TWENTY-THIRD
ANNUAL TAX SYMPOSIUM

November 15, 2014
SHERATON DETROIT NOVI
NOVI, MICHIGAN

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

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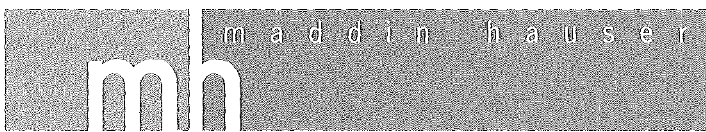

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November 15, 2014

Dear Tax Symposium Participant:

Welcome to our Twenty-Third Annual Tax Symposium. We are pleased that you have joined us this morning.

As we have done historically, our program will address tax and non-tax topics we believe will help you better represent your clients. This year there are two presentations that should be noted. First, Marc Wise will be providing an up-to-the-minute presentation on the reporting and recordkeeping requirements under the Affordable Care Act. This continues to be a top priority for our clients. Additionally, Bill Sigler will be continuing his annual survey of tax developments. Not only will you find Bill's presentation informative, we hope that you will use the materials Bill presents in the Symposium book as a research tool during this year.

We also would like to introduce our Breakfast Bites for Tax Practitioners program. These will be workshops offered at our office during the upcoming year and will provide you with an opportunity to consider in depth some of the topics which are being covered during the Symposium. These programs will also qualify for continuing education credits for Certified Public Accountants.

While our annual Tax Symposium features many of the tax and corporate members of our Firm, you should be aware that we are a "full service law firm." Please visit our website at www.maddinhauser.com to find out more about Maddin Hauser.

As always, we appreciate your attendance at the program and welcome your comments and suggestions.

Very truly yours,

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MADDIN, HAUSER, ROTH & HELLER, P.C.
TWENTY-THIRD ANNUAL TAX SYMPOSIUM PROGRAM

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GEOFFREY N. TAYLOR Married Couples and Joint Trusts: Has Portability Obviated the Need for Separate Trusts?	9:40 – 10:00	Page 60
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ALEXANDER G. DOMENICUCCI Federal Income Tax Issues Arising During the Life of a Partnership (or LLC)	10:40 – 11:00	Page 142
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**** Seminar Qualifies for Four CPE Credits ****

REJUVENATE THAT RETIREMENT PLAN

By: Gary M. Remer

I. WHY ARE WE DOING THIS?

A. The Pension Protection Act of 2006 ("PPA") restatement process for pre-approved defined contribution plans, including 401(k) plans, began May 1, 2014 and will run until April 30, 2016.

B. Approximately 10 years ago, the Internal Revenue Service ("IRS") implemented a new procedure which generally requires pre-approved retirement plans (Prototype and Volume Submitter Plans) to be restated every six years.

C. The IRS requires the restatements to incorporate changes made to the governing tax laws and regulations in order to maintain pre-approved status.

D. Using pre-approved plans saves plan sponsors tremendous costs in preparation and in IRS filing fees and, most importantly, provides reliance that the document language should not be challenged by the IRS.

II. HOW TO BECOME A HERO

A. Many plan document sponsors do little more than send their clients a restated document, which merely incorporates all of the same provisions and features that have been used in the past.

B. Restating a plan for PPA provides an excellent opportunity to review plan provisions, insure plans are meeting plan sponsors' objectives and even look for new planning opportunities.

C. Take this opportunity to listen to your clients and what their needs are. Are clients suddenly in a position to "shelter" large portions of their income, as long as the costs remain reasonable for the administration of the plan and contributions for their staff of employees?

III. 401(K) TO THE RESCUE

A. If a client still does not have a 401(k) feature, it is not too late to add it to their profit sharing plan. 401(k) plans provide the best "bang for the buck" until plan participants accumulate meaningful retirement benefits.

B. Adopt a Solo 401(k) plan.

1. A Solo 401(k) plan is a 401(k) plan for a single business owner with no employees.

2. The beauty of having a Solo 401(k) plan over a profit sharing plan is that it allows for a greater annual contribution.

EXAMPLE 1: The sole shareholder of the corporation has annual compensation of $100,000. With a profit sharing plan, the maximum contribution would be the lesser of the 25% of eligible compensation (deduction limit) or the IRC §415 limit of $52,000. Therefore, the maximum contribution is $25,000.

EXAMPLE 2: Using the same facts as in Example 1 but by adding a 401(k) feature, the maximum benefit that the owner can receive is now increased from $25,000 to $42,500 by making an elective deferral of $17,500. The 401(k) deferral is not subject to the 25% deduction limitation.

