the IRS under Section 446(e), to change a method of accounting for the tax year in which the transaction occurs or is expected to occur.

However, for the tax year that includes the date of the Section 381(a) transaction, the IRS won't grant permission to change a method of accounting for any separate and distinct trade or business of either party if the acquiring corporation will not operate that trade or business as a separate and distinct trade or business after the date of the Section 381(a) transaction, unless the requested method is the method that the acquiring corporation must use for the transferred or distributed items of that trade or business after the date of the distribution or transfer. Also, under these regulations, the limitations set forth in Rev. Proc. 2011-14, Sec. 4.02, will not apply to a taxpayer that changes its method of accounting in the final year of a trade or business that is terminated as the result of a Section 381(a) transaction. Accordingly, Rev. Proc. 2012-39 modifies Rev. Proc. 2011-14 to allow taxpayers to make otherwise qualifying automatic accounting method changes in the year of the section 381(a) transaction. It also modifies both Rev. Proc. 2011-14 and Rev. Proc. 97-27 to waive the limitation that precludes taxpayers that are under examination from seeking consent to change to an accounting method other than the principal or carryover method.

G. Warrants and Deductible Liabilities in a Spinoff. In a prior letter ruling, dated March 21, 2011, the IRS determined that a series of transactions in which a business was contributed from the distributing corporation to a controlled corporation, followed by a distribution of controlled corporation stock to distributing corporation's shareholders, qualified as a Section 368(a)(1)(D) tax-free corporate separation. PLR 201230008 supplemented this earlier private letter ruling by finding that: (i) deductible liabilities assumed by the controlled corporation will be excluded in determining the amount of the distributing corporation's liabilities assumed by the controlled corporation or to which property transferred to the controlled corporation is subject for Section 357(c) purposes, and (ii) for distribution purposes, warrants will be treated as stock and distributions of controlled corporation stock to warrant holders as part of the distribution will be treated as a distribution with respect to such stock.

VII. REAL ESTATE

A. Tax Court Denies Full Real Estate Rental Deduction. The Tax Court denied the taxpayer's full rental real estate deduction in *Dennis Manalo et ux. v. Commr.*, T.C. Summ. Op. 2012-30; No. 17261-10S. The taxpayers owned two residential rental properties. Sometimes they arranged for others to provide services, such as showing the properties, collecting rent, and making repairs. However, the taxpayers were always responsible for approving repair expenditures, deciding on rental terms, and approving new tenants. The taxpayers did not maintain a contemporaneous time log that detailed their real estate activities. However, they did maintain desk calendars on which were recorded various appointments. During the course of the examination, the petitioners submitted the calendar and a log of hours reconstructed on the basis of the notations in the calendars to the revenue agent. They subsequently submitted three revised versions of the original log. The estimates on the revised logs were based on emails and archived documents that were not offered into evidence by the taxpayer. Section 469 generally disallows passive activity losses. There are two primary exceptions that allow the current deductibility of losses associated with rental activities. The first exception is the real estate professional exception found in Section 469(c)(7), which requires more than half of the personal services performed in trades or businesses by the taxpayer to be performed in real estate property trades or businesses in which the taxpayer materially participates. In addition, the taxpayer must perform more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates. The Tax Court was

unable to conclude that the petitioners met the material participation standard. The other exception is found in Section 469(i). Even if a taxpayer's rental real estate activities are treated as passive activities, the taxpayer may still deduct losses up to $25,000 per year arising from rental real estate activity in which the taxpayer "actively" participates. The Tax Court found the "active" participation standard to have been satisfied. The IRS had asserted the accuracy-related penalty, and the court found that the IRS sustained its "burden of production" by demonstrating the "presence of a substantial understatement." This required the taxpayer to demonstrate that there was a reasonable cause for its position, and that the taxpayer acted in good faith. The court found that the evidence submitted by the taxpayer was sufficient to carry that burden. As a result, the IRS' assertion of the accuracy-related penalty was not sustained.

B. Façade Easement Charitable Deduction Denied. In *Loren Dunlap et al. v. Commissioner*; T.C. Memo. 2012-126; Nos. 28849-08 10393-09, 12168-09, 14860-09, 14865-09, 14866-09, 20138-09, (1 May 2012), the Tax Court determined that seven taxpayers did not qualify for charitable contribution deductions for gifts of conservation easements. The seven taxpayers were all owners of units in the Cobblestone Loft Condominium (Cobblestone), a loft building in a historic district of New York. Andrews Building Corp. (ABC) is the building manager and a board of five owners manage the property. ABC introduced a Sec. 501(c)(3) organization with the title NAT to the board in 2003. NAT has received over 500 conservation easements on buildings in New York City and expressed an interest in receiving and holding façade easements on Cobblestone. NAT suggested that an opinion letter be obtained from the law firm Herrick, Feinstein, LLP. Attorney Dennis Russo of that firm prepared an opinion letter dated December 31, 2003. However, a footnote in the letter referenced a document released in July of 2004. On September 29, 2003, Cobblestone asked the National Park Service to certify the condominium as an historic structure. It was certified in December of 2003. On December 16, 2003, the Cobblestone board voted to execute a façade easement deed. The deed was accepted by NAT and delivered to the New York City Department of Finance Office of the City Register on December 29, 2003. The Cobblestone board obtained an appraisal from Mr. Jonathan Miller, who is a licensed real estate appraiser in New York. The Miller appraisal included a comprehensive description of the property, discussed façade easements and stated that the fair market value of the easement granted was $8,171,000, or 12% of the appraised value of $68,095,000. The appraisal allocated the total charitable deduction to the various individual units. The appraisal determined the value based on the status as a certified historic structure, the fact that ads would no longer be permitted on the east façade and the existence of three street-level façades. NAT was founded by Springfield Management Services (SMS). During 2003, NAT received cash gifts together with conservation easements and paid the for-profit SMS $5.5 million for services. The cash gifts were to pay for "monitoring fees." SMS was responsible for visiting each site and photographing it once per year. It also would respond to requests for alterations or discuss sales of units with prospective new owners. Cobblestone was located in an area subject to the New York City Landmarks Preservation Commission (LPC). LPC designated Cobblestone as a "sound, first-class condition" property. This applied to only 150 out of 26,000 properties in New York and required a higher standard of preservation. Seven taxpayers were owners of Cobblestone units and reported charitable deductions ranging from $174,000 to $282,000. The IRS denied all deductions and assessed interest and penalties. The IRS claimed that the Cobblestone board did not have powers to grant the façade easement, the easement was not recorded until 2004, the substantiation was inadequate, the façade easement was not valid under Sec. 170 and the façade easement had no value. The Court reviewed appraisals by Marilyn Weitzman and Michael Ehrmann.

The Weitzman appraisal valued Cobblestone at $65,109,788 based on comparable sales. However, using the income approach she determined the valuation of Cobblestone as a rent-producing apartment to be $34,138,106. By reducing the value for the easement, she determined that the final value was $28,760,817. Using a 15.5% discount on the $65 million amount, she claimed the charitable deduction was $10,118,000. IRS expert witness Timothy Barnes noted that Ms. Weitzman's appraisal failed to use the required "highest and best use" standard consistently across her valuations. Mr. Ehrmann used a comparable sales approach. Based on his selected discount rate of 10% and multiple comparables, he determined a reduction in value of 16.45%. He then reduced that to 14.40% and finally to 12%, leading to an easement value of $6,795,000. IRS expert witness Barnes criticized Ehrmann's report and noted that the selected discount rate created a "huge distortion" in valuation. The Tax Court analyzed both of the taxpayer appraisers' methodologies. It determined that the Weitzman appraisal did not consistently base the value on Cobblestone's "highest and best use," but instead applied the 15.5% value reduction found using the income approach to the $65 million comparable sales valuation. Therefore her appraisal was not valid. In addition, the Weitzman report did not recognize the fact that under the LPC regulations enforcement was more stringent than NAT enforcement. NAT paid SMS approximately $5.8 million in 2004 and $13,345 was expended on monitoring expenses. The Court also noted that the Ehrmann report involved discounting that distorted the appropriate level of reduced price for the conservation easement. Based on the Court's calculation, the final spread was closer to 3% than the claimed 12%. The Court determined that the 3% reduction in value was not significant. Therefore, because the appraisers for the taxpayers failed to meet the burden of proving the Cobblestone façade easement value was greater than zero, there was no charitable deduction. The donors also had been required to make a cash gift of 7% of the value of the façade deduction to NAT as part of the transaction. The purpose of the cash gift was to cover the monitoring expenses. The IRS denied deductions for the cash gifts as a fee for services or a contingent gift. The Court noted that the services provided were fairly minor. Generally, it is permissible to pair a conservation gift with a cash gift. So long as the donor does not receive substantial direct benefits from the cash gift, it is deductible. The IRS also assessed an accuracy related penalty under Sec. 6662(a). However, the court found that the seven owners acted with good faith. They discussed the gift with an attorney prior to making the transfer. It was disclosed on their tax returns. They obtained an appraisal by a licensed New York real estate appraiser. The appraisal did substantially comply with all requirements. Therefore, there were no Sec. 6662(a) penalties. The final issue was a claim by the IRS that appraiser Jonathan Miller was not qualified because he had not done other façade appraisals. The Court noted that he was licensed in New York and had founded a major appraisal firm. In addition, he was managing principal of another firm that completed appraisals on commercial real estate. Therefore, the court deemed these acceptable qualifications to perform the façade conservation easement appraisal. The IRS has objected to the use of percentage discounts to value façade easements. To qualify for an easement, it is necessary to show that there is an actual reduction in the value under a "before and after" standard. In addition, the reduced value must exist as a result of the easement deed and not because of other regulatory actions such as the requirements of the New York Landmark Commission. For more on façade easements, see the First Circuit's July 19, 2012, decision in *Gordon Kaufman et ux. v. Commissioner*; Nos. 11-2017, 11-2022.

KNOCK KNOCK: WHO'S THERE?
THE IRS RETURN PREPARER VISITATION PROJECT

By: Charles M. Lax, Esq.

I. THE LETTERS PREPARERS RECEIVED

A. 2012 was the third year that the IRS contacted a select group of tax return preparers in an effort to improve the accuracy of the returns prepared.

1. Approximately 21,000 letters were sent in 2012.

2. Approximately 10,000 were sent in 2010 and 2011.

3. See Exhibit 1 for a copy of the 2012 letter and the three attachments that were included.

B. The letter was sent to preparers who prepared large numbers of 1040s with Schedules A, C or E and contained a high percentage of attributes that typically result in errors on those schedules.

C. What did the letter say?

1. It explained how and why they were selected for audit.

2. It advised them of their Circular 230 obligations including:

a. The expectation that they are knowledgeable in tax law.

b. The requirement to prepare accurate returns.

c. The requirement that they exercise due diligence in preparing returns.

d. While they may rely in good faith upon client provided information, the requirement that they not ignore the implications of what they know or reasonably should know.

e. The requirement to obtain and enter their PTIN number on all returns they prepare.

3. The preparers can be subject to preparer penalties under Section 6694(a) (the understatement of tax due to an unreasonable position) and under Section 6694(b) (the understatement of tax due to the intentional or reckless disregard of rules and regulations).

II. THE ONSITE COMPLIANCE VISITS

A. 2012 was also the third year that the IRS selected a group of tax return preparers for an "onsite compliance visit."

1. Approximately 2,000 visits were conducted in 2012.

2. Approximately 2,500 visits were made in 2010 and 2011.

3. The visits were scheduled between November 2011 and April 15, 2012.

4. No distinction was made among the preparers' professional designations.

B. The purpose of the visit was to determine whether the preparers met the following responsibilities:

1. Provided the client with a copy of the return.

2. Signed the return.

3. Furnished their identifying number.

4. Retained a copy or list of returns and claims for refund.

5. Refused to endorse or negotiate a check issued to the taxpayer.

6. Properly safeguarded taxpayer information.

7. Filed correct information returns.

C. While the IRS indicated that taxpayers "generally will not be contacted as a result of a return preparer visit," contacts could be made if necessary to confirm preparer violations.

1. Taxpayer compliance would not be the focus.

2. Preparer compliance would be the issue.

D. In cases where violations of a preparer's responsibilities were found, penalties and other action under Circular 230 were taken.

E. Different experiences were reported by different preparers.

1. Most reported short professional visits by revenue agents with the focus upon making sure the preparer understood their responsibilities.

2. A small number reported lengthy and detailed review of the preparer's returns, worksheets, notes and correspondence.

III. THE JUNE 29, 2012 TIGTA REPORT

A. On June 29, 2012, the Treasury Inspector General for Tax Administration (TIGTA) issued its report titled *Implementation of the Return Preparer Visitation Project Was Successful, But Improvements are Needed to Increase It's Effectiveness*.

B. In its review of the project, TIGTA conducted a survey of the preparers who were visited in 2010.

1. Approximately two-thirds of the preparers surveyed reported the visits were a "positive experience" and "helpful and/or informative."

2. Higher percentages of the preparers surveyed believed the revenue agents were “professional” and “knowledgeable.”

C. The principal finding of the report was that the selection criteria used did not identify preparers most in need of the visits.

1. The report focused on the fact that the criteria used for the letters and visits considered preparers “who filed high volumes of returns with schedules that had traditionally high error rates” rather than preparers identified as “filing returns with actual errors.”

2. The report also recognized:

a. That many of the preparers surveyed had completed continuing education courses which provided more extensive information than the visits.

b. That most of the preparers surveyed would not be making any changes to the way they did business.

D. The recommendations made by the report:

1. In future years, letters should be sent to preparers who filed returns with errors and those with the most egregious errors receive educational and enforcement visits.

2. A methodology be developed to determine the impact of the program on the preparer community, including the ability to monitor and track preparers who were visited to determine whether the accuracy of their returns improved.

TRUST PROTECTORS

By: Richard F. Roth, Esq.

I. TRUST PROTECTOR -- MCL 700.7103(n)

A. "Trust protector" means a person or committee of persons appointed pursuant to the terms of the trust, who has the power to direct certain actions with respect to the trust.

B. Trust protector does not include either of the following:

1. The settlor of a trust.

2. The holder of a power of appointment.

C. The definition of trust protector is new to the Estates and Protected Individuals Code.

Although the term may have previously been used in Michigan, this is the first time a trust protector has been covered by Michigan statute.

D. As stated above, the definition excludes settlors and holders of powers of appointment.

1. Settlors are excluded:

a. To ensure they are not subject to the fiduciary duties.

b. To enable a settlor to handle a trust in any manner he or she wishes.

2. The holder of a power of appointment is excluded from acting as a trust protector:

a. A power of appointment is a power to determine who will be entitled to a beneficial interest in property.

b. A holder may divest trust beneficiaries of their interest in the property.

c. The holder of a power of appointment has a fundamentally different role than a trust protector and there is a well-developed body of law concerning the scope of powers of appointment and their exercise.

d. A holder of a power may or may not be subject to fiduciary duties in the exercise of the powers.

E. The definition is extremely important because it distinguishes who may and who may not have fiduciary duties.

1. A person to whom a power was given to distribute property from the trust has a power of appointment. As such, they are not a trust protector.

2. A person to whom no title is given in the trust instrument may have a power to direct certain actions with respect to the trust, which power will make that person a trust protector, subject to the duties, powers and discretions conferred by the terms of the trust.

a. To ensure they are not subject to the fiduciary duties.

b. To enable a settlor to handle a trust in any manner he or she wishes.

II. <u>TRUST PROTECTOR'S EXERCISE OF POWERS -- MCL 700.7809</u>

A. Under MCL 700.7809, a trust protector, other than a trust protector who is a beneficiary of the trust, is subject to <u>all</u> of the following:

1. With one exception, the trust protector is a fiduciary to the extent of the powers, duties and discretions granted to him or her under the terms of the trust.

2. The trust protector must act in good faith and in accordance with the terms and purpose of the trust and the interests of the beneficiaries.

3. The trust protector is liable for any loss that results from the breach of his or her fiduciary duties. However, the terms of the trust establish the scope of liability for loss.

B. A trust protector may act in a non-fiduciary capacity only for powers of administration under IRC 675(4) as follows:

1. A power to vote or direct the voting of stock or other securities of a corporation in which the holdings of the grantor and the trust are significant from the viewpoint of voting control;

2. A power to control the investment of the trust funds either by directing investments or reinvestments, or by vetoing proposed investments or reinvestments, to the extent that the trust funds consist of stocks or securities of corporations in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; or

3. A power to reacquire the trust corpus by substituting other property of an equivalent value.

C. Although a trust may provide that a trust protector may exercise his or her duties in a non-fiduciary capacity, the trust does not relieve the trust protector from the requirement that he or she exercise and refrain from exercising any power, duty or discretion in good faith and in

accordance with the terms and purposes of the trust and the interests of the beneficiaries.

D. A trustee shall not be liable for acting in accordance with a trust protector's exercise of specific powers.

E. Notwithstanding the above, a trustee is not permitted to exercise any power contrary to terms of the trust or that would constitute a breach of fiduciary duty that a trust protector owes to the beneficiaries of the trust without first receiving prior direction from the court.

F. A trustee is not liable for any loss that results from:

1. Complying with the direction of a trust protector, except as stated above;

2. Failing to take any action that requires prior authorization of the trust protector if the trustee timely sought but failed to receive authorization;

3. Seeking a determination from court regarding the trust protector's actions or directions.

4. Refraining from taking a prohibited act.

G. The terms of a trust may confer upon a trustee or a trust protector the power to modify or terminate a trust.

H. By acting as a trust protector of a trust in this state, the trust protector submits to the jurisdiction of the courts in Michigan even if agreements provide otherwise, and the trust protector may be made a party to any action or proceeding relating to a decision, action or inaction of the trust protector.

I. A term of a trust that relieves a trust protector from liability for breach of his or her fiduciary duties is unenforceable to the extent either of the following applies:

1. The term relieves the trust protector from liability for acts committed in bad faith or with reckless indifference to the purposes of the trust or interests of the trust beneficiaries; or

2. The term was inserted in the trust as a result of an abuse by the trust protector of a fiduciary or confidential relationship to the settlor.

J. The obligations in the statute must prevail over the terms of the trust.

III. GENERAL PROVISIONS REGARDING TRUST PROTECTORS

A. The Michigan Trust Code provisions concerning trust protectors apply to trusts created before, on or after April 1, 2010.

B. Practitioners, settlors, trustees and trust protectors will need to consider how these provisions affect existing trusts.

C. For existing trusts, the grantor or settlor may wish to seek a modification or reformation of the trust, transfer situs of the trust administration to a state where the rules governing trust protectors are different or more in line with the terms of the trust.

D. Trust protectors are deceptively complex and raise numerous difficult issues with their implementation and exercise.

E. Great care should be taken to determine the scope of the trust protector’s duties.

F. Incomplete or ambiguous duties, powers or discretions in the trust may result in the trust protector being exposed to potential liability.

G. Failure to fully provide for the appointment, removal or succession of trust protectors and the implications and consequences of poor decisions could expose beneficiaries to harm.

H. Without well-described duties, problems could arise with a trust protector from poor investment of funds, improper or early termination or modification of the trust and to potential tax traps.

I. The exception to the general rules regarding trust protectors is for beneficiaries of the trust who are acting as trust protectors, because they can be expected and permitted to act in their own self-interests.

IV. DURABLE POWERS OF ATTORNEY - DEFINITIONS

A. “Durable Power of Attorney” is a legal document that enables an individual to designate another to act on his/her behalf, even if the individual becomes disabled or incapacitated.

B. “Principal” is the individual who authorizes another to act on his/her behalf.

C. “Attorney-in-fact” or “agent” is the person designated by the principal to represent him/her in business or financial matters, when the principal cannot act for himself. The attorney-in-fact is distinguishable from an attorney-at-law, and, importantly, the agent does not need to be a licensed lawyer.

D. “Durable” means that the powers given to the agent remain effective, even when the principal becomes mentally incompetent. However, these powers expire on the death of a principal.

E. “Fiduciary” is another term used in connection with Durable Powers of Attorney, as the agent or attorney-in-fact is a fiduciary for the principal. Fiduciary means “a person to whom property or power is entrusted for

the benefit of another." The law requires the attorney-in-fact to be completely honest with and loyal to the principal.

V. MICHIGAN'S DURABLE POWER OF ATTORNEY STATUTE - MCL 700.5501

A. Requirements

1. A durable power of attorney ("DPOA") must be in a writing that contains either of the following phrases or similar words to show the principal's intent that the authority conferred is exercisable notwithstanding the principal's subsequent disability or incapacity and notwithstanding the lapse of time since the instrument was executed:

    a. "This power of attorney is not affected by the principal's subsequent disability or incapacity, or by the lapse of time."

    b. "This power of attorney is effective upon the disability or incapacity of the principal."

2. The DPOA shall be voluntarily signed and dated by the principal (or a notary public on behalf of the principal pursuant to section 33 of the Michigan Notary Public Act); and

    a. Signed in the presence of two witnesses, neither of whom is the attorney-in-fact, and both of whom also sign the DPOA; or

    b. Acknowledged by principal before a notary public, who endorses such acknowledgment on the DPOA.