EXAMPLE 3: The sole shareholder of the corporation now makes $150,000 per year. The maximum allowable contribution with a profit sharing plan is $37,500 (25%

deduction limit). By adding the 401(k) feature, the maximum contribution is now increased to $52,000. The IRC §415 limitation now comes into play.

EXAMPLE 4: Now assume the same facts as in Example 3 except that our business owner is age 55. This has no impact if it is only a profit sharing plan. However, the maximum contribution with the catch up contribution of $5,500 now is increased to $57,500.

C. Add a safe harbor feature to a 401(k) plan.

1. For those clients who maintain 401(k) plans that are having difficulty passing the actual deferral percentage test ("ADP") (requiring the return of deferrals to the owners and other highly compensated employees), a safe harbor 401(k) plan should be considered.

2. Safe harbor plans may take two forms. The first will require the plan sponsors to commit a 3% fully vested contribution to all participants. In the other method it will require a matching contribution of approximately 4% percent of deferred compensation.

3. In some instances where the clients are hesitant to even make that commitment, a "wait and see safe harbor plan" may be preferable. This type of plan allows an employer to make the decision of adopting a safe harbor feature as late as 11 months into the plan year.

D. Add Roth features to a 401(k).

1. Although adding "Roth features" to a 401(k) plan is not new, many clients were hesitant to include Roth features because of various uncertainties.

2. At a minimum, young employees with lengthy horizons on retirement and older employees with estate plan considerations have all seen the great potentials of saving with a Roth vehicle.

3. In order to facilitate this, adding Roth features where they have not been available, as well as allowing for Roth 401(k) rollovers and "In-Plan Roth Conversions" will facilitate the use of Roth accounts for those employees.

IV. CROSS-TESTED ALLOCATION FEATURES

A. History. The concept of what is called "new comparability" or "cross-testing" originated back in 1981 with the issuance of Revenue Ruling 81-202. The Ruling allowed plan sponsors to demonstrate that a defined contribution plan was comparable to a defined benefit plan. However, the concept did not gain wide spread acceptability in the pension community until the late 90s as the result of the IRS constantly changing its position on the subject.

B. Underlying Concept.

1. A defined contribution plan defines the amount that will be contributed currently with no guaranty as to the amount of the benefit at the time of retirement. A defined benefit plan specifies the benefit at retirement without a predetermined annual contribution.

2. The underlying principal determining the funding of a defined benefit plan is the time value of money. For example, a

participant who is age 60 needs to have a larger contribution made to a retirement plan today in order to have that amount grow to $100 at retirement compared to the contribution required for a participant who is age 20 to have their benefit grow to $100 at retirement.

3. Each year a defined benefit plan is required to have an actuary calculate the required contribution by projecting the retirement benefit to be funded.

4. In simple terms, cross-testing works by looking at the contribution made to each participant currently and demonstrating that although each participant may receive a different contribution percentage compared to the other participants, the amount received is projected to be the same benefit at retirement.

5. The advantage of cross-testing is that it allows the grouping of participants so that members of each group may receive the same allocation percentage.

C. Technical Requirements. Key technical requirements must be satisfied to demonstrate that the cross-tested plan does not discriminate in favor of HCEs. This is done by demonstrating that a cross-tested plan is non-discriminatory under the general test of Treasury Regulation §1.401(a)(4)-2(c) by comparing equivalent amounts of benefits instead of contributions. A plan satisfies the general test if each "rate group" satisfies the requirements of IRC §410(b). A "rate group" is established for each HCE and consists of:

1. The HCE; and

2. All other employees (both HCEs and NHCEs) who have an equivalent accrual rate greater than or equal to the equivalent accrual rate of the HCE.

3. Each rate group then must either pass the ratio percentage test of Treasury Regulation §1.410(b)-2(b)(2) or the average benefit test under Treasury Regulation §1.410(b)-5.

D. Cross-tested plans must also satisfy the lesser of the two following minimum contribution requirements, in addition to the technical requirements described above:

1. A minimum 5% allocation rate to each non-highly compensated employee ("NHCE"); or

2. A minimum allocation rate to the NHCEs equal to 1/3 of the highest allocation rate for any HCE.

E. Show me the numbers! In this example a cross-tested plan is designed to allow the owner of the company to receive an allocation equal to 20% of his/her compensation while only providing a contribution of 5% to each of the other participants.