B. Attorney-in-Fact. An attorney-in-fact designated and acting under a DPOA has the authority, rights, responsibilities and limitations as

provided by law with respect thereto, including, without limitation, all of the following:

1. Shall act in accordance with the standards of care applicable to fiduciaries exercising powers under a DPOA, except as provided in the DPOA.

2. Shall take reasonable steps to follow the instructions of the principal.

3. Shall keep the principal informed of his/her actions upon request by the principal.

4. Shall provide an accounting to the principal upon request.

5. Shall not make a gift of any or all of principal's assets, unless provided for in the DPOA or by judicial order.

6. Shall not create an account or other asset in joint tenancy between the principal and attorney-in-fact, unless provided for in the DPOA or by judicial order.

7. Shall maintain records of his/her actions on behalf of the principal, including transactions, receipts, disbursements and investments.

8. May be liable for damages or losses to the principal and subject to any other available remedy, for breach of fiduciary duty owed to the principal. NOTE: The DPOA may exonerate the attorney-in-fact of any liability to the principal for breach of fiduciary duty, except for actions committed in bad faith or with reckless indifference. Importantly, an exoneration clause is not enforceable if inserted as the result of an abuse by the attorney-in-fact.

9. May receive reasonable compensation for his/her services, if provided for in the DPOA.

C. 2012 Changes.

1. An attorney-in-fact shall execute an acknowledgment of his/her responsibilities before exercising authority under a DPOA.

2. The acknowledgment must contain the substantive statements substantially in the following form:

I, the undersigned, have been appointed as attorney-in-fact for *NAME OF PRINCIPAL*, the principal, under a durable power of attorney dated *INSERT DATE*. By signing this document, I acknowledge that if and when I act as attorney-in-fact, all of the following apply:

(a) Except as provided in this DPOA, I must act in accordance with the standards of care applicable to fiduciaries acting under durable powers of attorney;

(b) I must take reasonable steps to follow the instructions of the principal;

(c) Upon request of the principal, I must keep the principal informed of my actions. I must provide an accounting to the principal upon request of the principal, to a guardian or conservator appointed on behalf of the principal upon the request of that guardian or conservator, or pursuant to judicial order;

(d) I cannot make a gift from the principal's property, unless provided for in the DPOA or by judicial order;

(e) Unless provided in the DPOA or by judicial order, I, while acting as attorney-in-fact, shall not create an account or other asset in joint tenancy between the principal and me;

(f) I must maintain records of my transactions as attorney-in-fact, including receipts, disbursements, and investments;

(g) I may be liable for any damage or loss to the principal, and may be subject to any other available remedy, for breach of fiduciary duty owed to the principal. In the DPOA, the principal may exonerate me of any liability to the principal for breach of fiduciary duty except for actions committed by me in bad faith or with reckless indifference. An exoneration clause is not enforceable if inserted as the result of my abuse of a fiduciary or confidential relationship to the principal;

(h) I may be subject to civil or criminal penalties if I violate my duties to the principal;

Signature:_____ Date:_____

D. Exceptions under the Statute:

1. Durable powers of attorney executed before October 1, 2012.

2. Delegations or similar powers of attorney created by a parent or guardian regarding the care, custody or property of a minor child or ward.

3. A patient advocate designation or a similar power of attorney relating to the principal's health care.

4. A durable power of attorney that is coupled with an interest in the subject matter of the power.

5. A durable power of attorney that is contained in or is part of a loan agreement, security agreement, pledge agreement, escrow agreement or other similar transaction.

6. A durable power of attorney in connection with a transaction with a joint venture, limited liability company, partnership, limited partnership, limited liability partnership, corporation, condominium, condominium association, condominium trust, or similar entity, including, without limitation, a voting agreement, voting trust, joint venture agreement, royalty agreement, license agreement, proxy, shareholder's agreement, operating agreement, partnership agreement, management agreement, subscription agreement, certification of incorporation, bylaws, or other agreement that primarily relates to such an entity.

7. A power of attorney given primarily for a business or commercial purpose

8. A power of attorney created on a form prescribed by a government or a governmental subdivision, agency or instrumentality for a governmental purpose.

MODIFYING IRREVOCABLE TRUSTS, POWERS OF APPOINTMENT, BACKDOOR PROVISIONS, ETC.

By: Geoffrey N. Taylor, Esq.

I. IS A TRUST IRREVOCABLE?

A. A trust is irrevocable if its terms provide it is irrevocable.

1. Trusts typically become irrevocable when the grantor of the trust dies.

2. Trusts sometimes also become irrevocable during any period the grantor is incapacitated.

3. A trust can also be irrevocable from inception. This is typically done when a grantor wants to remove assets from his taxable estate.

B. What if the trust agreement is silent as to irrevocability?

1. The Michigan Trust Code provides default rules for revocability of trust agreements.

2. Single trusts.

a. Unless the terms of a trust expressly provide that the trust is irrevocable, the grantor may revoke or amend the trust.

b. This is because grantors routinely and most commonly create trusts as will substitutes.

3. Joint trusts.

a. If a revocable trust is created or funded by more than one grantor, to the extent that the trust consists of

property other than community property, each grantor may revoke or amend the trust with regard to the portion of the trust property attributable to that grantor's contribution.

b. Upon notification by a grantor of the revocation or amendment of the trust by fewer than all of the grantors, the trustee shall promptly notify the other grantors of the revocation or amendment.

4. However, as is generally the case, the provisions of a trust agreement override contrary provisions of the Michigan Trust Code.

a. E.g., I typically provide in joint trusts that after the death of the first spouse/grantor the surviving spouse/grantor can amend or revoke the trust agreement unilaterally.

II. HOW IRREVOCABLE?

A. Can the grantor change the terms of an irrevocable trust?

1. As noted above, trusts are sometimes irrevocable upon creation. This is usually the case where the grantor is looking to remove assets from his taxable estate including, for example, proceeds from an insurance policy on the grantor's life.

2. These irrevocable trusts generally prohibit the grantor from changing the dispositive provisions, such as who gets what and when.

3. If the trust agreement authorizes the grantor to change the dispositive provisions, the trust assets generally will be included

in the grantor's taxable estate and the primary purpose of the trust is thereby frustrated.

4. However, the grantor can be given limited power to make changes (e.g., as trustee appointer – see discussion below).

B. Changes that can be made without court involvement.

1. The changes that can be made without court involvement depend on the date the trust became irrevocable.

2. Trusts that became irrevocable prior to, on, or after the Michigan Trust Code effective date of April 1, 2010.

a. Permitted changes are very limited and don't apply to most typical estate planning trusts.

i. Trustee can terminate the trust if no purpose of the trust remains.

ii. Trustee can terminate the trust if the purposes of the trust have become impossible to achieve.

b. If the trust assets are less than $50,000 and if the costs of administration do not justify the continuance of the trust, the trustee can terminate the trust.

3. Trusts that became irrevocable after the Michigan Trust Code effective date of April 1, 2010.

a. Permitted changes are only slightly broader than if the trust became irrevocable prior to April 1, 2010, given the following provisions are typically not included in trust agreements.

i. Trust terms, including dispositive provisions, can be modified with the consent of the trust beneficiaries and a trust protector who is given the power under the terms of the trust to grant, veto, or withhold approval of modification of the trust.

ii. Trust terms, including dispositive provisions, can be modified by a trustee or trust protector to whom a power to direct the modification of the trust has been given by the terms of the trust agreement.

b. Although not changes per se, the following matters may be resolved by a nonjudicial settlement agreement among the trustee and the trust beneficiaries:

i. The interpretation or construction of the terms of the trust.

ii. The approval of a trustee's report or accounting.

iii. Providing direction to a trustee to perform or to refrain from performing a particular act or to grant to or to withhold from a trustee any power.

iv. The resignation or appointment of a trustee.

v. The determination of a trustee's compensation.

vi. Transfer of a trust's principal place of administration.

vii. Liability of a trustee for an action relating to the trust.

c. However, a nonjudicial settlement agreement described above is valid only to the extent it does not violate a material purpose of the trust and includes terms and conditions that could properly be approved by the probate court.

C. Changes that require court involvement.

1. As with changes that do not require court involvement, an analysis must be done to determine the date the trust became irrevocable.

2. Trusts that became irrevocable prior to, on, or after the Michigan Trust Code effective date of April 1, 2010.

a. The probate court may terminate a trust if the court finds the trust unlawful or contrary to public policy.

b. The probate court may modify or terminate a trust or remove the trustee and appoint a different trustee if the court finds the value of the trust property is insufficient to justify the cost of administration.

c. The probate court may modify the terms of a trust, even if unambiguous, to conform the terms to the grantor's intention if it is proved by clear and convincing evidence that both the grantor's intent and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement.

d. The probate court may modify the terms of a trust in a manner that is not contrary to the grantor's intention in order to achieve the grantor's tax likely objectives.

3. Trusts that became irrevocable after the Michigan Trust Code effective date of April 1, 2010.

a. The trustee and the qualified trust beneficiaries consent and the court concludes that the modification or termination is consistent with the material purposes of the trust or that continuance of the trust is not necessary to achieve any material purpose of the trust.

4. Determining who must receive notice of a proceeding to terminate or modify a trust requires a careful review of the Michigan Trust Code and Court Rules.

D. In summary, relying on the Michigan Trust Code to provide flexibility with respect to irrevocable trusts will not produce favorable results in most cases and the parties will need to petition the probate court and hope the changes the parties desire to make are within the modifications the probate court may approve. The preferred approach is to build flexibility in the trust agreement as described below.

III. WHAT COULD/SHOULD HAVE BEEN DONE DIFFERENTLY?

A. Provide for a trustee appointer in the trust agreement.

1. A trustee appointer usually has the power to remove acting or appointed trustees and to appoint one or more successor trustees and/or co-trustees.

2. For a lifetime irrevocable trust, one of the issues a grantor typically struggles with is the appointment of a trustee and successor trustees because without trustee appointer provisions the grantor and the beneficiaries are stuck with the trustees the grantor initially appoints. Having a trustee

appointer significantly improves the otherwise inflexible nature of appointing trustees of an irrevocable trust.

3. If the grantor is given trustee appointer powers, great care must be taken to ensure there are no negative income, gift, or estate tax consequences. This is a highly complicated area of the law and requires counsel from an expert.

B. Grant powers of appointment under the trust agreement.

1. A power to appoint trust assets can provide tremendous flexibility to an irrevocable trust. For example:

a. An irrevocable trust is created for the grantor's two teenage children and ten years later one child has won the lottery and the other is dedicated to a lifetime of volunteering for charities. The power of appointment can shift the trust assets from the lottery winner to the charitable volunteer.

b. An irrevocable trust is created for the grantor's married daughter and the daughter's husband files for divorce shortly before the irrevocable trust agreement provides for a substantial, outright distribution to her. The power of appointment can provide for the assets to be held in continuing trust with appropriate spendthrift provisions for the remainder of the daughter's life or until the divorce has resolved.

2. The grantor's spouse is often given a power of appointment exercisable in favor of the grantor's issue and perhaps their spouses and one or more named or unnamed charities.

3. The grantor generally is not given a power of appointment over assets of an irrevocable trust because the trust assets will be included in the grantor's taxable estate and the primary purpose of the trust is thereby frustrated.

4. If a power of appointment is granted to a person who is also a beneficiary of the irrevocable trust (e.g., the grantor's spouse), great care must be taken to ensure there are no negative income, gift, or estate tax consequences to any exercise of the power. Like trustee appointer provisions, this is a highly complicated area of the law and requires counsel from an expert.

C. Provide for a trust protector.

1. Under the Michigan Trust Code a trust protector is a person appointed pursuant to the terms of the trust who has the power to direct certain actions with respect to the trust.

2. A person who holds only a power of appointment is not a trust protector.

3. Be careful, because someone fitting the definition of a trust protector under the Michigan Trust Code is a fiduciary. Furthermore, the trust agreement may not relieve a trust protector for liability for acts committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries.

4. See Richard Roth's materials for more detailed information.

FORECLOSURE AND SHORT SALES 101

By: Lindsey R. Johnson, Esq.

I. FORECLOSURE BASICS

A. Foreclosure is the process by which legal proceedings are initiated and pursued by a creditor to acquire collateral for a loan that is in default.

B. Michigan allows for non-judicial foreclosure by advertisement. MCL 600.3201 et seq.

1. Published and Posted Notice (MCL 600.3208) -- required for any foreclosure.

a. Publish foreclosure notice for once a week for four successive weeks in a newspaper published in the county where the premises are located. (MCL 600.3208)

b. Notice is posted in a conspicuous place upon any part of the premises within 15 days of first publication. (MCL 600.3208)

c. Required contents of the notice of foreclosure by advertisement. (MCL 600.3212)

i. The names of the mortgagor, the original mortgagee, and the foreclosing assignee, if any.

ii. The date of the mortgage and the date the mortgage was recorded in the applicable register of deeds.

iii. The amount claimed to be due on the mortgage on the date of the notice.

iv. A description of the mortgaged premises that substantially conforms with the description contained in the mortgage.

v. For a mortgage executed on or after January 1, 1965, the length of the redemption period as determined under section MCL 600.3240.

2. 3205a Notice (MCL 600.3205a) – requirements added by the legislature in July, 2009, (sunset December 31, 2012), for foreclosures on a "principal residence" (as determined by homestead tax standing) and where, if borrower had a prior loan modification, borrower has complied with the terms of the modification for at least 1 year.

a. Mailed by regular first-class mail and certified mail, return receipt requested to borrower's last known address.

b. Published one time within 7 days after mailing in a newspaper published in the county where the premises are located.

c. Required Contents of the 3205a notice:

i. The reasons that the mortgage loan is in default and the amount that is due and owing under the mortgage loan.

ii. The names, addresses, and telephone numbers of the mortgage holder, the mortgage servicer, or any agent designated by the mortgage holder or mortgage servicer.

iii. A designation of one (1) of the persons named in subdivision (b) as the person to contact and that has the authority to make agreements under sections 3205b and 3205c.

iv. That enclosed with the notice is a list of housing counselors prepared by the Michigan state housing development authority and that within 14 days after the notice is sent, the borrower may request a meeting with the person designated under subdivision (c) to attempt to work out a modification of the mortgage loan to avoid foreclosure and that the borrower may also request a housing counselor to attend the meeting.

v. That if the borrower requests a meeting with the person designated under subdivision (c), foreclosure proceedings will not be commenced until 90 days after the date the notice is mailed to the borrower.

vi. That if the borrower and the person designated under subdivision (c) reach an agreement to modify the mortgage loan, the mortgage will not be foreclosed if the borrower abides by the terms of the agreement.

vii. That if the borrower and the person designated under subdivision (c) do not agree to modify the mortgage loan but it is determined that the borrower meets criteria for a modification under section 3205c(1) and foreclosure under this

chapter is not allowed under section 3205c(7), the foreclosure of the mortgage must proceed judicially.

viii. That the borrower has the right to contact an attorney, and the telephone numbers of the state bar of Michigan's lawyer referral service and of a local legal aid office serving the area in which the property is situated.

3. 3205b Loan Modification Meeting (MCL 600.3205b) - borrower has 14 days to contact a housing counselor to set up a meeting to attempt to work out a loan modification. If this request is made, the foreclosure by advertisement cannot be commenced for 90 days.

a. Statutory guidelines for when a modification may be offered. (MCL 600.3205c)

i. The loan modification program or process targets a ratio of the borrower's housing-related debt to the borrower's gross income of 38% or less, on an aggregate basis. Housing-related debt under this subdivision includes mortgage principal and interest, property taxes, insurance, and homeowner's fees.

ii. If the mortgage loan is pooled for sale to an investor that is a governmental entity, the person designated under section 3205a(1)(c) shall follow the modification guidelines dictated by the governmental entity.

b. Before 90 days after the notice required under section 3205a(1) is sent or 10 days after the meeting between the borrower and the person designated under section 3205a(1)(c), whichever is later, the person designated under section 3205a(1)(c) shall provide the borrower with both of the following:

i. A copy of any calculations made by the person under this section.

ii. If requested by the borrower, a copy of the program, process, or guidelines under which the determination under subsection (1) was made.

c. If the results of the calculation under subsection (1) are that the borrower is eligible for a modification, the mortgage holder or mortgage servicer shall not foreclose the mortgage under this chapter but may proceed to foreclose the mortgage judicially. In the event that the borrower is not eligible for a modification or if subsection (7) applies, the mortgage holder or mortgage lender may proceed the foreclose the mortgage non-judicially.

d. If no modification is offered or, if offered, borrower does not return an executed modification agreement within 14 days, foreclosure by advertisement proceeding may proceed.

C. Michigan allows for foreclosure of a mortgage judicially pursuant to MCL 600.3101 et seq.

1. Accelerate the mortgage loan balance

a. If the mortgage has an acceleration clause, notice must be served on borrower in writing.

i. If there is no acceleration clause, note holder may only seek past due amounts.

ii. If the debt has been accelerated, the entire outstanding balance must be paid in order to stop the foreclosure proceedings.

2. Initiate Lawsuit

a. File complaint for judicial foreclosure.

i. Determine whether the lender should include a prayer for a monetary judgment relating to the deficiency balance.

ii. File and record a notice of lis pendens with the applicable register of deeds.

iii. If applicable, notify the IRS of the judicial foreclosure in order for the liens will be extinguish by the foreclosure.

iv. Default parties to the lawsuit that fail to respond to litigation.

b. Plaintiff in a judicial foreclosure action must wait at least 6 months before requesting a judgment of foreclosure. (MCL 600.3115)

2. Foreclosure sale following entry of judgment for judicial foreclosure

   a. Once judgment is entered, the lender may proceed with foreclosure sale.

   b. Publish the foreclosure notice for six (6) consecutive weeks in the legal news (or other designated newspaper) with which the subject property is located.

   c. Attend and bid on the foreclosure sale.

      i. Lender may bid the total amount of indebtedness.

      ii. Lender does not need to make a cash bid when the bidding amount in the amount of the indebtedness or less.

      iii. The foreclosure sale must be open to the public and comply with the requirements set forth in MCL 600.6053.

      iv. A sheriff's deed is issued to the successful bidder, however is not binding until the close of the redemption period.

   d. Redemption period is six (6) months (except for certain types of property).

   e. Judicial foreclosure sales must be confirmed. No notice to defendant required outside of notice of the Motion to Confirm. Plaintiff may seek a deficiency judgment at the time the sale is confirmed.

II. SHORT SALE BASICS

A. A short sale in a residential real estate context is a negotiated payoff of a mortgage loan in which the proceeds from selling the real property will fall short of the balance of the debt(s) secured by liens against the property. In addition, the property owner cannot afford to repay the liens' full amounts, whereby the lien holders agree to release their lien on the real estate and accept less than the amount owed on the debt.

B. A short sale will more than likely have the following outcomes:

1. The forgiveness of any deficiency;

2. The partial forgiveness of the deficiency with repayment of some portion of the deficiency at closing over time. When repaid over time the mortgagee may allow reasonable and affordable terms; or

3. A release of the mortgage for the net proceeds of the sale without a cancellation of the indebtedness.

C. The short sale is a lengthy process which may take anywhere from three (3) months to nine (9) months.

D. Lenders have differing requirements for the sort sale approval process; however, the basic guidelines one should follow when preparing a short sale packet are as follows:

1. Contact the lender requesting requirements for approval process.

a. For example, borrowers may have to be in default under the terms of the mortgage before the short sale request

will be considered by the lender; has the second lien holder signed off on the purchase agreement, etc.

b. Although the lender may not require it, order title work early.

2. Provide a recent appraisal of the real property

3. Provide a monthly household budget

4. Provide updated financials

a. Last two (2) years of tax returns

b. Last two (2) months of bank statements

5. Purchase agreement with detailed contingencies

a. Provide an estimated HUD-1 statement

6. Provide lender authorization to speak directly with real estate agent and/or title agent

E. Coordinate with subordinate lien holders as soon as possible

F. Tax liabilities for the forgiven debt

1. Basics to consider

2. Mortgage Fairness Debt Relief Act of 2007

WHAT DO YOU MEAN THIS IS A PROHIBITED TRANSACTION: IRC §4975

I. WHAT ARE WE GOING TO COVER?

A. Who are Disqualified Persons?

B. What transactions constitute Prohibited Transactions?

C. How do you correct a Prohibited Transaction?

D. How do you calculate the excise tax under IRC §4975?

II. WHO ARE THE BAD GUYS? THE DISQUALIFIED PERSONS?

A. Prohibited Transactions are covered under both Title I of ERISA and IRC §4975.

B. Who are Disqualified Persons and Parties-In-Interest?

1. Disqualified Person is the term used under IRC §4975 and Party-In-Interest is the term used under Title I of ERISA. The definitions are mostly (but not completely) identical.

2. Disqualified Persons are listed in §4975(e)(2) as any person having one of the following relations with a plan:

a. Fiduciaries;

b. Persons providing services to the plan;

c. Employers whose employees are covered by the plan; and

d. Employee organizations whose employees are covered by the plan.

3. The rules of attribution under IRC §267 are used to determine indirect ownership.

4. Ownership is attributed to a related person or entity.

   Example: Alpha Corporation is owned by Harvey and maintains a profit sharing plan. The plan loans $20,000 to Harvey's son Lowell. Lowell is a Disqualified Person.

5. Attribution applies to family members of a Disqualified Person.

   a. Very broad definition of family member used – not the definition in IRC §1563 (used for IRC §414 purposes).

   b. Includes spouse, ancestors (parents, grandparents, etc.), lineal descendants (children, grandchildren, etc.) and spouses of lineal descendants.

   c. In the example above with Alpha Corporation, the plan could not loan money to Lowell's spouse as she would also be a Disqualified Person.

   d. The attribution rules also cover LLCs and partnerships.

      Example: Jim owns 100% of Delta, LLC. Delta, LLC maintains a money purchase pension plan. Jim owns 50% of Epsilon, LLC. Ten (10%) percent of Epsilon, LLC is owned by Heidi. The Delta, LLC plan sells Heidi a piece of real estate. Since Heidi owns at least 10% of Epsilon, LLC, Heidi is a DP.

   e. In a corporation, the 50% test is met either by:

      i. 50% of voting power; or

      ii. 50% of the value of the stock.

Example: Ted owns 50% of Beta Corporation. Beta Corporation maintains a profit sharing plan. The plan sells a piece of real estate to Gamma Corporation. Ted owns 50% of Gamma Corporation. Gamma Corporation is a Disqualified Person.

f. The rules apply to the employer, or other related entities.

g. In the prior example, Beta Corporation could not sell the piece of real estate to Mary, an HCE employed by Gamma Corporation (who earned more than 10% of all wages paid). Mary is also a Disqualified Person.

III. WHAT'S THE PROBLEM? WHAT ARE PTs?

A. Six types of transactions are categorized as Prohibited Transactions.

B. Three categories of exemptions exist from the Prohibited Transaction rules.

C. Statutory Exemptions.

1. 23 are listed in IRC §4975(f).

2. The most known examples include plan participant loans and exempt ESOP loans.

D. Class Exemptions.

1. Granted by the Department of Labor for the exemption of classes of transactions.

2. Often requested by an industry group.

3. Examples include sale of a life insurance policy from a plan to a participant and short term interest free loan by a plan sponsor to the plan.

E. Private Exemptions.

1. Granted by the Department of Labor as letter ruling to specific parties for specific transactions.

2. Transaction must be in the best interests of the plan and participants.

3. An example would be a sale of property by a plan to a Disqualified Person, if there is no readily available purchaser and there is a need for liquidity.

4. These transactions can go either way – to or from a plan.

5. What cannot be done directly cannot be done indirectly through the use of a straw man to circumvent the rules.

   Example: Zeta Profit Sharing Plan owns a Florida condominium which was used as an investment. Diane, who is the trustee, wants to buy it, but she recognizes a sale to her would be a Prohibited Transaction. Diane asks whether the plan can sell the property to Sandy her next door neighbor and then she'll buy it from Sandy.

F. Types of Transactions.

1. A contribution of property to a plan to meet a funding obligation is also a Prohibited Transaction. Substantively, this is no different than a sale of an asset to the plan.

2. Even if there is no obligation, a contribution of property encumbered by a loan is a Prohibited Transaction. Substantively, this is no different than the plan paying the Disqualified Person an amount equal to the loan.

3. Repaying a loan with property is also a Prohibited Transaction.

4. These transactions can go either way – to or from a plan.

5. What cannot be done directly cannot be done indirectly utilizing a mutual transaction to circumvent the rules.

   Examples: Jeff owns 100% of the stock of Eta Company which sponsors a profit sharing plan. Eta Company needs $50,000. Jeff borrows $50,000 from the profit sharing plan (qualifying for the participant loan exemption) but immediately loans the money to Eta Company.

   Chuck, an attorney and trustee of his profit sharing plan, agrees that he will loan Marc, an attorney who shares space with him, $100,000 from his plan in return for Marc, who is trustee of his own plan, loaning Chuck a like amount.

6. Other extensions of credit may not be so clear where a Disqualified Person receives an indirect benefit.

   Example: A law firm's retirement plan loaned money to its client pending a resolution of their case. The IRS ruled that this constituted an indirect benefit to the law firm and constituted a Prohibited Transaction (TAM 9118001).

7. Guarantees may also be a prohibited extension of credit.

   a. Easy case – plan guarantees a loan to the plan sponsor.

   b. Less clear – a third party loan to the plan which is guaranteed by the plan trustee.

   c. Even if the guarantees are never enforced, it is still a Prohibited Transaction.

8. The participant loan exemption.

   a. Under Title I of ERISA, all participants are parties in interest. Under IRC §4975, only Highly Compensated Employees (with at least 10% of all compensation paid by the employer) are Disqualified Persons.

b. The requirements necessary to meet exemption are:

i. Loans must be available to all participants on a reasonably equivalent basis;

ii. Loans may not be available in greater amounts for Highly Compensated Employees, officers, or shareholders;

iii. Plan document or separate loan policy must specify procedures for applying any limits, the kind of collateral that will be required, etc.;

iv. The loan must bear a reasonable rate of interest; and

v. The loan must be adequately secured.

Examples: Theta Company is a property management firm that sponsors a retirement plan which invests in rental property. Can the plan use the services of the plan sponsor to manage its own rental property and pay an appropriate fee?

Luta Company maintains a profit sharing plan. Richard, the owner and trustee, retains his daughter, Karen, a CPA to file the plan's Form 5500. Can the plan use Karen's services and pay an appropriate fee?

c. Principal exemption for reasonable compensation or reasonable services:

i. The contract must be reasonable;

ii. The compensation paid must be reasonable;

iii. The services must be necessary for establishment or operation of the plan; and

iv. Presumably the IRS, like the Department of Labor, will deem a contract to be unreasonable unless fees have been disclosed in accordance with IRC §408(b)(2).

Examples: Kappa Company maintains a profit sharing plan. Sally, its president and trustee of the plan, uses plan assets to pay company debts. This is clearly a Prohibited Transaction even if no loans were established.

Lambda Company's profit sharing plan pays the legal fees for a defense of Steven, the plan's trustee, who was charged with criminal violations.

d. Usually the fiduciary has entered into a transaction where they receive a personal benefit.

Example: Tony is the sole owner of Dr. Tooth, P.C. and is trustee of its profit sharing plan. Tony learns of an investment opportunity to acquire a piece of real estate, which is being sold at an extremely depressed price. Unfortunately, Tony has insufficient funds to personally acquire the property, but he decides to personally acquire half and have the profit sharing plan acquire the other half.

e. The rules are also meant to prohibit "kickbacks."

Example: Henry is the trustee of the Mu Company Profit Sharing Plan. The Mu Company Profit Sharing Plan loans Nu Company $250,000. Nu Company hires Wendy, Henry's daughter, who is unemployed.

IV. HOW DO YOU FIX IT? CORRECTION OF PT

A. No description of correction exists under IRC §4975.

B. IRS generally uses the private foundation rules of IRC §4941. Undo the transaction to the extent possible, but in no case put the plan in a worse condition than if the Prohibited Transaction never occurred.

C. Rescind or reverse the sale when possible.

D. The amount repaid should be the lesser of:

1. The consideration received by the plan, or

2. The Fair Market Value at the time of the sale or rescission.

E. Any profits earned by the Disqualified Person must also be returned to the plan.

Example: Xi Defined Benefit Plan sold a piece of rental property to Joe, the trustee, for $100,000. When the correction occurred, the property was worth $110,000. During the time Joe owned the property, he earned $5,000 under a "triple net lease." To correct:

1. Joe must re-convey title to the plan;

2. The plan must pay Joe $100,000; and

3. Joe must pay the plan the $5,000 he earned.

F. If the Disqualified Person has sold the property (to a non-Disqualified Person), rescission is not necessary.

1. The Disqualified Person must pay the plan the excess of what he received over the amount that would have been paid if rescission had occurred.

2. The Disqualified Person must also repay any profits he earned on the original sale proceeds.

Example: Same facts as last example, but Joe sold property to a third person for $110,000. Joe must pay Xi Defined Benefit Plan $10,000, plus the $5,000 in profits he earned.

G. Rescind or reverse the sale when possible. The amount repaid should be the greater of:

1. The consideration received by the Disqualified Person, or

2. The Fair Market Value at the time of the sale or rescission.

H. The Disqualified Person must also repay the plan the income he earned on the cash from the sale.

Example: Omicron Profit Sharing Plan purchased a piece of rental property from Sam, the trustee, for its FMV of $200,000. When rescission occurred, the property was worth $150,000. Sam earned $8,000 with the sale proceeds prior to rescission. To correct:

1. The plan must re-convey title to the Disqualified Person;

2. Sam must pay the plan $200,000; and

3. Sam must also pay the plan the $8,000 he earned.

I. Correction can also be made by sale to a third party if:

1. The Disqualified Person pays the plan the excess of the amount the Disqualified Person would have paid had the sale been rescinded over the amount received in the third party sale.

2. The Disqualified Person must also repay any profits he earned on the original sale proceeds.

Example: Same facts as last example, but the plan sold the property for $180,000. Sam must pay the Omicron Profit Sharing Plan $20,000, plus the $8,000 he earned.

J. To correct a loan it must be repaid.

Example: Pi Pension Plan loaned Pi Company $10,000 at its then fair interest rate of 4% per annum. When correction was made, the fair interest rate was 6%. To correct, Pi Company:

1. Must repay the loan; and

2. Must pay additional interest calculated at 6% over the life of the loan.

K. To correct a lease it must be terminated. The Disqualified Person must also pay the plan the greater of fair rental value or fair interest rate over the actual rental value or interest determined at either the outset or at correction, whichever is greater.

L. If no interest is specified in a loan document, IRS says use the rate specified in IRC §6621(a)(2) for underpaid taxes.

M. If the employer qualifies for the Department of Labor's Voluntary Fiduciary Correction Program and repayment occurs in 180 days, the employer will be exempt under IRC §4975.

N. Presumably this would cover situations where there is an exemption that allows a Disqualified Person to perform services but the fee is merely excessive.

O. Correction requires the Disqualified Person to repay the excess amount plus lost earnings to put the plan in the position it would otherwise have been in.

P. Prohibited Transactions also cover both the service providers and fiduciaries.

Q. Department of Labor regulations provide that if compensation paid was reasonable, correction requires termination of contract or providing the required disclosure.

R. Correction only applies prospectively to service providers.

S. A complete exemption may be available for the fiduciary if:

1. Fiduciary did not know the disclosure was deficient;

2. Upon discovery, the fiduciary requests in writing that it be corrected; and

3. If the failure continues for more than 90 days, the fiduciary notifies the Department of Labor.

V. HOW EXPENSIVE IS THE PROBLEM? CALCULATING THE TAX

A. IRC §4975 contains two levels of tax:

1. Initial tax of 15% of the amount involved for a Prohibited Transaction for each year or part of a year during the taxable period; and

2. Second level of tax of 100% of the amount involved for a Prohibited Transaction that is not corrected within the taxable period.

B. What is the amount involved?

1. Generally it is the greater of the amount of money or Fair Market Value of property given or received.

2. In the use of money (loan) or the use of property (lease), the amount involved is:

a. The greater of the amount paid or Fair Market Value of the use for the period of time the money or property is used.

b. A Prohibited Transaction occurs on the date of the initial transaction, and a new Prohibited Transaction occurs on the first day of each year thereafter.

3. In the case of unreasonable compensation, that fails the exemptions under IRC §4975(d)(2) or (10), the amount involved is the excess compensation paid.

4. In the case of the failure to meet the disclosure requirements of IRC §408(b)(2), the amount involved may be the entire amount of fees collected during the period of noncompliance.

C. What is the taxable period?

1. Begins on the day the Prohibited Transaction occurs.

2. Ends on the earliest of the date:

   a. It is cured;

   b. The tax is assessed; or

   c. The notice of deficiency is mailed.

3. IRS website indicates that it will "usually" grant an additional 90 days after notice of deficiency is mailed and <u>may</u> grant additional reasonable time to correct, if necessary, before assessing the second level tax.

D. Sale of property to the plan by a Disqualified Person.

Example: Ed, the trustee of Rho Pension Plan, sold the plan a piece of vacant real estate on July 1, 2011. The sale price was $10,000 but the Fair Market Value was only $4,000. On July 1, 2012, the transaction was corrected. What is the total first tier excise tax?

Answer:

<u>For 2011</u>

Amount involved = $10,000
$10,000 x 15% = $1,500

For 2012

Amount involved = $10,000
$10,000 x 15% = $1,500
Total tax (all years) = $3,000

E. Loan by a plan to a Disqualified Person.

Example: The Sigma Profit Sharing Plan loans Sigma Company $100,000 on April 1, 2011. The interest rate provided for in the loan document (a demand note) is 6% (which is a fair interest rate). Interest is paid on the loan balance on December 31st of each year. On December 31, 2013 the loan is repaid. What is the total first tier excise tax?

Answer:

For 2011

Amount involved = $10,000 x 6% x 9/12 = $4,500
$4,500 x 15% = $675

For 2012

Amount involved (Transaction 1) = $4,500
$4,500 x 15% = $675
Amount involved (Transaction 2) = $100,000 x 6% = $6,000
$6,000 x 15% = $900
Total tax (for 2012) = $1,575

For 2013

Amount involved (Transaction 1) = $4,500
$4,500 x 15% = $675
Amount involved (Transaction 2) = $6,000
$6,000 x 15% = $900
Amount involved (Transaction 3) = $100,000 x 6% = $6,000
$6,000 x 15% = $900
Total tax (for 2013) = $2,475
Total tax (all years) = $4,725

F. Lease of property by a plan to a Disqualified Person.

Example: The Tau Profit Sharing Plan owns a piece of rental property and leases it to Ronald, the son of Stuart who owns Tau Company. The monthly rent paid is $1,000 but the fair rental value is $2,000 per month. The lease began on January 1, 2012 and was corrected on April 1, 2014. What is the total first tier excise tax?

Answer:

For 2012

Amount involved = $2,000 x 12 = $24,000
$24,000 x 15% = $3,600

For 2013

Amount involved (Transaction 1) = $24,000
$24,000 x 15% = $3,600
Amount involved (Transaction 2) = $2,000 x 12 = $24,000
$24,000 x 15% = $3,600
Total tax (for 2013) = $7,200

For 2014

Amount involved (Transaction 1) = $24,000
$24,000 x 15% = $3,600
Amount involved (Transaction 2) = $24,000
$24,000 x 15% = $3,600
Amount involved (Transaction 3) = $2,000 x 3 = $6,000
$6,000 x 15% = $900
Total tax (for 2014) = $8,100
Total tax (all years) = $18,900

G. Payment of excess compensation by the plan.

Example: Upsilon Retirement Plan retains Harry as its TPA. Harry is the second cousin of Marvin, the owner of Upsilon Company. For 2012 and 2013, the plan pays Harry a fee of $10,000 each year. The fair value of Harry's services is determined to be $3,000 per year. On February 15, 2014, the transaction is corrected. What is the total first tier excise tax?

Answer:

For 2012

Amount involved = $10,000 - $3,000 = $7,000

For 2013

Amount involved (Transaction 1) = $7,000
$7,000 x 15% = $1,050
Amount involved (Transaction 2) =
$10,000 - $3,000 = $7,000
$7,000 x 15% = $1,050
Total tax (for 2013) = $2,100

For 2014

Amount involved (Transaction 1) = $7,000
$7,000 x 15% = $1,050
Amount involved (Transaction 2) = $7,000
$7,000 x 15% = $1,050
Total tax (for 2014) = $2,100
Total tax (all years) = $5,250

H. Late payment of employee deferrals to a plan.

Example: Phi Company maintains a 401(k) plan. For the payroll period ending September 30, 2011, it failed to pay over to the plan $50,000 of employee deferrals. October 1, 2011 was the first date the company could reasonably have segregated the assets. The deposit was finally made on March 31, 2013. The IRC §6621(a)(2) rate in effect on October 1, 2011, January 1, 2012, and January 1, 2013 is 3%. What is the total first tier excise tax?

Answer:

For 2011

Amount involved = $50,000 x 3% x 3/12 = $375
$375 x 15% = $56.25

For 2012

Amount involved (Transaction 1) = $375
$375 x 15% = $56.25
Amount involved (Transaction 2) =
$50,375 ($50,000 + $375) x 3% = $1,511.25
$1,511.25 x 15% = $226.69
Total tax (for 2012) = $282.94

For 2013

Amount involved (Transaction 1) = $375
$375 x 15% = $56.25
Amount involved (Transaction 2) =1,511.26
$1,511.25 x 15% = $226.69
Amount involved (Transaction 3) =
$51,886.75 ($50,375 + $1,511.25) x 3% x 3/12 = $389.15
$389.15 x 15% = $58.17
Total tax (for 2013) = $341.31
Total tax (all years) = $680.60

I. General Rule.

1. Three year statue starts at the later of the due date or date Form 5500 is actually filed if the Prohibited Transaction is adequately disclosed.

2. If the Prohibited Transaction is not disclosed, a six year statue will apply.

3. If a plan sold an asset to a Disqualified Person and it was adequately disclosed on the 2009 Form 5500, the statute will run on July 31, 2013 (for all years).

4. If a plan makes a loan to a Disqualified Person during 2009 and adequately disclosed it on the 2009 Form 5500, the statute will run for the first year on July 31, 2013. For subsequent years Prohibited Transactions, the statute will run on each subsequent July 31st.

J. Sufficient disclosure requires answering:

1. Question 10(b) on Form 5500-SF (reporting non-exempt transactions with parties-in-interest).

2. Schedule G, Part III (detailed information about non-exempt party-in-interest transaction).

3. Schedule I, Question 4(d) (disclosure of non-exempt party-in-interest transactions).

HEALTH CARE COMPLIANCE FOR 2013/2014

By: Marc S. Wise, Esq.

I. INTRODUCTION

Additional provisions of the Patient Protection and Affordable Care Act ("ACA") become effective in 2013 and 2014. Although full implementation of the ACA occurs in 2014, new requirements apply in 2013 and 2013 should be used in planning for the 2014 implementation.

II. EMPLOYEE NOTIFICATION REQUIREMENTS FOR 2013 AND 2014

A. Health Care Notifications

1. Summary of Benefits and Coverage

The ACA mandates a new plan document entitled Summary of Benefits and Coverage ("SBC"). The mandates are effective for the first enrollment period beginning on or after September 23, 2012, and include strict timeframes for the generation and distribution of the SBC — penalties apply for noncompliance.

Non-compliance with SBC regulations can result in a civil penalty of up to $100 per day per affected individual; an excise tax of $100 per day per affected individual; and fines of up to $1,000 per affected individual for willful violations.

a. Plans Covered

Government regulations provide that the SBC requirements apply to the following types of plans:

- Self-funded and insured medical plans
- Individual plans
- Limited benefit plans

- Student health insurance
- Expatriate plans (U.S.-based benefits only)
- Certain other plan types (e.g., HRAs, pharmacy and EAP if considered a group health plan)

The purpose of the SBC is to give eligible employees and beneficiaries information about a health insurance plan's benefits in "plain language," so they can make appropriate purchasing, enrollment and coverage decisions. All customers and insurers must use the SBC document format prescribed by the final regulations.

The required, four-page (double-sided) SBC document includes:

- Basic benefits and coverage, cost sharing requirements and exclusions and limitations of the plan
- Two coverage examples: one for having a baby and one for Type 2 Diabetes
- Information about how to access a "uniform" glossary that provides definitions of health coverage and medical terminology used in the SBC. The glossary must also be provided upon request.

b. Who needs to provide the SBC?

All group health plans and health insurance issuers are required to provide an SBC. The requirement also applies to grandfathered health plans.

Responsibility for the preparation of the SBC depends on the nature of the plan. For self-insured group health plans, the plan (including the plan administrator) will be responsible for providing an SBC.

For fully-insured plans, both the insurer and the plan are jointly responsible. Generally, SBCs will be drafted by insurers and third-party administrators. The plan or insurer is not liable for enforcement if they have an arrangement with a TPA, they monitor the TPA, and they take action in the event of a violation.

The rules also apply to health reimbursement arrangements. However, if the health reimbursement arrangement is coordinated with another major medical plan, two separate SBCs will not be required.

The SBC requirements will also not apply to stand-alone retiree health plans.

c. When must SBCs be provided?

For group health plan coverage, the regulations provide that, for disclosures with respect to participants and beneficiaries who enroll or re-enroll through an open enrollment period (including late enrollees and re-enrollees), the SBC must be provided beginning on the first day of the first open enrollment period that begins on or after September 23, 2012.

For disclosures with respect to participants and beneficiaries who enroll in coverage other than through an open enrollment period (including individuals who are newly eligible for coverage and special enrollees), the SBC must be provided beginning on the first day of the first plan year that begins on or after September 23, 2012.

The SBC is going to be a part of the annual enrollment processes going forward.

There are basically five circumstances in which the document and the glossary will need to be provided:

i. At enrollment (i.e., initial enrollment) - with any written enrollment application materials the plan provides. If no such materials are provided, then no later than the first date the participant is eligible to enroll himself or any beneficiary in coverage.

ii. If there are changes to the SBC - no later than the first day of coverage.

iii. HIPAA special enrollees - no later than 90 days following enrollment. This time period is coordinated with the requirement for providing the group health plan SPD.

iv. Early delivery required upon enrollee's request.

v. Upon renewal (i.e., annual enrollment) - if applicable, only for those benefit options in which the participant or beneficiary is enrolled, by either the date the written renewal application materials are distributed to the plan sponsor or, in the case of automatic renewal, no later than 30 days prior to the first day of the new plan year.