NAME	AGE	MPENSATION	NTRIBUTION	% OF PAY
HCE #1	57	$260,000	$52,000	20%
NHCE#1	23	$42,000	$2,100	5%
NHCE#2	34	$38,216	$1,910	5%
NHCE #3	22	$35,000	$1,750	5%
NHCE #4	46	$68,000	$3,400	5%
NHCE #5	39	$56,000	$2,800	5%
NHCE #6	36	$32,000	$1,600	5%
TOTALS		$531,216	$65,560	

V. SHIFTING THE ECONOMIC BURDEN

A. Historically, many of our plan clients have borne the administrative costs of maintaining their retirement plans.

B. A trend has developed recently whereby employers are passing along many of the administrative costs to participants.

C. In many of these cases, it is limited to the cost directly attributable to the services that the employees utilize.

D. This may mean charging a participant's account for the cost of plan loans, Qualified Domestic Relations Orders, hardship distributions and other distributions.

E. In other instances, administrative costs such as accounting, legal, investment and other fees are charged to the accounts of plan participants.

F. In other cases, plans are being amended to provide that forfeitures are first used to pay plan expenses instead of increasing contributions or benefits to plan participants.

VI. SAVE AS MUCH AS YOU CAN

A. When a client realizes the traditional amounts of money being put away in defined contribution plans won't work, perhaps this is the time to approach talking to a client about a defined benefit plan or a special form of defined benefit plan called a cash balance pension plan.

B. A defined benefit plan specifies the benefit that a participant will receive at retirement.

C. The risk associated with the growth of retirement funds is borne by the employer. If the market declines, the employer must fund the shortfall in the retirement plan.

D. This is different from a defined contribution plan where if there's a decline in the market, the participant suffers the loss.

EXAMPLE ONE - You have a single owner with 9 employees. Ninety-one percent of the total contribution benefits the owner and 9% benefits the other 9 employees.

NAME	AGE	PLAN COMP.	ASSUMED DEFERRALS	SAFE HARBOR	PROFIT SHARING	CASH BALANCE	TOTAL AMOUNT
Owner	52	$260,000.00	23,000.00	$0.00	$15,600.00	$145,000.00	$160,600.00
NHCE #1	50	35,783.32	0.00	1,073.50	715.67	1,073.50	2,862.67
NHCE #2	62	38,701.36	0.00	1,161.04	774.03	1,161.04	3,096.11
NHCE #3	40	18,525.10	0.00	555.75	370.51	555.75	1,482.01
NHCE #4	35	19,282.12	0.00	578.46	385.65	578.46	1,542.57
NHCE #5	29	17,146.57	0.00	514.40	342.93	514.40	1,371.73
NHCE #6	51	38,181.36	0.00	1,145.44	763.63	1,145.44	3,054.51
NHCE #7	44	27,135.45	0.00	814.06	542.71	814.06	2,170.83
NHCE #8	30	18,261.00	0.00	547.83	365.22	547.83	1,460.88
NHCE #9	26	17,501.00	0.00	525.03	350.02	525.03	1,400.08
HCE'S	=	$260,000.00	$23,000.00	$0.00	$15,600.00	$145,000.00	$160,600.00
NHCE'S	=	$230,517.28	0.00	$6,915.51	$4,610.37	$6,915.51	$18,441.39
TOTAL	=	$490,517.28	$23,000.00	$6,915.51	$20,210.37	$151,915.51	$179,041.39

EXAMPLE TWO - You have two owners with 8 employees. Ninety-six percent of the total contribution benefits the two owners and 4% benefits the other 8 employees.

NAME	AGE	PLAN COMP.	ASSUMED DEFERRALS	SAFE HARBOR	PROFIT SHARING	CASH BALANCE	TOTAL AMOUNT
Owner #1	52	$260,000.00	$23,000.00	$0.00	$16,562.00	$145,000.00	$161,562.00
Owner #2	50	$260,000.00	23,000.00	0.00	16,562.00	$135,000.00	$151,562.00
NHCE #1	62	38,701.36	0.00	1,161.04	774.03	1,064.29	2,999.36
NHCE #2	40	18,525.10	0.00	555.75	370.51	509.44	1,435.70
NHCE #3	35	19,282.12	0.00	578.46	385.65	530.26	1,494.37
NHCE #4	29	17,146.57	0.00	514.40	342.93	471.53	1,328.86
NHCE #5	51	38,181.36	0.00	1,145.44	763.63	1,049.99	2,959.06
NHCE #6	44	27,135.45	0.00	814.06	542.71	746.22	2,102.99
NHCE #7	30	18,261.00	0.00	547.83	365.22	502.18	1,415.23
NHCE #8	26	17,501.00	0.00	525.03	350.02	481.28	1,356.33
HCE'S	=	$520,000.00	$46,000.00	$0.00	$33,124.00	$280,000.00	$313,124.00
NHCE'S	=	$194,733.96	0.00	$5,842.01	$3,894.70	$5,355.19	$15,091.90
TOTAL	=	$714,733.96	$46,000.00	$5,842.01	$37,018.70	$285,355.19	$328,215.90

What this all means is that there are options available to prepare for retirement, no matter how soon it may be approaching.