   A participant or beneficiary can also request an SBC during renewal for an option in which they are not enrolled.

vi. Upon request – no later than seven business days.

d. What if plan coverage is materially modified (change to coverage that would be considered by the average plan participant to be an important change)?

i. ERISA requires participant notice to be provided within 60 days after a material reduction in benefits. Notice must be provided within 210 days after adoption of any other amendment.

ii. The SBC requirements impose an advance notice of material modifications if the material modification to the plan affects SBC content, and the modification occurs other than in connection with renewal (new enrollment period).

iii. The timing of the notice depends upon the effective date of the material modification. If a material modification is effective as of the first day of the plan year, the SBC to be provided in connection with the open enrollment preceding the effective date must reflect the modification.

iv. If a material modification is effective during the plan year, the notice of the material modification (or updated SBC) must be distributed at least 60 days before the change takes effect.

2. Grandfather Notice

Summary of Grandfather Rules

Group health plans that were in existence as of March 23, 2010 that meet the new grandfathering rules do not need to comply with many of the new health insurance reforms. These health plans are referred to as “grandfathered plans” under the HCA. This protection remains even when new employees or family members are added to the health plan.

a. Most health plans will lose the grandfather status and will be subject to the full rules of the HCA. The Department of Health and Human Services issued interim final regulations (the "Regulations") explaining what changes a plan sponsor can make to a group health plan that was in existence on March 23, 2010 without causing the plan to forfeit its grandfathered status. The Regulations also provided that certain HIPAA accepted plans such as stand-alone dental, vision and retiree medical plans are not subject to the HCA’s group market reforms.

b. Permitted Changes. The Regulations permit plan sponsors to make routine design changes and cost changes within narrow parameters, providing limited flexibility to plan sponsors that want to retain grandfather status.

In order to be grandfathered, a benefit option must have been in existence on March 23, 2010. It is not necessary that the option continues to cover the same participants as were covered on March 23, 2010.

c. Benefit Changes. Any one of the following changes will result in the loss of grandfathered status with respect to the benefit package affected by the change:

i. Changes in insurance carriers: Except with respect to insured grandfathered collectively bargained plans, a change in insurance carrier ends grandfather status for that benefit package option. The government has indicated that it may provide guidance as to when a change in insurance carries will not be treated as a loss of grandfather status.

ii. Changes in the scope of benefits: The elimination of benefits to diagnose or treat a particular condition, even if the condition affects relatively few individuals under the plan, results in loss of grandfather status.

iii. The elimination of benefits for any necessary element to diagnose or treat a particular condition also results in loss of grandfather status. For example, if a plan covers a particular mental health condition, the treatment for which includes prescription drugs and counseling, elimination of counseling would result in loss of grandfather status.

iv. Increases in percentage cost sharing requirements: Any increase in any percentage cost-sharing amount (such as increasing a 20% coinsurance requirement for in-patient surgery to 30%) results in loss of grandfather status.

v. Increases in fixed amount cost sharing: For fixed amount cost sharing other than co-payments (e.g., deductibles) the maximum permitted increase in the fixed amount (since March 23, 2010) without loss of grandfather status is the medical inflation (from March 23, 2010), plus 15 percentage points.

For co-payments, the maximum permitted increase (since March 23, 2010) without loss of grandfather status is the greater of (a) the sum of medical inflation plus 15%, or (b) $5 increase by medical inflation.

vi. Changes in rate of employer contributions for premiums: A decrease in the employer contribution rate of more than 5% below the rate on March 23, 2010, for any tier of coverage for similarly situated individuals' results in loss of grandfather status.

In general, the employer contribution rate is the amount of contribution made by an employer compared to the total cost of coverage, as determined under the COBRA continuation rules.

In the case of a self-insured plan, contributions by the employer are equal to the total cost of coverage minus the employee contributions toward the total cost of coverage. According to the examples in the regulations, pre-tax salary reduction contributions are considered employee contributions for this purpose.

Under this rule, although the dollar amount of employee contributions may increase, there is no loss of grandfather status as long as the rate (i.e., the relative proportion) of employee contribution does not increase more than permitted.

vii. Changes in annual limits: The addition of an overall annual limit on the dollar value of benefits to a grandfathered plan that did not impose an overall annual or lifetime dollar limit on March 23, 2010, results in loss of grandfather status.

If a grandfathered plan that had only a lifetime dollar limit on March 23, 2010, is modified to add an annual dollar limit on benefits, grandfather status is lost unless the annual limit is not less that the lifetime limit.

If a grandfathered plan lowers an annual dollar limit on benefits below the limit in effect on March 23, 2010, grandfather status is lost. (Note: life-time limits are prohibited for plan/policy years beginning after Sept. 23, 2010; this prohibition applies to grandfathered plans.)

viii. Other Changes: According to the preamble, changes other than those described in the regulations as resulting in loss of grandfather status do not affect the grandfather status.

Changes that do not result in loss of grandfather status include changes required to comply with federal or state law, changes to voluntarily comply

with HCA or increase benefits, and changes in third-party administrators with respect to a self-insured plan.

d. Disclosure requirements: In order to maintain grandfather status, a plan or health insurance coverage must include a statement in any plan materials provided to participants that the plan believes it is a grandfathered health plan and must provide contact information for questions (and complaints). This required disclosure is required to be provided for each plan year following the effective date of the ACA (March 23, 2010).

Most materials from insurance companies and insurance agents for fully-insured plans do not include this required language.

e. Model Grandfather Notice

The DOL has provided the following model grandfather notice that can be used, as modified, for compliance with the ACA employer-sponsored health plans:

> This [group health plan or health insurance issuer] believes this [plan or coverage] is a "grandfathered health plan" under the Patient Protection and Affordable Care Act (the Affordable Care Act). As permitted by the Affordable Care Act, a grandfathered health plan can preserve certain basic health coverage that was already in effect when that law was enacted. Being a grandfathered health plan means that your [plan or policy] may not include certain consumer protections of the Affordable Care Act that apply to other plans, for example, the requirement for the provision of preventive health services without any cost sharing. However, grandfathered health plans must comply with certain other consumer protections in the Affordable Care Act, for example, the elimination of lifetime limits on benefits.

Questions regarding which protections apply and which protections do not apply to a grandfathered health plan and what might cause a plan to change from grandfathered health plan status can be directed to the plan administrator at [insert contact information]. You may also contact the Employee Benefits Security Administration, U.S. Department of Labor at 1-866-444-3272 or www.dol.gov/ebsa/healthreform. This website has a table summarizing which protections do and do not apply to grandfathered health plans.

f. Substantiation requirements: For as long as a plan or insurance carrier takes the position that the plan or coverage is grandfathered, the following records must be maintained:

i. Records documenting the terms of the plan or health insurance coverage in effect on March 23, 2010; and

ii. Any documents necessary to support the status as a grandfathered plan (for example, a copy of a legally binding contract in effect on March 23, 2010).

These documents must be made available for examination by participants, beneficiaries, individual policy subscribers and federal agency officials.

g. Likelihood of Maintaining Grandfather Status. The Preamble to the Grandfather Regulations indicates that the government expects between 49% and 80% of small plans and between 34% and 64% of large plans to lose their grandfathered status between now and 2013. Due to the loss of flexibility in benefit design and well as mandates by insurance companies for fully insured plans, these percentages will likely be much higher.

h. U.S. Department of Labor ("DOL") Health Care Investigations. We have assisted a number of clients over the past year with DOL health care investigations. The level of documentation that must be provided to the DOL is extensive.

The level of scrutiny and documentation required is magnified if the plan sponsor is claiming grandfather status.

3. **60 Day Advance Notice**. The ACA requires plans and issuers to provide at least 60 days' advance notice of any material modification in plan terms or coverage that are not described in the most recent SBC. The DOL's proposed regulations offer additional guidance on when plans and issuers must provide the 60-day advance notice to enrollees.

a. The proposed regulations state that plans and issuers are required to issue the 60-day advance notice when:

- A material modification is made that would affect the content of the SBC;
- The change is not already included in the most recently provided SBC; and
- The change is a mid-plan year change (that is, it does not occur in connection with a renewal of coverage).

***Note: Under the proposed regulations, plans and issuers must provide the SBC before the beginning of each plan year. Changes that occur in connection with a new plan year should be described in an updated SBC provided before the beginning of the plan year.**

When a plan timely provides the 60-day advance notice in connection with a material modification, the proposed

regulations state that the plan will also satisfy ERISA's requirement to provide an SMM.

b. Guidance on Material Modifications. The proposed regulations describe a "material modification" as any change to a plan's coverage that independently, or in connection with other changes taking place at the same time, would be considered by the average plan participant to be an important change in covered benefits or other terms of coverage.

A material modification may include:

- An enhancement in covered benefits or services or other more generous plan or policy terms (for example, reduced cost-sharing or coverage of previously excluded benefits); or
- A reduction in covered services or benefits or more strict requirements for receiving benefits (for example, a new referral requirement or increased premiums or cost-sharing).

4. Summary Plan Description ("SPD") Issues

ERISA health and welfare benefit plans (other than governmental plans and church plans) must distribute an SPD to each participant covered under the plan.

The plan administrator generally must furnish the SPD within 90 days after a participant first becomes covered under the plan. For new plans, the plan administrator must furnish the SPD to covered participants within 120 days after the plan's establishment.

The summary plan description (SPD) is the primary vehicle for informing participants and beneficiaries about their rights and

benefits under the employee benefit plans in which they participate. Consequently, ERISA is quite specific about the content requirements for an SPD and establishes extensive and detailed requirements regarding the information that must be disclosed.

Some of the required information that must be contained in the SPD for a health and welfare plan includes the following:

a. Name — the name of the plan (and, if different, the name by which the plan is commonly known).

b. Sponsor — the name(s) and address(es) of one of the following:

- The single employer who sponsors the plan.
- The employee organization that sponsors the plan.

In the case of a collectively bargained plan, a list of all employers and unions involved in sponsoring the plan and:

- A statement that a complete list of participating employers and employee organizations may be obtained by written request to the plan administrator (and is available for examination); or
- A statement that participants and beneficiaries may receive (after written request to the plan administrator) information regarding whether a particular employer or employee organization is a sponsor of the plan (and the sponsor's address).

In the case of a plan established or maintained by two or more employers, the representative of a group of employers who sponsor a plan and:

- A statement that a complete list of participating employers sponsoring the plan is available for examination by participants and beneficiaries and may be obtained by written request to the plan administrator; or

- A statement that participants and beneficiaries may receive (after written request to the plan administrator) information regarding whether a particular employer or employee organization is a sponsor of the plan (and the sponsor's address).

c. EIN — the plan sponsor's employer identification number (assigned by the IRS).

d. Plan Number — the 3-digit plan number (assigned by the plan sponsor). Welfare plans begin with 501 and are numbered consecutively.

e. Plan Year — the date of the plan's fiscal year selected for ERISA purposes.

f. Type of Plan — the type of welfare benefit plan (for example, group health plan, disability, prepaid legal services, etc.).

g. Administration — the type of administration (for example, contract administration, insurer administration, etc.).

h. Plan Administrator — Name, business address, and telephone number of the plan administrator.

i. Service of Process — Name and address of the person designated as agent for service of legal process, and a statement that service can be made on a plan trustee or the plan administrator.

j. Trustee — Name, title and address of the principal place of business of each trustee.

k. Collective-Bargaining Agreement — For collectively bargained plans, a statement referencing the collective-bargaining agreement, and a statement that the collective-bargaining agreement is available for examination and that a copy may be obtained by written request to the plan administrator.

l. Eligibility — A description of the plan's requirements for eligibility to participate and to receive benefits. For example, the SPD might describe a waiting period (such as three months) before a participant is eligible to participate and the class or classes of eligible participants (such as all full-time, salaried employees).

m. Description of Benefits — Welfare benefit plans must also include a general description of the benefits provided under the plan. For welfare plans providing extensive schedules of benefits, only a general description is required if reference is made to detailed schedules of benefits which are available without cost to any participant or beneficiary who so requests.

n. Plan benefits and exclusions;

    i. the impact of discount arrangements with providers, insurers, or administrators on a participant's copayments, deductibles, annual and lifetime maximum benefits, and subrogation provisions;

ii. any cost-sharing provisions, including premiums, deductibles, coinsurance, and copayment amounts for which the participant or beneficiary will be responsible;

iii. any annual or lifetime caps or other limits on benefits under the plan;

iv. a description of a medical plan's procedures governing qualified medical child support order (QMCSO) determinations, or a statement indicating that participants and beneficiaries can obtain, without charge, a copy of such procedures from the plan administrator;

v. the extent to which preventive services are covered under the plan;

vi. whether, and under what circumstances, existing and new drugs are covered under the plan;

vii. whether, and under what circumstances, coverage is provided for medical tests, devices, and procedures;

viii. provisions governing the use of network providers, the composition of the provider network and whether, and under what circumstances, coverage is provided for out-of-network services (in the case of plans with provider networks, the listing of providers may be furnished as a separate document, provided that the SPD contains a general description of the provider network and indicates that provider lists are

furnished automatically, without charge, as a separate document);

ix. Any conditions or limits on the selection of primary care providers or providers of specialty medical care;

x. Any conditions or limits applicable to obtaining emergency medical care; and

xi. Any provisions requiring pre-authorizations or utilization review as a condition to obtaining a benefit or service under the plan.

o. Subrogation — A plan description must include language describing subrogation and other plan terms and conditions that may reduce benefits.

p. Cessation of Benefits — A statement identifying the circumstances which can lead to disqualification, ineligibility, or denial, loss, forfeiture or suspension of benefits.

q. In addition, SPDs must include the following:

i. a summary of any plan provisions governing the authority of the plan sponsors or others to terminate the plan or amend or eliminate benefits under the plan and the circumstances, if any, under which the plan may be terminated or benefits may be amended or eliminated.

ii. a summary of any plan provisions governing the benefits, rights, and obligations of participants and beneficiaries under the plan upon termination

of the plan or amendment or elimination of benefits under the plan; and

iii. a summary of any plan provisions governing the allocation and disposition of assets of the plan upon termination.

r. COBRA Continuation Rights — In the case of a group health plan subject to the COBRA benefit continuation provisions, the regulations require a description of the rights and obligations of participants and beneficiaries with respect to continuation coverage, including, among other things, information concerning qualifying events, premiums, notice, and election requirements and procedures, and duration of coverage.

s. Contributions — The SPD must identify the source of contributions (for example, employer, employee, union) and the method by which the amount of contribution is calculated.

t. Funding Medium — The SPD must disclose the identity of the funding medium used to accumulate assets and pay benefits, along with the name of any insurance company, trust fund, or other institution which maintains the fund. If a health insurance issuer is responsible, in whole or in part, for the financing or administration of a group health plan, the SPD shall note the name and address of the insurer, whether and to what extent benefits under the plan are guaranteed under the policy or contract, and the nature of any administrative services provided (for example, contract administrator or claims payer).

u. Claims Procedure — While most employers disclose claims rules in their SPDs, the DOL regulations allow claims procedures to be provided separately to employees, rather than in the SPD. When plan sponsors do not include the procedures in the SPD, a statement must appear in the SPD alerting participants and beneficiaries that the claims procedures will be provided separately automatically and without charge. The SPD still must generally describe the procedures by reference. The procedures governing claims for benefits include:

- Procedures for obtaining pre-authorizations, approvals, or utilization review decisions in the case of group health plan services or benefits; filing claim forms; notifications of benefit determinations; and review of denied claims in the case of any plan; and
- Applicable time limits and remedies available under the plan for the redress of claims which are denied in whole or in part.

v. Medical Claims Appeal Procedures — In July 2010, the DOL released final regulations reflecting enhanced internal claims and appeals requirements and external review procedures for group health plans and insurers offering individual coverage. The final rules applied to group health plan claims filed in the first plan year that began on or after September 23, 2010, but in any event, no later than January 1, 2011.

w. Disability Claims Appeal Procedures — In November 2000, the DOL released the final regulations relating to claims procedures. These procedures apply to disability

plans. The final rules first applied to disability plan claims filed on or after January 1, 2002.

x. Maternity or Newborn Coverage — For a group health plan that provides maternity or newborn infant coverage, the SPD must contain a statement describing the federal or state law requirements applicable to the plan (or any health insurance coverage offered under the plan) relating to hospital length-of-stay in connection with childbirth for the mother or newborn child.

y. Foreign Language Statement — An employer subject to a foreign language disclosure requirement should include a statement, prominently displayed and in the appropriate, non-English language, telling how, when, and where participants can receive an oral, non-English explanation of the plan.

z. HIPAA Special Enrollment Rights — for medical and other HIPAA plans, the SPD must include an explanation of events that trigger a special enrollment right and the time limits that apply to such enrollment rights.

aa. Mastectomy Reconstruction — Health plan SPDs must contain a statement regarding the limits of the mastectomy reconstruction benefit.

bb. Qualified Medical Child Support Orders (QMCSOs) — Health plan SPDs must contain either the procedures for handling QMCSOs or a statement indicating that participants and beneficiaries can obtain, free of charge, a copy of the procedures.

cc. ERISA Rights — All SPDs must include the statement of ERISA rights.

dd. HIPAA Privacy — Group health plans must provide covered employees with a Notice of their Privacy Practices. Plan sponsors may use a shorter explanation of the privacy rules and the plan's responsibilities in the SPD.

The above listing is a summary of the required disclosures. The various insurance company documents can be combined with this summary plan description in order to meet the required ERISA disclosures. Many health and welfare plans are in violation of this ERISA requirement.

5. Insurance Exchange

a. General Information. The ACA amends the Fair Labor Standards Act ("FLSA") to require that employers provide all new hires and current employees with a written notice about the health benefit Exchange and some of the consequences if an employee decides to purchase a qualified health plan through the Exchange in lieu of employer-sponsored coverage.

This new disclosure requirement is generally effective for employers beginning on March 1, 2013. Employees hired on or after the effective date must be provided the Notice of Exchange at the time of hiring. Employees employed on the effective date must be provided the Notice of Exchange no later than the effective date (i.e., no later than March 1, 2013).

Regulations implementing the Notice of Exchange requirement will be issued by the Secretary of Labor.

b. Content Requirements. The Notice of Exchange must include the following. First, employees must be informed of the existence of an Exchange, given a description of the services provided by the Exchange, and told how to contact the Exchange to request assistance. Second, employees must be informed that they may be eligible for a premium tax credit (under Code § 36B) or a cost-sharing reduction (under ACA § 1402) through the Exchange if the employer plan's share of the total cost of benefits under the plan is less than 60%. Finally, employees must be informed that (a) if they purchase a qualified health plan through the Exchange, then they may lose any employer contribution toward the cost of employer-provided coverage; and (b) all or a portion of employer contributions to employer-provided coverage may be excludable for federal income tax purposes.

It is anticipated that a model notice and further information on distribution requirements for the Notice of Exchange will be coming from the government in early 2013.

6. Insurance Refunds

a. General Information. The ACA established medical loss ratio (MLR) standards for health insurance issuers. Issuers are required to provide rebates when their spending for the benefit of policyholders on reimbursement for various health care services, in relation to the premiums charged, is less than the MLR standards established pursuant to the statute. Rebates are based upon aggregated market data in each state

and not upon a particular group health plan's experience.

To the extent that distributions, such as premium rebates, are considered to be plan assets of employer-sponsored health care plan, they become subject to the requirements of Title I of ERISA. Anyone with authority or control over plan assets is a "fiduciary," and subject to, among other things, the fiduciary responsibility and prohibited transaction provisions of ERISA. The DOL issued Technical Release 2011-04 to provide employers and plan fiduciaries guidance on handling any insurance company rebates received.

b. Who is Entitled to the Refund? Under ERISA section 401(b)(2), if the health care plan is the policyholder, the policy would be an asset of the plan, and in the absence of specific plan or policy language to the contrary, the employer would have no interest in the distribution. The policy for most small plans is in the name of the employer.

It is the DOL's position that the employer named as the policyholder or the owner of the policy would not, by itself, indicate that the employer may retain the distributions. In determining who is entitled to the distribution, the DOL requires a careful analysis of terms of the governing plan documents and the parties' understandings and representations.

Under ordinary notions of property rights, if a contract is ambiguous, other evidence may be used to determine the intent of the parties. In the absence of more direct

evidence, the DOL has looked to the sources of the insurance policies' premium payments. For example, where the premium is paid entirely out of trust assets, it is the view of the Department that the entire amount received from the insurer by the policyholder constitutes plan assets.

c. Allocating the Refund. Assuming the plan documents and other extrinsic evidence do not resolve the allocation issue:

i. the portion of a rebate that is attributable to participant contributions would be considered plan assets. Thus, if the employer paid the entire cost of the insurance coverage, then no part of the rebate with respect to this particular policy would be attributable to participant contributions.

ii. if participants paid the entire cost of the insurance coverage, then the entire amount of the rebate would be attributable to participant contributions and considered to be plan assets.

iii. if the participants and the employer each paid a fixed percentage of the cost, a percentage of the rebate equal to the percentage of the cost paid by participants would be attributable to participant contributions.

iv. if the employer was required to pay a fixed amount and participants were responsible for paying any additional costs, then the portion of the rebate under such a policy that does not

exceed the participants' total amount of prior contributions during the relevant period would be attributable to participant contributions.

v. if participants paid a fixed amount and the employer was responsible for paying any additional costs, then the portion of the rebate under such a policy that did not exceed the employer's total amount of prior contributions during the relevant period would not be attributable to participant contributions.

vi. In any case, employers that sponsor group health plans that use insurance policies to provide benefits would be prohibited by ERISA section 403(c)(1) from receiving a rebate amount greater than the total amount of premiums and other plan expenses paid by the employer. To the extent that an employer's portion of the rebate exceeds the amount of such employer's total amount of premiums and other plan expenses paid, that excess amount must be held in trust for the exclusive benefit of participants and beneficiaries.

7. Employee Notice/Form 5500 Issues.

Health and welfare benefit plans that are either unfunded or insured welfare plans and which have fewer than 100 participants are generally not required to file an annual Form 5500 with the DOL.

a. Small Welfare Exemption from the Form 5500 Requirements. A summary of page 4 (Item c) of the

instructions to the 2011 Form 5500 provides the following with regard to the small welfare plan Form 5500 exemption:

- if your welfare plan (medical, dental, life insurance, disability, etc) has fewer than 100 participants at the beginning of the year, you are exempt from filing Form 5500 if it is (a) unfunded, (b) fully insured, or (c) a combination of insured and unfunded. See 29 CFR 2520.104-20.

b. 29 CFR 2520.104-20 (a regulation issued by the DOL), provides as follows with respect to the small plan exemption for Form 5500 filing:

This exemption applies only to welfare benefit plans if —

- the plan had fewer than 100 participants at the beginning of the plan year;

- the plan's benefits are paid as needed solely from the general assets of the employer ..., or are provided exclusively through insurance contracts or policies issued by an insurance company..., the premiums for which are paid directly by the employer or employee organization from its general assets, or partly from its general assets and partly from contributions by its employees or members (provided that participant contributions are forwarded by the employer or the employee organization within three months of receipt), or are provided through a combination of payments from the general assets of the employer or the employer organization and insurance contracts; and

- the plan is insured, and the funds to which contributing participants are entitled are returned to them within three months of receipt by the employer or employer organization, and contributing participants are informed when they enter the plan about the plan's provisions

on the allocation of refunds. DOL regulation 2520.104-20(b)(3).

c. IRS Notifications. It appears that the IRS may be breaking the ice on this issue. One small company received a letter from the IRS containing the following statement:

If you have fewer than 100 participants on your group welfare benefit plan(s) you are exempt from filing a Form 5500 provided you have an SPD in place with the appropriate "refund allocation" language. The Form 5500 filing exemption may be lost if a Plan Sponsor does not disclose how insurer refunds are allocated. This can be problematic because many small employers do not prepare and distribute an SPD containing this language, nor do they file a Form 5500-relying on the small plan exemption. However, failure to prepare and file Form 5500 by the deadline can result in a DOL penalty of up to $1,100/day.

III. EMPLOYEE/GOVERNMENT NOTIFICATIONS

A. W-2 Reporting – January 2013

The ACA requires employers to report the cost of coverage under an employer-sponsored group health plan on the 2012 Form W-2. Until further guidance is issued, this requirement will only apply to employers that issue 250 or more Forms W-2 for the 2011 calendar year. All employers of the controlled group are aggregated for this 250 Forms W-2 requirement.

1. What is Required to be Reported?

Code Section 6051(a)(14) provides that the aggregate cost of employer-sponsored health insurance coverage must be included on the Form W-2. The reported costs are generally as used for COBRA purposes for “Applicable Employer-Sponsored Coverage”.

Applicable Employer-Sponsored Coverage does not include:

a. Coverage only for accident, or disability income insurance, or any combination thereof;

b. Stand-alone dental and vision coverage (ex. employees can choose dental and/or vision and not health coverage);

c. Coverage issued as a supplement to liability insurance;

d. Liability insurance, including general liability insurance and automobile liability insurance;

e. Workers' compensation or similar insurance;

f. Automobile medical payment insurance;

g. Credit-only insurance;

h. Other similar insurance coverage, specified in regulations, under which benefits for medical care are secondary or incidental to other insurance benefits;

i. Coverage for specific diseases or illness (ex. cancer insurance); or

j. Hospital indemnity or other fixed indemnity insurance.

Note: Until further guidance is issued by the IRS, contributions to union multiemployer health plans should not be reported on the Form W-2.

Only current and former employees who are required to receive a Form W-2 for the year are to have the cost of health benefits included on the Form W-2. If you are not required to issue a Form W-2 to the individual, there is no additional reporting required.

Current guidance provides that if an employee leaves employment during the calendar year and requests the issuance of a Form W-2 within 30 days of such termination of employment which is before the end of the calendar year, no health care costs are required to be included. An exception is in the case of a Form W-2 required to be issued after the end of the calendar year. In such case, a reasonable method relating to the cost of such coverage must be listed on the Form W-2.

2. Calculating the Cost of Coverage.

   a. Insured Plans – Use the premium charged by the insurance company rate for the employee's selected coverage. The costs reported on the Form W-2 are calendar year payments and not the payments for the insurance policy year.

   b. Self-Insured Plans – Use the method currently used for COBRA purposes for the employee's selected coverage, except that the reported costs must be determined on a calendar year basis. The costs reported on the Form W-2 are calendar year payments and not the payments based on the self-insured plan's fiscal year. You will need to discuss this issue further with Employee Benefit Concepts.

   c. Mid-Year Employee Coverage Changes - If an employee changes coverage during the year, the reportable cost under the plan for the employee for the year must take into account the change in coverage by reflecting the different reportable costs for the coverage elected by the employee for the periods for which such coverage is elected.

B. Section 125 FSA Changes

Effective for tax years beginning after December 31, 2012, in order for a health FSA to be a qualified benefit under a cafeteria plan, the maximum amount available for reimbursement of incurred medical expenses of an employee, the employee's dependents, and any other eligible beneficiaries with respect to the employee, under the health FSA for a plan year (or other 12-month coverage period) cannot exceed $2,500. The $2,500 limit will be indexed for cost-of-living adjustments for plan years beginning after December 31, 2013.

1. IRS Notice 2012-40, provides the following guidance and clarifications regarding the $2,500 limit.

   a. The $2,500 limit does not apply for plan years that begin before 2013.

   b. The term “taxable year” in Code Sec. 125(i) refers to the tax year of the cafeteria plan (and not the tax year of the employee or employer).

   c. A plan cannot change its tax year for the principal purpose of delaying the application of the $2,500 limit.

   d. Plans may adopt the required amendments to reflect the $2,500 limit at any time through the end of calendar year 2014, provided that they otherwise operate in accordance with the Code Section 125(i) requirements.

   e. If a cafeteria plan has a short plan year beginning after 2012, the $2,500 limit must be prorated accordingly.

   f. The $2,500 health FSA cap doesn't limit the amount permitted for reimbursement under other employer-

provided coverage, such as an FSA for dependent care assistance.

g. In the case of a plan providing the optional grace period, unused salary reduction contributions to the health FSA for plan years beginning in 2012 or later that are carried over into the grace period for that plan year will not count against the $2,500 limit for the subsequent plan year.

2. 2013 Open Enrollment

Employees should be notified of this $2,500 limitation, assuming the plan provides for a health FSA contribution that exceeds $2,500, prior to the beginning of the 2013 plan year.

IV. NEW HEALTH CARE FEES

A. Patient-Centered Outcome Research Fees

The ACA imposes a new Patient-Centered Outcomes Research Institute (PCORI) fee, formerly the comparative effectiveness research fee, on plan sponsors and issuers of individual and group policies. The first year of the fee is $1 per covered life per year, the second year the fee adjusts to $2 per covered life and then it is indexed to national health expenditures thereafter until it ends in 2019.

On April 17, 2012, the IRS issued proposed regulations that provide guidance on calculating the fee.

For policy or plan years ending after September 30, 2012, issuers and employers sponsoring certain group health plans must pay a fee of $1 per covered life per year. The fee adjusts to $2 per covered life for policy or plan years ending October 1, 2013, through September 30, 2014. For policy or plan year ending after September 30, 2014, the dollar amount in effect for such policy or plan year will be adjusted by

the Secretary of Treasury based on the percentage increase in the projected per capita amount of national health expenditures. The fee will not apply to policy or plan years ending after September 30, 2019.

Under the IRS proposal, issuers and plan sponsors are responsible for paying the fee, which is treated like an excise tax by the IRS. A federal excise tax return (Form 720) reporting liability for the fee must be filed by July 31st of the calendar year immediately following the last day of the plan year.

The insurance company is responsible for filing IRS Form 720 and paying the required fee in the case of fully insured coverage. The employer of a self-funded plan must complete IRS Form 720 and pay the fee directly to the IRS. It should be noted that if a FSA or HRA is sponsored by a plan sponsor that also has a self-funded health plan (that is not a FSA or HRA), the two arrangements may be treated as one plan. The HRA/FSA for employers using fully insured health plans will have to file separately for the HRA or FSA. More guidance will be forthcoming.

The administrative costs to the employer for self-funded plans will far outweigh the actual fee paid.

B. Transitional Reinsurance Fees

The ACA provides that a transitional reinsurance program is to be established in each state to help stabilize premiums for coverage in the individual market during the years 2014 through 2016. All health insurance issuers, and third-party administrators (TPAs) on behalf of self-insured group health plans, will submit contributions to support reinsurance payments to issuers that cover high-cost individuals in non-grandfathered individual market plans.

The program will operate from 2014 to 2016. The first quarterly reinsurance payment is due January 15, 2014.

The Transitional Reinsurance Fee applies to both insured and self-funded group health plans. Even though final regulations were issued March 23, 2012, the annual amount of this per capita fee is still unknown. Preliminary estimates indicate that the annual fee could be at least $60, and perhaps as high as $105, per covered life (covered employees and their dependents).

"Third-party administrators," which is not defined in the final regulations, must remit payments on behalf of self-funded group health plans and their sponsors, which will bear the financial responsibility for the Transitional Reinsurance Fee.

HIPAA-excepted stand-alone dental and vision plans, HIPAA-excepted Health FSAs, and Medicare supplemental plans are not subject to the fee. It should be noted that retiree-only plans that are not HIPAA-excepted plans are subject to the fee.

The final amount of the per-capita fee to be levied in 2014 is expected to be announced in the next few months. The per-capita fee is expected to change each year. Although this new fee will be a moving target for plan sponsors, the Transitional Reinsurance Fee should be part of the plan sponsors budgeting for health care and it should be included in the analysis in the decision of whether to "play or pay."

V. EMPLOYEE ANALYSIS FOR EMPLOYER PAY OR PLAY

The pay or play provisions of the ACA are set forth in the Code Section 4980H. This Code Section imposes a penalty on an "applicable large employer" that either fails to offer its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage, or fails to offer affordable coverage or coverage that provides minimum value within

the meaning of Code Section 4980H where one or more full-time employees is certified to receive a premium tax credit or cost-sharing reduction. The new pay or play requirements are effective for health plan years beginning on or after January 1, 2014.

Code Section 4980H defines an applicable large employer for a calendar year as an employer that employed an average of at least 50 full-time employees on more than 120 business days during the preceding calendar year. For this purpose, the term "full-time employees" means the sum of the employer's full-time employees and full-time equivalent employees ("FTE's").

The ACA does not require employers to provide health insurance overage to its employees. However, employers that do not provide minimum "essential health benefits which will be defined by the U.S. Department of Health and Human Services ("HHS") may be liable for an additional tax.

A. Applicable Employer Penalties

There are two types of applicable taxes:

1. Tax of Failure to Provide Coverage

Employers with 50 or more FTE's (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 full-time 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 on average of at least 30 hours or more per week. An employer will not be considered to have 50 FTE's if the employer's workforce exceeds 50 FTE's for 120 days or fewer during the calendar year, or the employers in excess of 50 FTE's 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.

It appears that the actual number of part-time employees do not count for calculating the penalty. Thus, only employers with at least 31 full-time employees will have to prepare this calculation. This is because the first 30 full-time employees are excluded form the penalty.

2. Tax on Failure to Pay a Specific Amount

Employers with 50 or more FTE's 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:

a. 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

b. 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 or the cost of such coverage is more than 9.5% of the employee's household income. The IRS has modified this requirement and permits employers to us the employee's Form W-2 wages (as opposed to household income) to determine whether premiums are "affordable" (i.e. do not exceed 9.5% of an employee's income) for purposes of the penalty tax.

The amount of the monthly employer tax penalty is $3,000 divided by 12, for each full-time employee who is eligible and enrolls in taxpayer-subsidized health coverage for the month. Employees who receive an ACA free choice voucher are excluded from this penalty. The total tax penalty may not be greater than the tax penalty that would apply if the employer offered no coverage at all.

B. Full-Time Employee Analysis – IRS Notice 2012-58

On August 31, 2012, the Internal Revenue Service ("IRS") issued guidance on the determination of "full-time employees" in the form of Notice 2012-58.

The Notice provides safe harbors for both new and ongoing employees, which will allow employers to avoid making a determination as to an individual's full-time employee status on a month-by-month basis. Employers may rely on this guidance through the end of 2014.

1. Variable Hour and Seasonal Employees

The new guidance provides more information on the definitions of “variable hour employee” and “seasonal employee”, which are terms that are used in several places in applying the pay or play mandate. A “variable hour employee” is defined as an employee who, based on the facts and circumstances at the start date, cannot be determined to be reasonably expected to work on average at least 30 hours per week (in some cases, they may start out at 30 hours, but this is expected to be of limited duration).

In determining if an employee is a “seasonal employee” the guidance clarifies that you may use a good faith interpretation of the term.

2. Safe Harbors

The guidance provides several safe harbors that should make it easier for employers to identify full-time employees and to calculate penalties under the pay or play mandate.

3. Measurement Periods

For both new and ongoing employees, employers must establish “measurement periods” for counting hours, which must be at least three, and not more than twelve months long. Measurement periods for ongoing employees are referred to as “standard measurement periods”. If a new employee has not been employer for one full standard measurement period, employers may use a different measurement period referred to as “initial measurement period”. In each case, employers must apply the measurement period uniformly to all employees in one of the following permissible classifications –

- collectively bargained and non-collectively bargained employees;
- salaried and hourly employees;
- employees of different business entities; and
- employees located in different states

4. Stability Periods

An employee who averages at least 30 hours per week during a measurement period must be treated as a full-time employee during the following "stability period". Conversely, an employee who did not average 30 hours per week during the measurement period will be considered a part-time employee during the following stability period. The determination of an employee's full-time status will apply during the entire stability period regardless of his or her actual hours. This provision will conflict with most health insurance policies that we currently see. The stability period may not be less than 6 months or, if longer, the length of the measurement period. The employer must us the same stability period for both new and ongoing employees in the same classification.

Special rules may apply if an employee has a change in employment status and in some cases, further guidance will be needed. There are also special rules provided for variable hour and seasonal employees, and special transition rules where your initial measurement period is different than your standard measurement period (e.g., one is calendar year and one is not).

The Notice also allows employers to adopt an "administrative period" of up to 90 days after the end of each measurement period to allow for enrollment during the next stability period. During the administrative period employees must continue to offer coverage to ongoing employees deemed full-time during the previous stability

period to avoid gaps in coverage. For new employees, the administrative period when combined with the initial measurement period may not extend beyond the last day of the first calendar month beginning or after the on-year anniversary of the employee's start date.

C. New Employees: Reasonably Expected To Work Full-Time

If an employee is reasonably expected at his or her start date to work full-time, an employer that sponsors a group health plan that offers coverage to the employee at or before the conclusion of the employee's initial three calendar months of employment will not be subject to the employer responsibility payment under Code § 4980H by reason of its failure to offer coverage to the employee for up to the initial three calendar months of employment.

MERGERS, ACQUISITIONS & COMBINATIONS OF MEDICAL PRACTICES

By: Stuart M. Bordman, Esq.

I. THE PUSH TO BIGGER

A. Acquisition by Health Care Systems ("HCS").

1. Control over physicians through employment agreements and post termination agreements not to compete.

2. Profitability of the practice accrues to the HCS.

3. Profitability from ancillary services accrues to the HCS.

B. Acquisition by Mega Medical Groups ("MMG").

1. Not all physicians employed by the MMG are shareholders. The MMG will have few shareholders and a large group of employed physicians.

2. Physicians benefit from cross referrals.

3. Physicians may benefit in the form of increased compensation.

4. Economies of scale.

5. Reduced administrative burden.

C. Physicians completing training are being hired to work for HCS's at big starting salaries.

D. MMG only want to employ physicians with active practices that generate ancillary services.

II. PURCHASE PRICE - HCS

A. Tangible Assets – FMV appraisal by a third party.

B. Intangible:

1. May not be saleable where the physician becomes an employee of the HCS.

2. May not take into account the value or volume of future referrals.

3. State law prohibits the payment of any consideration for medical records MCLA 750.410(2).

C. Who receives electronic health record payments and Medicare and Medicaid?

III. CASH FORECAST

A. Lump sum payment or installment payments.

B. Accountant's role: analyze cash from sale, collection of accounts receivable ("A/R") and payment obligations of seller.

C. All secured liabilities of seller must be paid at closing and all other liabilities by a specified date.

D. Final retirement plan contribution.

E. Proceeds from assets not desired by purchaser.

F. Accounting for assets abandoned such as leaseholds.

IV. POST ACQUISITION RELATIONSHIP- HCS

A. None – Seller(s) retire and sign post termination agreements not to compete.

B. Sellers become employees of HCS and are compensated based on:

1. Revenue generated.

2. Relative value units or WRVC – Worked Relative Value Units.

3. Compensation for administrative duties.

C. Agreement Not to Compete.

1. Enforceability.

2. May be waived if the physician remains in the system.

D. Purchaser will decide which support personnel continue.

E. Lease of medical building to purchaser if owned by seller or a related entity.

F. Loss of control by selling physicians.

G. Elimination or reduction of administrative responsibility.

V. POST ACQUISITION RELATIONSHIP – MMG

A. Sellers become employees.

B. Compensation is based on profitability of profit center – office.

C. MMG will handle a large part of the administrative load.

D. Sellers can withdraw and reverse the transaction: easy in and easy out.

V. ASSET PURCHASE VS STOCK PURCHASE

A. Asset Purchase.

1. A/R

a. Seller retains and collects A/R and pays accounts payable.

b. Purchaser “buys” A/R subject to a guaranty by the seller and charges a percentage to collect the same.

2. Purchaser may assume office and equipment leases.

3. Purchaser has no exposure for undisclosed or unknown liabilities of seller such as malpractice; audits by third party payers, etc.

B. Stock Sale.

1. Risks not inherent in asset purchase:

a. Malpractice claims.

b. Audits by third party payers.

2. Seller may have leases, licenses or contracts that are **not** subject to assignment.

3. Remember to search for change in control provisions.

VII. PAYMENT OF PURCHASE PRICE - HCS

A. Cash.

B. Down payment with balance over time.

1. Financial strength of purchaser.

2. Security for purchase price.

VIII. POWER TO REVERSE TRANSACTION

A. Can the seller get out if he/she is not happy being part of a large organization?

B. What are the terms and conditions of withdrawal?

C. What happens if some sellers but not all wish to reverse the transaction?

VIX. MEDICAL RECORDS CUSTODY RECORDS AGREEMENT

A. What records are transferred to purchaser?

B. What records must be retained by seller and for how long?

X. TERMINATION OF RETIREMENT PLANS – FULL VESTING OF PARTICIPANTS.

XI. TAX ISSUES

A. Asset sale. Limit liability to one level.

1. What type of entity is the seller?

a. "C" corporation – Collect the A/R; pay the liabilities and use any cash to pay severance bonuses.

b. "S" corporation.

c. Limited liability company.

2. Seller will remain in existence to collect A/R and pay bills. A final tax return will be necessary.

B. Stock sale.

1. Termination of “S” election.

2. PC acquires the stock of an “S” corporation with annual receipts of $10,000,000. Target renders ancillary services and is not a PC. “S” election ends because the sole shareholder of the Target is a corporation which cannot own stock in an “S”. Cash basis cannot be used because the target is now a “C” corporation.

C. Amount allocated to covenant not to compete will be ordinary income.

D. Asset purchase agreement must allocate purchase price. Accountant must complete IRS Form 8594-Asset Acquisition Under §1060.

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 article entitled, *Protect More of your Assets from the Estate Tax,* has been published 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 in close to 30 years in business, construction, securities, family and shareholder related matters with a particular focus on resolution of those disputes. He frequently counsels clients on construction contracts, acquisitions and sales of businesses, securities and computer related matters. He served for many years as an arbitrator for FINRA (Financial Industry Regulatory Authority) in employment and securities disputes, acts as a private arbitrator and is a member of the American Bar Association (Construction Forum, Litigation and Family Law Sections), State Bar of Michigan (Litigation and Family Law Sections), and Oakland County Bar Association. He has been actively involved in a number of non-profit 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 and the Treasurer of the Franklin Community Association. **Education:** University of Detroit, Detroit, Michigan, Juris Doctor, 1983, University of Michigan, Ann Arbor, Michigan, M.S.W., 1976, Harpur College, Binghamton University, Binghamton, New York, B.A. 1974. **Professional Memberships:** American Bar Association, State Bar of Michigan, Oakland County Bar Association, and Detroit Area Construction 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 President and Chief Executive Officer of the firm, and presiding member of its 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 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. Mr. Sallen is also the head of Maddin Hauser's environmental law practice group. Mr. Sallen's most recent publications include: From Lemons to Lemonade; Successful Management of Lease Termination Negotiations Can Lead to New Opportunities For Commercial Property Owners (*Michigan Lawyers Weekly*, April 21, 2008) and New IRS Rules for Lenders May Help Troubled Commercial Borrowers (*Michigan Lawyer's Weekly*, November 2, 2009). Mr. Sallen is also the Editor and regular contributor to *Real e-State, an electronic newsletter for real estate professionals*, published quarterly by the Maddin Hauser real estate law practice group. Mr. Sallen is also the creator and owner of an instructional program for commercial real estate brokers entitled, ***Commission-Safe®*** which publishes periodic training materials and business broker tools. Mr. Sallen has been named one of *The Best Lawyers In America by Best Lawyers®*, and a *Top Lawyer* by dbusiness®, both in the field of real estate law.

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 an experienced business litigator, shareholder, and Co-Chair of the Real Property and Mortgage Dispute Resolution Group. He graduated from the University of Michigan in 1991 and Wayne State University Law School in 1994. Mr. Frenkel was formerly employed by the Michigan Department of Attorney General and has been with Maddin Hauser since 1997 where he specializes in real estate and financial services litigation and quasi-litigation matters including mortgage, banking, construction and title-related disputes. He is admitted to practice in Michigan as well as the federal courts for both the Eastern and Western Districts of Michigan and the United States Court of Appeals for the Sixth Circuit. Mr. Frenkel's publications include: Navigating the Waters of Real Estate Arbitration published in Commercial, Inc. Magazine, and Seven Common Mistakes in Selecting/Managing Outside Counsel in the Mortgage Industry which was published as a three part series in the Mortgage Bankers Association News Link. Mr. Frenkel was a speaker at the 2009 Mortgage Bankers Association Legal Issues Conference where he delivered his presentation entitled, Reducing In House Counsel Frustrations and Creating Cost Savings in Litigation Defense: The Outside Counsel Perspective. He developed the program entitled, The Litigation Tsunami and the Mortgage Banking Industry, a case study on the need to control spending on outside counsel for use by in-house counsel within the financial services industry. He also developed the Mortgage Defense Optimizer - a tool for use by mortgage banking clients to streamline the handling of litigation matters. Mr. Frenkel was recently featured in an article published in Crain's Detroit Business focusing on mortgage litigation trends. In 2008, he was selected by his peers as one of Michigan's Rising Stars as noted in Michigan Super Lawyers and Rising Star Magazine. Mr. Frenkel's roles with the firm include being a representative to the Mortgage Bankers Association, and the Law Firm Alliance – a worldwide confederation of boutique mid-sized law firms.

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, shareholder at Maddin Hauser Wartell Roth & Heller, PC. Kas manages risks for businesses in loan, real estate, asset-based and start-up 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 on the board of the Indo-American Chamber of Commerce and has launched The Meet Market so that members can actively collaborate based on their contacts and relationship database. As an active member of TiE Detroit, Kas has organized and designed events which promote entrepreneurship. She is also a recurring speaker for the Ann Arbor Sparks Start Your Own Business series. 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, 2010 and 2012 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." Ms. Biasell is listed on the 2012 Rising Stars list published by Michigan Super Lawyers, which names fewer than five percent of attorneys on the list.

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 is an associate of the firm and member of the Real Property and Mortgage Dispute Resolution Group. He 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, and the United States Court of Appeals for the Sixth Circuit. Mr. Plaza concentrates his practice in real estate, appellate, construction and financial services litigation, representing financial institutions and insurance carriers in disputes involving mortgage priorities,

mortgage loan modifications, title insurance, wrongful foreclosure, construction liens, and adverse possession. Mr. Plaza had his article on the impact of the Saurman decision on mortgage litigation published in Michigan Lawyer's Weekly.

Courtney D. Roschek Thompson is an associate and member of the firm's Real Property and Mortgage Dispute Resolution group. Ms. Thompson specializes in regulatory compliance, litigation, and quasi-litigation matters focusing on mortgage and financial services issues. She is currently assisting the firm in managing a national foreclosure and default servicing compliance matter. While attending Michigan State University College of Law, Ms. Thompson was an active participant in the Moot Court and Mock Trial Advocacy Board, winning national oral advocacy awards. Since graduating Ms. Thompson continues to coach mock trial teams, including three of the MSU law school's most accomplished teams. Previously, Ms. Thompson worked with the United States District Court for the Eastern District of Michigan in developing and conducting the certification program for trial attorneys desiring to use the shared, advanced technology courtroom. Ms. Thompson graduated magna cum laude from Western Michigan University in Kalamazoo, Michigan. She later received her Juris Doctorate from Michigan State University College of Law, graduating magna cum laude, and with a certificate from MSU Law's Trial Practice Institute (a focused curriculum teaching the fundamental concepts of litigation, developing enhanced trial skills, and emphasizing professional practice decorum).

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

David G. Michael practices primarily as a member of the firm's Real Property and Mortgage Dispute Resolution Group. He also practices in the areas of bankruptcy, landlord-tenant law and commercial leasing 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. His professional affiliations include the State Bar of Michigan, Business Law and Real Property Law sections; the American Bar Association, Litigation Section; the Oakland County Bar Association, Real Estate Committee; and the Federal Bar Association.

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.

Jayson M. Macyda is a graduate of the Vermont Law School and served as a member of the National Moot Court team where he earned numerous awards for oral and written advocacy. He also served as a Teacher's Assistant for the 1-L research and writing course at Vermont Law School and received a Certificate of Studies in European Union Law from Oxford University-Magdalen College. Mr. Macyda specializes in domestic and international litigation proceedings involving contract disputes, the Uniform Commercial Code, business torts, environmental law, and bankruptcy. He represents foreign and domestic companies locally and nationwide. Mr. Macyda has also served as a pro bono attorney for the Sugar Law Center and provided pro bono legal advice to indigent litigants at the U.S. District Court for the Eastern District of Michigan through the Court's "ask the lawyer" program. Mr. Macyda has published articles in the Wayne Law Review which address various developments in Michigan civil procedure law, and published an article in the Chamber News, a publication of the Livonia Chamber of Commerce, which addresses developments in federal bankruptcy law. Based upon his articles, Mr. Macyda has been admitted into Scribes-The American Society of Legal Writers, a legal writing professional organization.

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.

Dawn Yeaton practices primarily in the areas of business law and real estate litigation. She earned her Juris Doctor, Magna Cum Laude, from the University of Detroit Mercy School of Law where she served as an editor of the Law Review. Her professional affiliations include the State Bar of Michigan and Oakland County Bar Association. She joined the firm as an associate in 2011.

Daniel Warsh received his Bachelor of Arts Degree, summa cum laude, from the University of Pennsylvania in 2088. Daniel earned his Juris Doctor from the University of Michigan in 2011, where he received the Certificate of Merit for International Environmental Law and Policy. While in law school, Daniel served as

Associate Editor on the Michigan Telecommunications and Technology Law Review. Daniel joined the firm as an associate in 2011.

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.

Jason M. Fisher is an associate in the firm who received his Bachelor of Arts in General Business Administration-Prelaw with honors from Michigan State University. Mr. Fisher received his Juris Doctor and also his Master of Laws in Taxation from the University of Denver. While pursuing his degrees at the University of Denver, Mr. Fisher worked at the Low Income Taxpayer Clinic at the University of Denver, where he represented taxpayers before the Internal Revenue Service. After receiving his Masters of Law in Taxation, Mr. Fisher continued his tax controversy practice in Colorado until he joined the firm in 2012. Mr. Fisher now focuses his practice in the areas of taxation, corporate and business law, and Mr. Fisher continues to represent taxpayers before the Internal Revenue Service and state taxing authorities. He is licensed to practice in Michigan, Colorado, and the United States Tax Court. He is a member of the State Bar of Michigan and the Oakland County Bar Association.

Karen Libertiny Ludden concentrates her practice on commercial insurance and professional liability coverage litigation and specializes in negotiating global resolutions on complex commercial cases. She is a member of the Firm's Defense Practice and Insurance Coverage Group. She graduated from the University of Michigan Law School and published in its *Journal of International Law* in 1993. She graduated *magna cum laud*e from the University of Michigan with a Bachelor of Arts degree in 1990. Ms. Ludden is AV Preeminent rated; the highest peer rating available from Martindale-Hubbell. She sits as a commercial case evaluator in Oakland County and a tort case evaluator in Wayne County. She has served as a moot court judge for the University of Michigan Law School and has received commendation for her pro bono work. She sits on the Executive Board for the Michigan Chapter of the Federalist Society and is a member of the Federal Bar Association, the Oakland County Bar Association, and the American Bar

Association. Ms. Ludden is admitted to practice in the United States Court of Appeals for the Sixth Circuit, the United States District Courts for the Eastern and Western Districts of Michigan, the Bankruptcy Court for the Eastern District of Michigan, and all Michigan state courts.

Kristina Janssens is an associate and member of the firm's Real Property and Mortgage Dispute Resolution group. Ms. Janssens specializes in regulatory compliance, litigation, and quasi-litigation matters focusing on mortgage and financial services issues. She is currently assisting the firm in managing a national foreclosure and default servicing compliance matter. Ms. Janssens is member of the long range planning committee of the Real Property Law Section of the Michigan Bar Association. Ms. Janssens graduated magna cum laude from Michigan State University in East Lansing, Michigan. She later received her Juris Doctorate from Wayne State University Law School.

Kate Matlen received her Bachelor of Science degree from the University of Michigan in 2007, and received her Juris Doctor degree, *cum laude*, from Wayne State University Law School in 2012. While in law school Kate served as a Senior Articles Editor and a Voting Member of the Editorial Board for the Wayne Law Review. Kate joined the firm as an associate in 2012.

Ryann O'Boyle Bunch received her Bachelor's of Arts degree with high distinction from the University of Michigan in August 2000, and her Juris Doctor degree, *magna cum laude*, from University of Detroit Mercy School of Law in December 2004. While in law school, Ms. Bunch was Editor in Chief of the Law Review. Ms. Bunch concentrates her practice in the areas of real estate and finance.

NOTES

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WELCOME

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

TWENTY-FIRST ANNUAL TAX SYMPOSIUM

Steven D. Sallen, Esq.

IDENTIFYING WAGE & HOUR COMPLIANCE ISSUES

Ron Sollish, Esq.
Attorney at Law

Statutory Framework

FEDERAL LAW

Fair Labor Standards Act of 1938

- Minimum Wage
- Overtime
- Child Labor

MICHIGAN LAW

Minimum Wage Act of 1964

- Michigan Minimum Wage
- Child Labor

Michigan Wage & Fringe Benefit Act

- Time for Payment of Wages
- Obligation to Pay Wages
- Obligation to Pay Benefits
  (i.e. vacation, bonuses, commissions)
- Deductions from Wages
- Disclosure of Wages

Exempt Employees

A. Salary Basis Test

B. Exemptions

Employees Exempt from Overtime and Minimum Wage

- Executive
- Administrative
- Professionals
- Highly Compensated Individuals
- Computer Employees
- Outside Sales
- Commissioned Sales

Non-Exempt Employees

A. Minimum Wage

B. Work Week

C. Hours of Work

D. Hourly Rate

E. Calculating Overtime

Child Labor

A. Hazardous Occupations
   - 16 & 17 Year Olds

B. Hazardous Occupations
   - 14 & 15 Year Olds

C. Permissible Occupations
   - 16 & 17 Year Olds

D. Work Permit

Miscellaneous Topics

A. Record Keeping

B. Breaks

C. Postings

D. Travel

E. Deductions from Wages

F. Individual Liability

G. Settlements

OFFICER LIABILITY IN MICHIGAN: Personal Liability for Delinquent Business-Entity Taxes

Jason M. Fisher, Esq.

Common Misconception of "Limited Liability" Entities

- Using a limited liability entity does not completely insulate its owners from personal liability.
- Dissolving the company **does not** necessarily discharge liability for unpaid taxes.

Corporate Officer Liability in General

- Officers, members, managers, and/or partners can be **personally liable** for an entity's unpaid state and federal taxes.
- Liability is **derivative**: it arises only if the company fails to pay the required tax due.

IRS Trust Fund Recovery Penalty (§6672)

- 100% penalty on willful failure to pay payroll taxes to the IRS.

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§6672 Generally Only Applies to Trust Fund Taxes

- **Trust Fund Taxes**
  - Taxes required to be collected or withheld from any person and to pay over such tax to the United States.
  - Funds are held “in trust” for the United States.
- Penalty only applies to the **employee’s** share of payroll taxes, not the **employer’s** share.

The Responsible Party's Failure to Pay Must Have Been Willful

(1) Responsible Persons:
Who is a "Responsible Person"?

- A **responsible person** is anyone who is responsible for collecting, accounting for, and paying over trust fund taxes.

(2) Willfulness: Was the act "willful"?

- The responsible person acted voluntarily, consciously, and intentionally.

Michigan Officer Liability (MCL 205.27a(5))

(1) If the company fails to file returns or to pay taxes

(2) For any reason

(3) Any officer, member, manager, partner who the Department of Treasury determines has control or supervision of, or responsibility for, making the returns or payments is personally liable.

Michigan Officer Liability (MCL 205.27a(5))

- Applies to more types of taxes than just trust fund taxes.
- Personal liability can attach for:
  - Income Taxes
  - Withholding Taxes
  - Michigan Business Tax (MBT)
  - Single Business Tax (SBT)
  - Corporate Income Tax (CIT)
  - Sales and Use Taxes
  - Fuel and Tobacco Taxes

Michigan Officer Liability (MCL 205.27a(5))

- No willfulness requirement
- The reason for nonpayment of taxes is **irrelevant.**
- Where there are multiple responsible persons, they have joint and several liability.

Major Area of Interpretation

- Did that person have control or supervision of, or responsibility for, making the returns or payments?

A Person's Signature on Tax Returns or Checks in Payment of Taxes is Prima Facie Evidence of Their Responsibility for Making the Returns and Payments.

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Prima Facie Evidence of Their Responsibility…

- If Department of Treasury establishes this, the burden shifts to the officer to prove that he or she did not have control or supervision of, or responsibility for, making the returns or payments.

Personal Liability Will Not Attach to Officers Who Simply Have Significant Involvement in the Financial Affairs of a Corporation; the Involvement Must be Tax Specific.

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…The Involvement Must be Tax Specific

- Has control over the making of the corporation's tax returns and payments of taxes;
- Supervises the making of the corporation's tax returns and payment of taxes; or
- Is charged with the responsibility for making the corporation's returns and payments of taxes to the state.

Rebutting the Presumption

- It is not sufficient to show that someone else was also responsible.
- Once the Department of Treasury has met its burden, it is the person's responsibility to show that **his or her involvement was not tax specific.**

Rebutting the Presumption
No Tax Specific Involvement

- No control over making returns or payment of taxes.
- Did not supervise making the returns or payment of taxes.
- Did not have the responsibility for making the returns or paying the taxes.

Rebutting the Presumption
No Tax Specific Involvement

- Title as officer was merely titular in nature. Person had no corresponding duties an officer.
- No authority or control to pay taxes due.
- Signature was not authorized.
- No tax specific involvement during time period in question.

Major differences between TFRP and Michigan Officer Liability:

TFRP	Michigan
Willfulness required	No willfulness requirement
Can apply to officers and employees	Only applies to officers, managers, members, and partners
Limited to withholding taxes	Applies to all taxes administered under the Michigan Revenue Act

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Preventative Measures Avoiding Personal Liability

- If you are not the one responsible for submitting the tax returns and payments of taxes to the Department of Treasury:
  - **DON'T SIGN THE RETURN!**
  - **DON'T SIGN CHECKS IN PAYMENT OF TAXES!**
- Make sure all taxes are duly paid.

LIFE INSURANCE FRIEND OR FOE

Robert D. Kaplow, Esq.

Why Have Insurance

Applying for Insurance

Paying for it

Uses

Transfer

Getting Money

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Why?

- Family Funding
- Estate Planning
- Investment Vehicle
- Business

Insurance Application

- Correct Information Required
- Owner Alternatives
- Insurable Interest
- Beneficiary Choices

Premium Payments

- Seven Pay Test
- Modified Endowment Contract (MEC)
- Gifts
- Premium Financing
- Split Dollar

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Uses

- Family Funding
- Estate Planning
- Investment Vehicle
- Business
- Death Proceeds
- Insurance Review

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Transfer

- Change of Owner
- Change of Beneficiary
- Gifts
- Sale of Policy
- Transfer for Value – Exceptions
- Loans
- §1035

Proceeds

- Cash Value
- Death Benefits
- Loans
- Surrender of Policy
- Sale of Policy

FATHER KNOWS BEST

(Or So He Thinks):

Father Knows Best *(Or So He Thinks):*

- **I was Mom's favorite!**
  (Inability to Act??)
- **Mom, you know I'm your favorite!**
  (Incapacity and undue influence??)
- **Mom, tell them I'm your favorite!**
  (Undue influence??)

America is aging. Deal with it.

America is aging and living longer than ever before. While this is not earth-shattering news, it is interesting to note that there are 35 million Americans over age 65 of whom 4.6 million are over age 85 and 60,000 are over age 100.

In addition, over 50% of women as well as 30% of men who reach 65 will live until age 85.

With aging comes the possibility that clients may not be fully aware of what they are doing with respect to their respective estate plans.

Aging-related illnesses should send a warning flag to all professionals (estate planners, CPAs, financial planners, etc.), as, for a number of reasons, an elderly client is more likely than a younger client to be or become incapacitated.

As individuals age, physical and mental abilities "slow down," even lacking a specific illness such as dementia or delusions.

Lawsuits challenging the validity of wills and trusts (or specific provisions in them) have become increasingly common, some while the client is still alive.

All of us involved in gift and estate planning for our clients may one day receive the subpoena to appear and provide testimony as to the client's capacity or worse yet, receive a lawsuit
after the client dies.

Various grounds exist to contest will or trusts, the most common claims are that the person who executed the documents

(1) lacked the required mental capacity or

(2) was subject to undue influence by another.

"Money-giving is a very good criterion…of a person's mental health. Generous people are rarely mentally ill people."

Dr. Karl A. Menninger

Intellectual capacity and mental power vary in individuals in infinite degrees. As such, the law can do no more than set forth a general definition or standard in determining whether mental capacity to make a will exists in a given case.

Accordingly, the required capacity to execute a will is usually very low.

- No delusions or hallucinations? **Good.**
- Understand the basics of what your will accomplishes? **Good.**
- General understanding of your assets and their worth? **Good.**
- Know who your relatives and beneficiaries are? **Done.**

Note that nowhere in there did you read anything about little Johnny telling Mom that he won't take care of her anymore if she doesn't leave
him everything;

or Johnny's wife telling the mother-in-law that she will never see the grandkids again if she doesn't get the family jewels; nor hours and hours of rehearsing with Mom what she should tell the lawyer if he asks her about anyone "influencing her to make this decision."

You also didn't see anything about the charity representatives calling and meeting with the client over 50 times in the past 6 months, sending letters and appealing to her passion for helping others while convincing her that she doesn't need to talk to anyone else other than the charity's representatives to ensure that the annuity it is selling will take care of her and her loved ones forever while helping so many people.

Influence is Fine; "Undue" Influence is Not.

Different jurisdictions define undue influence in a variety of ways. Black's Law Dictionary defines "undue influence" as "coercion that destroys a testator's free will and substitutes another's objectives in its place."

To say it another way, influence over a donor/grantor does not cause a gift/bequest to be invalid. For such influence to be "undue," the gift planner essentially must have pressured or coerced the donor to make a gift that she would not otherwise have made.

Estate planning, financial planning and accountant professionals will not and should not replace lawyers and doctors when it comes to determining a person's mental capacity or effects of any hidden undue influences on the decisions that they make.

Nevertheless, as trusted advisors and "influences" that we hold with our clients, we do have a duty (legal, ethical or otherwise) to look for warning signs of a possible challenge and to ensure that it would be upheld (or to investigate further BEFORE assisting in making the gift).

Some Practical Tips include:

- Answer the “Why” Question.
- Videotape???
- No Contest Clauses.
- Specific Capacity Concerns.
- Specific Undue Influence Concerns.
- Increased Malpractice Limits.

Round Up of Recent Tax Developments

William E. Sigler, Esq.

Topics Covered

- Washington Update
- Federal Tax Developments
- Michigan Tax Developments
- Employee Benefits
- Estate Planning

Washington Update

- Extenders
- Bush Tax Cuts
- Major Reform

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"Lame-Duck" Session

- Congress and Administration will be faced with negotiating:
  - Year-end expiration of the Bush tax cuts
  - Deep cuts in the federal budget slated for January
  - Dealing with an increase in the federal debt ceiling

"Lame-Duck" Session

- The President can be expected to push to extend most of the 2001 and 2003 tax provisions, but not the tax cuts for higher-income taxpayers
- Republicans are demanding an extension of all of the Bush tax cuts, regardless of income levels

Prior to their recess:

- The House and Senate passed separate bills extending the Bush tax cuts
- The Senate Finance Committee approved a $200 billion extenders bill, the Family and Business Tax Cut Certainty Act of 2012, which awaits action in the full Senate
- The Ways and Means Committee has yet to act on its own extenders package, but House taxwriters hope to mark up a tax extenders package in the post-election lame-duck session of Congress

Examples of Expiring Tax Provisions Affecting Small Businesses if not Extended

- **Work Opportunity Tax Credit**
  - credit provided for wages they pay to qualified members of a targeted group
- **Straight-Line Cost Recovery for Leasehold, Restaurant, and Retail Improvements**
  - 15-year straight-line cost recovery for qualified leasehold improvements made to restaurant and retail properties
- **Additional First-Year Depreciation on 100% of Basis of Qualified Property**
  - Small businesses are no longer able to depreciate the cost of qualified property on a 100% basis, but rather at 50%

Expiring Tax Provisions – con't

- **Increase in Expensing to $500,000/$2,000,000 and Expansion of Definition of Sec. 179 Property**
  - Limits the amount of Sec. 179 property a small business can expense from $125,000 in 2007-2010, to $250,000 in 2008, and to $500,000 in 2011. If not extended, the limit moves to $25,000 in 2013.
- **Special Rules for Investing in Qualified Small Business Stock**
  - Investors in small business stock lose an incentive that allowed 50% or 100% exclusion of gain from sale of small business stock

Expiring Tax Provisions – con't

- **Reduction in S Corporation Recognition for Built-In Gains Tax**
  - Small S Corporations lose the benefit of reduced built-in gains attributable to a C corporation taxable to itself for the first 10 years and drops to 5 years
- **Temporary Payroll Tax Cut**
  - A reduced rate of tax of 4.2% will no longer apply to employees on their wages

Expiring Tax Provisions – con't

- **Additional First-Year Depreciation on 50% of Basis of Qualified Property**
  - Small businesses will no longer receive any additional first-year depreciation deduction ("bonus depreciation")
- **Election to Accelerate AMT Credits in Lieu of Additional First-Year Depreciation**
  - Small businesses will no longer be able to elect to claim an increased AMT tax credit in lieu of claiming bonus depreciation for qualified property

"Sequestration"

- Result of last summer's debt ceiling deal, which cut $1 trillion in government spending over the next decade outright and then put responsibility for finding another $1.2 trillion on Congress.
- Because Congress failed to agree on the mixture of lower spending and higher taxes to hit that figure, a mechanism in the debt ceiling-raising legislation causes automatic spending decreases to hit the $1.2 trillion figure.
- About $109 billion in lower government spending every year for the next decade.

"Sequestration" – con't

- OMB outlined the $109 billion in spending cuts for 2013 as follows:
  - Hits to defense programs of either 9.4 percent or 10 percent, depending on how they receive their appropriations from Congress ($55 billion).
  - Payments to Medicare providers will be reduced by 2 percent ($11 billion).
  - Cuts to non-defense spending (like elementary and secondary education or rehabilitation services and disability research) will be cut at either 8.2 percent or 7.6 percent (totaling $43 billion).

Looking Ahead

- There will likely be a temporary extension of the expiring tax provisions
- A 12-month extension is the most likely scenario
- A temporary extension would buy time for Congress to develop tax reform legislation in 2013
- Permanent estate and gift tax reforms may be part of that temporary extension
- In the meantime, another short-term extension of the Bush tax cuts is possible
- With the possible exception of the extenders, it's likely that none of the rest of this will be resolved until early 2013

Federal Tax Developments

- Capital gains taxes increasing in 2013
- Temporary regulations on deduction v. capitalization of tangible property
- IRS acquiesces on pro-taxpayer application of PAL rules to LLCs

2013 Capital Gains Rates

- **Top rate increasing to 20%**
  - Result of expiring 2001 and 2003 tax cuts
- **Phase out of itemized deductions returns**
  - So called "Pease" provision will add as much as an additional 1.2%
- **Health care reform imposes new tax on investment income of high-income taxpayers, including capital gains**
  - Adds another 3.8% to the capital gains rate
- **Phase-out of AMT exemption**
  - Adds 25¢ back to AMT taxable income, which can be subject to tax at as much as 28%, resulting in an extra 7¢ of tax on that dollar of capital gain

"Repair" Regulations

- Temporary regulations generally effective for years beginning on or after January 1, 2012
- Provide guidance on whether cost related to tangible property are currently deductible repairs or capital improvements that must be deducted over a period of years

"Repair" Regulations – con't

- **A unit of property is "improved" if the amount paid or activities performed**:
  - Results in a betterment of the property
  - Restores the property or
  - Adapts the property to a new or different use
- **"Unit of property" means:**
  - The building and its structural components
  - But, must consider effect of expenditure on certain specifically defined components of the building, instead of the building and its structural components as a whole

"Repair" Regulations – con't

As a result, must capitalize costs that results in an improvement to:

- The building structure; or
- Any of the specifically enumerated building systems
  - HVAC system
  - Plumbing system
  - Electrical system
  - All escalators
  - All elevators
  - Fire protection and alarm systems
  - Security systems
  - Gas distribution systems

"Repair" Regulations – con't

The temporary regulations do not change the rules for:

- Depreciable lives
- Bonus depreciation
- Availability of cost segregation studies

"Repair" Regulations – con't

- Prior to 2012, taxpayers were required to capitalize and depreciate the cost to replace a structural component of a building, and to continue to recover the cost of the original structural component
  - E.g., if a taxpayer capitalized the cost of replacing an entire roof the taxpayer would have to continue depreciating the removed roof, and at the same time capitalize and depreciate the replacement roof over the same recovery period as the building
- The temporary regulations revise the definition of a disposition, so that a taxpayer may treat the retirement of a structural component of a building as a disposition of property

"Repair" Regulations – con't

The temporary regulations may require taxpayers to:

- Change accounting methods
- Make Section 481(a) adjustments to prevent duplicated or omitted tax benefits
- Capitalize amounts previously deducted
- Deduct amounts previously capitalized

IRS Acquiesces on Pro-Taxpayer Application of PAL Rules to LLCs

- The passive activity loss rules impose limitations on the deductibility of losses.
- Under the current economic climate, many investors have experienced considerable losses.
- Generally, a person's ability to deduct losses from a passive activity, i.e., an activity in which the taxpayer does not "materially participate," is limited under Section 469 to income generated from other passive activities.
- In contrast, losses arising from an active activity can immediately offset taxable income from any source, including the taxpayer's salary, wages, interest and dividends.

IRS Acquiesces on Pro-Taxpayer Application of PAL Rules to LLCs – con't

- For investors using the limited partnership form of business, the correct characterization of an activity as active or passive simply depends on whether the investor is a general partner or limited partner.
- But for investors using the limited liability company form of business, the correct characterization of an activity has been uncertain.
- Recently, several courts have clarified that ownership interests in limited liability companies are not presumptively passive limited partnership interests.

IRS Acquiesces on Pro-Taxpayer Application of PAL Rules to LLCs – con't

- The IRS has acquiesced in these cases, albeit in the result only. A.O.D. 2010-02, 2010-14 I.R.B. 515.
- The IRS subsequently issued guidance in the form of proposed regulations, which address how the general passive activity loss rules apply to LLC members. Prop. Reg. § 1.469-5(e)(3)(i).
- The new guidance relies on an LLC member's right to participate in the management of the entity to distinguish between limited partners and general partners.

Michigan Tax Developments

- Court finds owners worked for professional employer organization
- Court holds unpaid SBT tax is non-dischargeable excise tax
- Manufacturer found by court to be in business of selling tangible personal property

Owners Worked for PEO

- A taxpayer did not have to add back to its SBT base the compensation paid to the taxpayer's leased officer and employees, because they were employed by two PEOs
  - The leased officer was the taxpayer's owner and president and sole director
- The court found that the Department failed to recognize that former MCL§ 208.4(4)(a) provides that compensation does not include compensation paid by the PEO to the officers and employees of the taxpayer whose employment operations are managed by the PEO
  - The responsibility of directing the employees' work can be shared by the PEO with the taxpayer
  - Neither the statute or case law has carved out an exception for officers or employees who are also owners of the operating company

Adamo Demolition Co. v. Mich. Department of Treasury, Mich. Tax Tribunal, Dkt. No. 427308, 09/13/2012

Unpaid SBT Tax is Non-Dischargeable Excise Tax

- A taxpayer's assessment for a company's unpaid SBT was not dischargeable in bankruptcy because it was a non-dischargeable excise tax under 11 U.S.C. § 507(a)(8)(E)
  - *Paul A. Henderson v. Mich. Department of Treasury*, Mich. Tax Tribunal, Dkt. No. 431375, 08/24/2012.)
  - A federal district court reached a similar conclusion in Michigan, Quiroz v. State, U.S. Dist. Ct., E.D. Mich., Dkt. No. 11-CV-12672, 03/27/2012
- The SBT taxes at issue arose from the business activity of a limited liability company, of which the taxpayer was an manager or member.
- The return date for the taxes at issue was more than three years before the date of the filing of the taxpayer's petition in bankruptcy, which would mean the taxes would be dischargeable under 11 U.S.C. § 507(a)(8)(E) unless they were an excise tax on a transaction.
- The SBT is an excise tax because it is a tax upon the privilege of doing business

Manufacturer was in Business of Selling Tangible Personal Property

- The taxpayer manufactures and sells automobile parts to automobile manufacturing companies both within and without Michigan
- Certain large customers purchased raw materials which were shipped to the taxpayer for use in manufacturing parts sold to the customer
- In a case involving the SBT, the Michigan Department of Treasury argued that the taxpayer was performing a service that should be allocated to Michigan under former MCL§ 208.53
- In rejecting this argument, the court held that the taxpayer was selling tangible personal property subject to apportionment under MCL§ 208.52

Michigan Production Machining, Inc. v. Michigan Department of Treasury, Mich. Tax Tribunal, Dkt. No. 409641, 08/18/2012

Employee Benefits

- The next round of plan amendments
- Changes to the determination letter program
- Final service provider fee regulations
- Release-of-claims provisions may require Section 409A amendments before year-end
- Pension funding stabilization
- Circuits split as to the FICA tax treatment of severance pay

Plan Amendments
INDIVIDUALLY DESIGNED PLANS
5 YEAR CYCLE

Last digit of Plan Sponsor's TIN	Cycle	RAP Ends
1 or 6, electing groups	A	1/31/2012
2 or 7, multiple employers	B	1/31/2013
3 or 8, governments	C	1/31/2014
4 or 9, multi-employers	D	1/31/2015
5 or 10	D	1/31/2016

Plan Amendments
PRE-APPROVED PLANS
6 YEAR CYCLE

If the Plan is -		Next Submission Period	Next 6-Year Remedial Amendment Cycle
Defined Contributions	Mass Submitter (Lead & Specimen Plans) and Nat'l Sponsor Plans	02/01/2011 to 4/2/2012	02/01/2011 to 01/31/2017
Defined Benefit	Mass Submitter Lead and Specimen Plans and National Sponsor Plans	02/01/2013 to 10/31/2013	02/01/2013 to 01/31/2019

Determination Letter Program

The IRS determination letter program will undergo two key changes in 2012:

- elimination of the option to obtain a determination letter that a plan passes the coverage and non-discrimination requirements
- elimination the option on the part of an employer adopting a pre-approved plan to obtain a determination letter, unless the employer has modified the pre-approved plan to such an extent that it causes the plan to be treated as individually designed

Final Service Provider Fee Regulations

- The DOL has issued final regulations for service provider fee disclosures under ERISA § 408(b)(2)
- Registered investment advisors, certain broker-dealers, third party administrators, and other service providers receiving $1,000 or more in direct or indirect compensation from plan assets, must make initial disclosures to plan fiduciaries of covered plans by July 1, 2012
- Those plan fiduciaries must then make disclosures to plan participants
- The first annual plan, expense and investment disclosures to participants must be made by August 30, 2012 (later for plan years beginning in August, September or October)
- The first quarterly expense disclosure to participants is due November 14, 2012
- Plan fiduciaries can request additional information from covered service providers if necessary to complete a participant disclosure or Form 5500.

Release-of-Claims Provisions May Require Section 409A Amendments Before Year-End

- Section 409A applies to many employment, severance and other similar arrangements that provide for post-termination severance or other compensation payments
- These agreements often condition severance payments upon an employee's execution of a release-of-claims
- The IRS has expressed concern that these provisions violate Section 409A if they give an employee an indirect election as to when to receive or start receiving severance payments depending on when the employee signs the release
- In Notice 2010-6 and Notice 2010-80 the IRS provided employers with guidance on how to address this problem
- All affected agreements must be amended to bring them into compliance with these rules before the end of the year

Pension Funding Stabilization

- The Moving Ahead for Progress in the 21st Century Act (S. 1813) addresses this issue in the short-term by basing pension plan interest rates on historical averages
- Interest rates determined under prior law, which were based on the two-year average of interest rates, would be adjusted so that they are within 10% of the 25-year average of interest rates
- At least in 2012 and 2013, this law effectively helps compensate for the artificiality of today's low rates
- It is estimated to raise almost $9.5 billion over 10 years, which will be used to help pay for lower student loan interest rates

Circuits Split as to the FICA Tax Treatment of Severance Pay

- The U.S. Court of Appeals for the Sixth Circuit has held that payments made by an employer to its employees upon involuntary termination due to business cessation did not constitute wages for purposes of FICA
- The court noted that it did not agree with the Federal Circuit's approval of the IRS's position that payments falling within the statutory definition of supplemental unemployment compensation benefits can still be treated as dismissal pay subject to FICA taxes

United States v. Quality Stores, Inc., No. 10-1563 (6th Cir. Sept. 7, 2012)

Estate Planning

- Prospects for legislation
- Planning for uncertainty
- Portability
- Family limited partnership cases
- “Shark Fin” CLATs
- Formula gifts

Transfer Tax Laws

2011 and 2012	2013	Opportunity
Two-year extension of various tax provisions in effect since 2001, "Bush tax cuts" ▪Portability introduced ▪Top estate, gift and GST tax rate dropped to 35% ▪Estate, gift and GST exemptions increased to $5,120,000	*Unless new legislation is passed* ▪Portability lapses ▪Top tax rate is scheduled to go back to 55% ▪Estate and gift tax exemptions are scheduled to drop to only $1,000,000 ▪GST exemption would drop to approximately $1,400,000	*"Use it, or perhaps lose it"*

Congressional Focus on Taxes to Date

- Most of the attention has been on expiring individual marginal rates, capital gains and dividend rates
- Less discussion around expiration of the estate and gift tax rate structure
- Assumption is that a deal to extend the individual tax provisions would address expiration of the estate and gift tax provisions

Congressional Focus on Taxes to Date

Prior to recess, the House and Senate passed separate bills extending the Bush tax cuts:

- House-passed bill would extend the 2012 estate tax parameters for another 12 months
- Senate bill was silent on the estate tax
  - Democrats in the Senate were unable to reach agreement
  - So, a provision to drop the exemption to $3.5 million and raise the rate to 45% was removed from the bill

Result?

- May have to wait for a deal to extend the individual income tax provisions to get a resolution of the estate and gift tax issues
- In the meantime, a key consideration to planning is flexibility

Lifetime Credit Shelter Trust

- Benefits spouse and/or descendants during spouse's lifetime, with balance to children
- Distributions
  - Independent trustee – discretionary
  - Spouse as trustee – health, maintenance and support
- Each spouse can do a similar trust for the other, provided that the "reciprocal trust" rule is avoided

Lifetime Marital QTIP Trust

- Instead of making a direct gift to the "recipient," if the donor is married, create a lifetime marital QTIP trust with the remainder to the "recipient"
- If the $5 million gift tax exemption is extended, and assuming a current taxable gift is not desired, then the donor could make a QTIP election
  - Assets would be in the QTIP trust, and the independent trustee could possibly distribute to the spouse outright
- If the $5 million gift tax exemption is not extended, no QTIP election would be made
  - Transfer results in a taxable gift and would use the gift tax exemption in 2012
  - Assets would stay in the trust for the benefit of the spouse, and ultimately pass to the remaindermen (children and/or descendants)

Portability

- When first introduced, there was the possibility of "Portability Recapture"
  - New regulations eliminate recapture
  - If client has ported exclusion, may want to make a gift using that exclusion
- Unclear how exclusion would be used, i.e., the "ordering rule"
  - New regulations make it clear
  - Ported exclusion is used up first, then survivor's basic exclusion amount is used

Portability – con't

- New temporary and proposed regulations
- Must file an estate tax return to take advantage of portability
- Deadline is still the due date for the estate tax return (plus extensions)
- Form 706 may now simply include an "estimated value" for property, to the nearest $250,000, if:
  - the entire amount is being left to a spouse or charity (such that the value, whatever it would be, is offset by a marital or charitable deduction anyway), and
  - the estate is under the $5,120,000 exemption
- This eliminates the need (and cost) to get appraisals for all of the property in the estate

Family Limited Partnership Cases

- **FLP assets includable in gross estate**
  - *Liljestrand v. Commr.*, T. C. Memo 2011-259 (Nov. 2, 2011)
- **FLP assets not includable in gross estate**
  - *Estate of Stone v. Commr*, T. C., No. 23290-09, T. C. Memo. 2012-48, 2/22/12
- **Tax on FLP assets includable in gross estate not offset by formula marital deduction because gifts of FLP interests were made to others, not spouse**
  - *Estate of Clyde W. Turner, Sr., et al. v. Commr.*, 138 T.C. No. 14 (2012)
- **Gifts of FLP interests qualify for the annual gift tax exclusion because limited partners received a substantial present economic benefit (partnership agreement called for all partnership profits and all distributions of net cash flow to be allocated to the partners according to their proportional partnership interests)**
  - *Estate of George H. Wimmer*, TC Memo 2012-157

"Shark-Fin" Charitable Lead Annuity Trusts

- The ability of a CLAT to back load annuity payments to a charity may increase both the total charitable distributions and the amounts passing to the CLAT's remainder beneficiaries
- Prior IRS guidance has indicated that a CLAT can provide for escalating annuity payments, but the IRS has failed to provide specific insight into the extent to which the payments may be back loaded.
- Recently, in PLR 201216045, the IRS reviewed the use of a CLAT formula that annually increased the annuity payments by 120 percent of the prior year's payment for the annuity term.

Formula Gifts

- Hard-to-value assets are often subject to dispute between the donor and the IRS
- Early attempts to solve this problem by means of a formula gift were failures
- Later cases suggested that the keys to a formula clause being upheld were that the donor did not attempt to undo any part of the transfer, and that the benefit of the increased estate valuation all went to charity

Formula Gifts – con't

- A more recent case, *Wandry v. Comm'r*, T.C. Memo 2012-88, indicates that a charity is not necessary
- In *Wandry*, the donors each executed gift documents stating:

  "I hereby assign . . . a sufficient number of my Units so that the fair market value of such Units for federal estate tax purposes shall be as follows . . . ."

- Assuming that *Wandry* stands, the donors can gift or sell hard-to-value assets without fear of a large unexpected gift tax

THE END!

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KNOCK KNOCK: WHO'S THERE?

THE IRS RETURN PREPARER VISITATION PROJECT

Charles M. Lax, Esq.

The Background

- In December of 2009, the IRS Commissioner published the *Return Preparer Review*
- The Report contained recommendations designed to "better leverage the preparer community" in order to:
  - Increase taxpayer compliance
  - Ensure uniform and high ethical standards

The Background

- On January 7, 2010 the IRS announced the Return Preparer Visitation Project (RPVP)
- The Project would have two components: correspondence and visitations

The Letters
The Preparers Received

- The number of preparers that received them
- The criteria used to determine who received the letter
- What the letters said

The Onsite Compliance Visits

- The number of preparers that were visited
- The criteria used to determine who was visited
- The purpose of the visits
- The results of the visits

The TIGTA Report

- The background for the Report
- What TIGTA found through their investigation and survey of the visited preparers
- What recommendations were made by the report

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PROTECTORS, PRINCIPALS AND FIDUCIARIES: What's New in Estate Planning in 2012?

Richard F. Roth, Esq.

Trust Protector:

A person or committee of persons with the power to direct certain actions pertaining to the Trust.

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Settlors or Grantors are excluded from acting as a Trust Protector.

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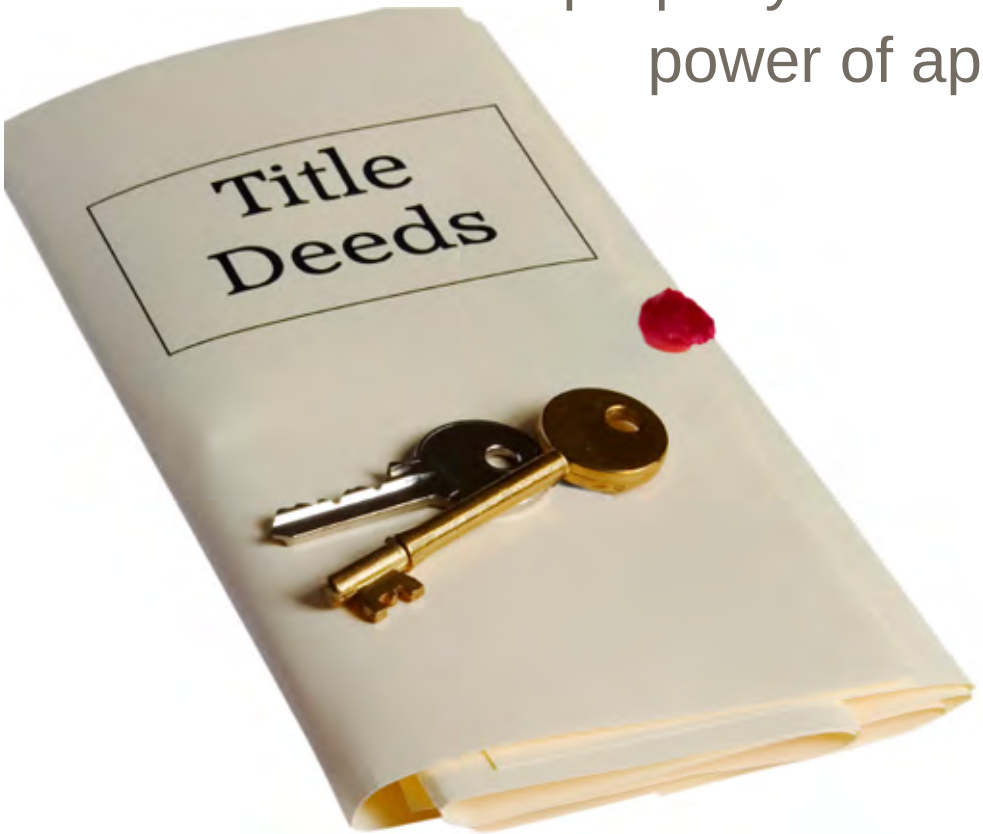
The holder of a power of appointment is excluded from acting as a Trust Protector.

A person given a power to distribute property from the trust has a power of appointment.



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A trust protector may act in non-fiduciary capacities, such as

- ✓ a power to vote or direct the voting of stock or other securities, if the grantor and trust are significant from the viewpoint of voting control;
- ✓ a power to control the investment of trust funds
- ✓ a power to reacquire the trust corpus by substituting other property of equivalent value

A trust protector must exercise any power, duty or discretion in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.

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A trustee is not permitted to exercise any power contrary to the terms of the trust or that would constitute a breach of fiduciary duty that a trust protector owes to the beneficiaries of the trust, without first receiving prior direction from the court.

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By acting as a trust protector of a trust in this state, the trust protector submits to the jurisdiction of courts in Michigan.

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What is a Durable Power of Attorney?

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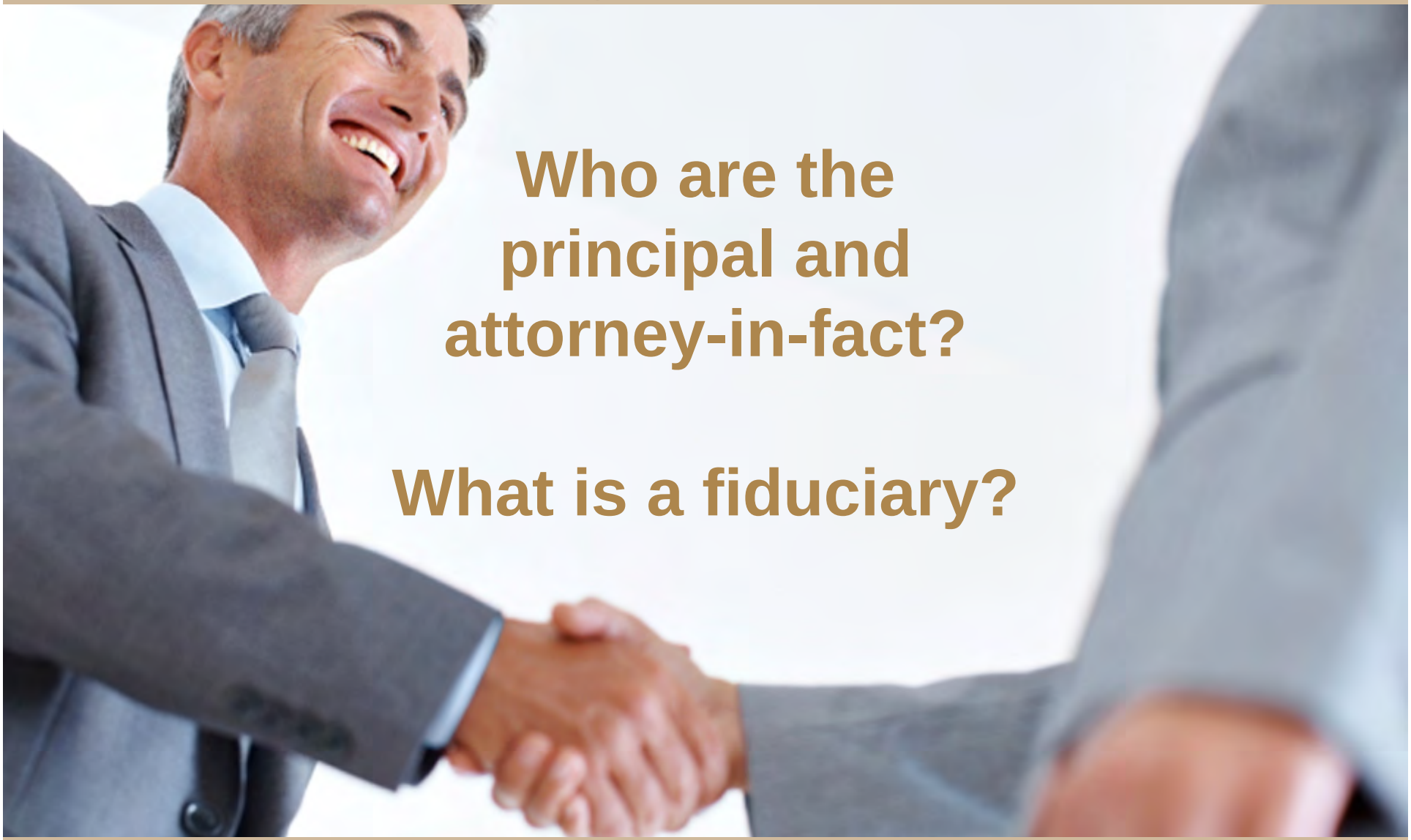

Who are the principal and attorney-in-fact?

What is a fiduciary?

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Springing Powers

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Execution Requirements:

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Rights and Responsibilities of Attorney-in-Fact

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2012 Changes - Acknowledgement

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Exceptions under the Statute

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THANK YOU FOR YOUR PARTICIPATION

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MODIFYING IRREVOCABLE TRUSTS, POWERS OF APPOINTMENT, BACKDOOR PROVISIONS, ETC.

Geoffrey N. Taylor, Esq.

A Trust is Irrevocable:

a. Only if the grantor has died

b. If the trust agreement is silent as to revocability

c. If the Michigan Trust Code says it's irrevocable

d. None of the above

Correct Answer:

d. None of the above

What if the Grantor Wants to Change the Irrevocable Trust:

a. The grantor can

b. The grantor cannot without court approval

c. It depends on the trust's terms

d. Some of the above

Correct Answer:

d. Some of the above

An Irrevocable Trust Agreement Should Contain:

a. Power of appointment provisions

b. Trustee appointer provisions

c. Trust protector provisions

d. All of the above

Correct Answer:

d. All of the above

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A SPIDER MAN'S WEB

Applying Statutory Guidelines and Practice Tips Relating to the Foreclosure and Short Sale Processes

Background

Twenty-five years ago, childhood sweethearts Peter Parker and Mary Jane Watson-Parker (“Parkers”) married right out of college.

Background

They purchased their first home in Milford, Michigan with the assistance of a Best Buy Bank home loan in the amount of $230,000 (present day balance of $200,000), which was secured by a first priority lien on the property ("Best Buy Bank Loan").

Background

Eight years ago the Parkers refinanced with Best Buy Bank in order to take advantage of the dropping interest rates.

Background

Three years later the Parkers obtained a home improvement loan from Kitchen Aid Loans in the amount of $25,000 (present day balance of $20,000) in order to repair damage to their kitchen resulting from a cooking experiment gone awry (“Kitchen Aid Loan”).

The home improvement loan is secured by a subordinate lien on the property.

Background

Over the last year, the Parkers have had difficulties making the payments on both loans stemming from a drop in sales at the local newspaper (Peter Parker's employer) and Mary Jane's inability to book print ad work.

Background

With the Parkers rapidly approaching retirement age, and their dream house approximately $30,000 under water, the Parkers are looking to unload their home, negotiate their loan obligations, and relocate to New York in order to be closer to their grown children and grandchildren.

Background

The Parkers have had their home on the market for over a year with minimal interest.

At this time, they have an offer on the property from a long-time family friend, Harry Osborn, in the amount of $170,000, which is $50,000 less than owed on the Best Buy Bank Loan and the Kitchen Aid Loan.

Background

The Parkers are 90 days delinquent on the Best Buy Loan and the Kitchen Aid Loan and have recently received a letter from Best Buy Bank stating that the balance on the Best Buy Loan has been accelerated and is now due and owing.

Foreclosure Process
Best Buy Bank's Perspective

Pre-Foreclosure Factors

Factors

- Review Mortgage Documents for Acceleration Clause and Power of Sale Clause
- Obtain a title search
- Obtain an appraisal of the property

Best Buy Bank Scenario

- Mortgage and Note documents allow for acceleration of the balance of the loan based on Parkers' default
- Mortgage has a power of sale clause
- Title search results – Best Buy Bank is made aware of the Kitchen Aid Loan
- Property is appraised for $170,000 (>$30,000 than balance owed on the Best Buy Bank Loan)

Foreclose: Judicially vs. Non-Judicially

Judicially
PROS

- Complaint for judicial foreclosure can also allow for a judgment for the deficiency balance
- Collectability of Borrower(s)
- Priority Disputes
- Litigious Borrower(s)

Non-Judicially
PROS

- Expeditious process
- Relatively inexpensive
- Allows for loan modification

Foreclose: Judicially vs. Non-Judicially

Judicially
CONS

- Not an expeditious process – cannot foreclose the property until 6 months have passed from the date the complaint was filed
- Litigation fees and costs
- Open up the possibility of a counter-complaint

Non-Judicially
CONS

- Loan modification meeting requirement under MCL 600.3205
- HAMP Loan Modification Servicing Requirements

Foreclosure Process
Best Buy Bank's Perspective

Best Buy Bank's Bottom Line:

Best Buy Bank decides to move forward with a non-judicial foreclosure based on the expeditious and cost-effective nature of the foreclosure by advertisement, coupled with the Parkers' desire to not stay in their home.

Short Sale Process
From the Borrower's Perspective

Parkers' Goals:

- Walk away from their residence without creditors breathing down their necks in order to collect on deficiency balances;
- Have debt obligations forgiven or negotiated to nominal amounts; and
- Resolve the debt obligations in a manner that will have the least negligible effect on their credit reports

Short Sale Process
From the Borrower's Perspective

Parkers' Bottom Line:

Parkers' want to avoid the foreclosure process at all costs, and have decided to present Harry Osborn's purchase offer to Best Buy Bank in order to avoid the foreclosure process.

Short Sale Process
From the Borrower's Perspective

Parkers' Preliminary Steps:

- Obtain an appraisal of property and recent comparables in the area;
- Obtain a title search;
- Coordinate with subordinate lien holders as soon as possible; and
- Prepare breakdown of purchase offer and how it will be applied to the Best Buy Loan and Kitchen Aid Loan.

Parkers' Proposed Short Sale Offer ($170,000.00):		
Loan Balance	**Proposed Payoff**	**Deficiency to be Forgiven**
Best Buy Bank Loan: $200,000	$162,000 - $9,750* $152,250 *(allocation of 75% of transfer fees)	$47,750
Kitchen Aid Loan: $20,000	$8,000 - $3,250* $4,750 *(allocation of 25% of transfer fees)	$15,250
Total Liabilities $220,000	Total Purchase Offer: (Payoffs plus transaction costs) $170,000 Payoffs* *$13,000 Transaction costs (transfer tax, broker commissions and title policy)	Total Remaining Deficiency: $63,000

Short Sale Process
From the Borrower's Perspective

Practice Tips for Preparing the Short Sale Package:

- Provide a recent appraisal of the real property;
- Provide a monthly household budget;
- Provide update financials
  - Last two (2) years of tax returns
  - Last two (2) months of bank statements
- Provide a purchase agreement with detailed contingencies;

Short Sale Process
From the Borrower's Perspective

Practice Tips for Preparing the Short Sale Package:

- Provide an estimate HUD-1 statement;
- Provide lender authorization to speak directly with real estate agent and/or title agent; and
- Provide lender authorization to speak directly to subordinate lien holder(s).

Short Sale Process
From the Borrower's Perspective

Other Considerations:

- Credit reporting implications;
- Basics of tax implications of forgiven debt
  - Short sale may result in capital gain, depending on the documentation used and type of loan; and
  - Application of Mortgage Debt Relief Act of 2007

WHAT DO YOU MEAN THIS IS A PROHIBITED TRANSACTION?

Disqualified Persons (“DPs”)

Who are the Bad Guys?

- Fiduciaries
- Persons providing services to the plan
- Employers whose employees are covered by the plan
- Employee organizations whose employees are covered by the plan

How do you Fix It?

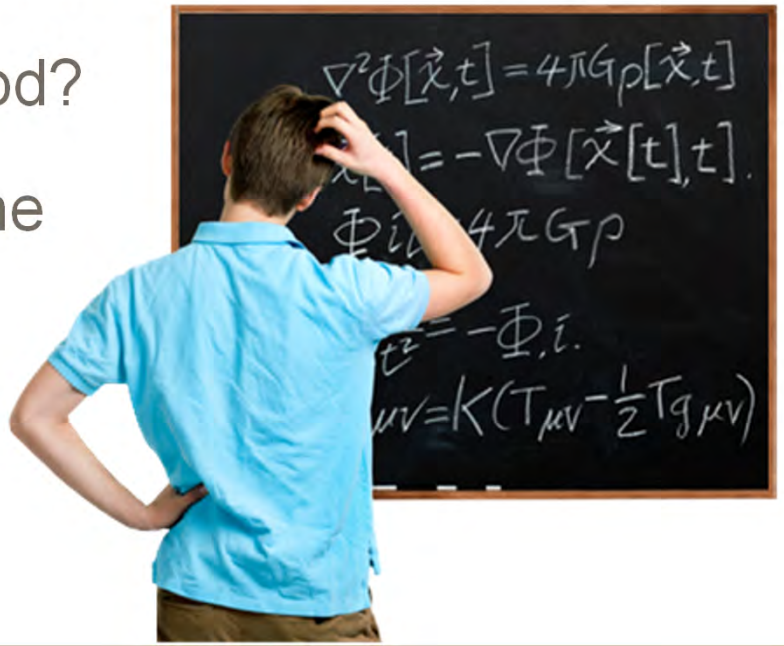
- No description of correction in §4975
- IRS uses the private foundation rules of §4941 generally
- General Rule: Undo the transaction to the extent possible, but in no case put the plan in a worse condition than if the PT never occurred

How do you Fix It?

- Rescind or reverse the sale when possible
- The amount repaid should be the lesser of:
  - The consideration received by the plan or
  - The lesser of FMV at the time of the sale or rescission

Calculating the Tax

- §4975 Contains two levels of tax
- What is the amount involved?
- What is the taxable period?
- Sale of the property to the plan by a DP
- Loan by a plan to a DP



HEALTH CARE COMPLIANCE FOR 2013/2014

Marc S. Wise, Esq.

Employee Notification Requirements for 2013/2014

- Health Care Notifications
- Employee/Government Notifications

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Employee Notification Requirements for 2013/2014

Employee Health Care Notifications

- SBC
- Grandfather Notice
- 60 Day Advance Notice
- SPD Issues
- Insurance Exchange
- Insurance Refunds

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Employee Notification Requirements for 2013/2014

Summary of Benefits and Coverage

- March 23, 2012
- Four-page Benefit Summary
- Required Provisions
- Fully-Insured Plans: Insurance Company
- Self-Insured Plans: Plan Sponsor
- HRA/MERPS

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Employee Health Care Notifications

- Grandfather Notice – Plan Years on or after 9/23/10
- 60 Day Advance Notice – Plan Years on or after 3/23/10
- SPD Issues – Plan Years on or after 9/23/10
- Insurance Exchange Notice – 3/1/13
- Insurance Refunds – New enforcement?

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Employee/Government Notifications

- W-2 Reporting – January 2013
- Section 125 FSA

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New Healthcare Fees

- Patient – Centered Outcome Research Fees
- Transitional Reinsurance Fees

Employee Analysis for Employer Pay or Play

- Tax for Failure to Provider Coverage
- Tax for Failure to Pay a Specific Amount
- IRS Notice 2012-58 – Full-Time Employees

Employee Analysis for Employer Pay or Play

- Variable Hour and Seasonal Employees
- Safe Harbors
- Measurement Periods
- Stability Periods

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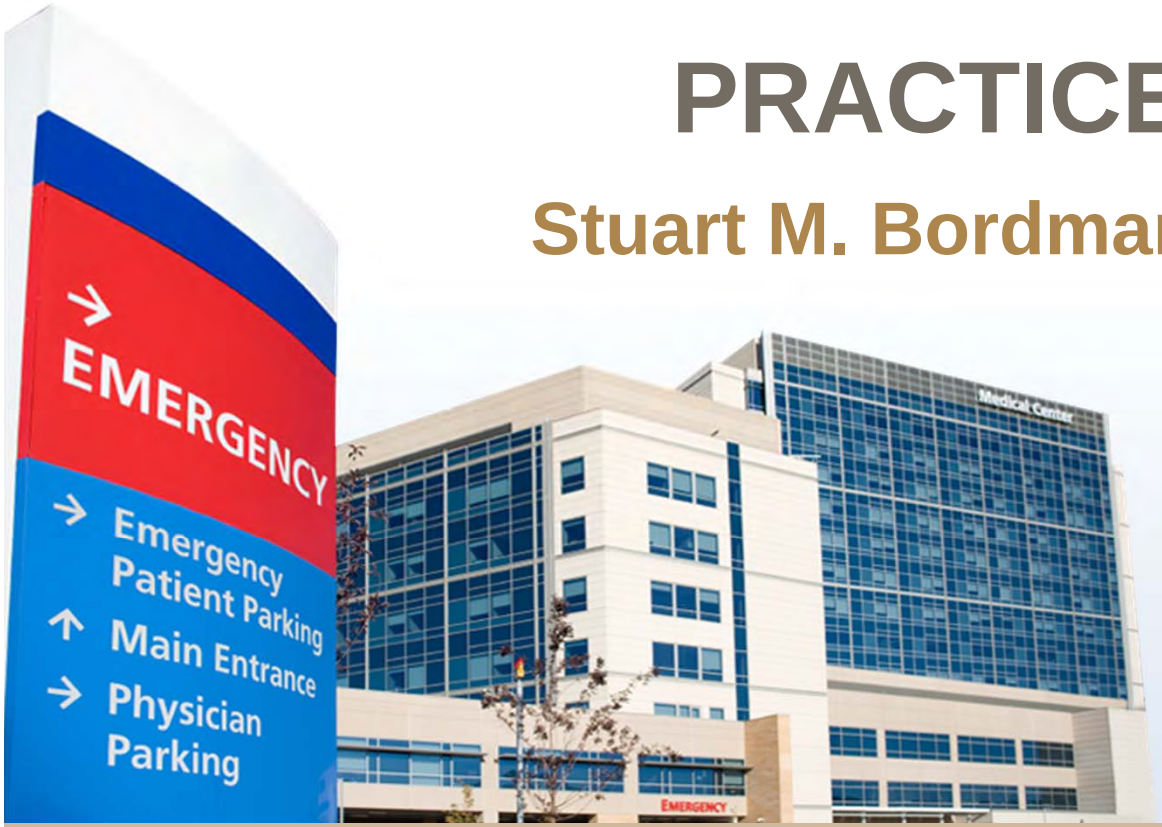
MERGERS, ACQUISITIONS & COMBINATIONS OF MEDICAL PRACTICES

Stuart M. Bordman, Esq.



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I. The Urge to Merge

A. Acquisition by Health Care Systems

B. Acquisition by (merger into) Mega Medical Groups

II. Purchase Price

A. Tangible Assets

B. Intangible Assets

III. Post Acquisition Relationship

A. None

B. Shareholders of Seller Become Employees of Acquiring Entity

C. Employees may be subject to post termination agreements not to compete

IV. Compensation of Physicians By Acquiring Entity

A. Relative Value Units

B. Profit Center

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V. Miscellaneous

A. Medical Records

B. Retirement Plans

C. Tax Issues

QUESTIONS AND ANSWERS

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