NON-COMPETE AND NON-DISCLOSURE AGREEMENTS

By: Michelle C. Harrell

I. NON-COMPETE AGREEMENTS

A. History

1. Until March 29, 1985 virtually all contracts that restricted employment were considered to be void and illegal as a restraint of trade.

2. The exception was a route list. The ability to compete was limited to a maximum of ninety (90) days.

B. The Michigan Antitrust Reform Act, MCLA 445.774a, states:

> An employer may obtain from an employee an agreement or covenant which protects an employer's reasonable competitive business interest and expressly prohibits an employee from engaging in employment or a line of business after termination of employment if the agreement or covenant is reasonable as to its duration, geographical area, and the type of employment or line of business. To the extent any such agreement or covenant is found to be unreasonable in any respect, a court may limit the agreement to render it reasonable in light of the circumstances in which it was made and specifically enforce the agreement as limited.

1. What is an employer's protectable interest?

   a. The statute does not provide a definition.

   b. The legislative analysis suggests that trade secrets, client lists and confidential employment materials are protectable.

c. A seminal case on trade secrets is *Hayes Albion Corp v Kuberski,* 421 Mich 170 (1984), rehearing denied, 42 Mich 1202 (1985).

d. Goodwill and customers constitute a reasonable business interest. *Merrill Lynch v Grall*, 836 F Supp 428 (WD Mich, 1993).

e. An agreement prohibiting an ex-stockbroker from soliciting customers he serviced while he worked for his former employer was reasonable because it lasted for one (1) year, did not prevent him from working as a broker and did not restrict him geographically from working. *American Express Financial Advisors v Scott*, 955 F Supp 688 (ND Texas, 1996).

f. Customer lists, profit margins and pricing information are protectable. *Lowry Computer Products, Inc. v Head*, 984 F Supp 1111 (ED Mich 1997).

C. What are Non-Compete Agreements?

1. Agreements to restrict a certain type of business competition between an employer and its employees.

2. Names, types, or forms.

a. Non-compete agreements.

b. Restrictive covenants.

c. Non-solicitation agreements.

d. Similar to, but different from, non-disclosure agreements.

e. May be part of other standard employment agreements, including employment manuals, employment relationship statements, severance agreements, non-disclosure agreements, and release agreements.

D. Why use Non-Compete Agreements?

1. Use Non-Compete Agreements to protect legitimate business interests and to prevent unfair business competition.

2. Use to protect the tangible and intangible assets of a business.

3. Non-Compete Agreements help prevent unreasonable competition.

4. Non-Compete Agreements help obtain injunctive relief and monetary damages from unreasonable competition.

5. Employees have a legal duty of honesty and loyalty during the term of employment.

6. Employees have no legal obligation not to compete with you after their employment with you, absent a specific written agreement to the contrary.

E. When and How to use Non-Compete Agreements.

1. Non-Compete Agreements should be used as standard operating procedure or as standard method of operation.

2. Non-Compete Agreements should be used with <u>most employees</u> and with <u>all independent contractors</u>.

3. Non-Compete Agreements should be used often. There is rarely a reason not to use Non-Compete Agreements.

4. Non-Compete Agreements should be used in conjunction with other standard employment agreements, including employment manuals, employment relationship statements, non-disclosure agreements, severance agreements, and release agreements.

F. What are the elements of a Non-Compete Agreement?

1. There should be a specific restriction or prohibition concerning certain types of competition.

2. There should be a specific remedy and damages in the event of a breach or default of the restriction.

3. Draft or edit restriction to protecting reasonable and legitimate existing business interests and nothing more.

4. The restrictions should be reasonable as to:

   a. Time or Term

      i. Six (6) months to five (5) years, usually thought of as reasonable and enforceable depending on the industry and position of the employee.

      ii. Ten (10) years to twenty (20) years, usually thought of as unreasonable and unenforceable.

      iii. The shorter the time, the more reasonable and the more likely to be enforced.

   b. Geography or Area

      i. One (1) mile to twenty (20) miles, usually thought of as reasonable and enforceable.

ii. Twenty-five (25) miles, a state, the nation, or the world may be viewed as unreasonable and unenforceable.

iii. The shorter or smaller the geographic area, the more reasonable and the more likely to be enforceable.

c. Scope or Coverage

i. Restriction limited to legitimate business interests.

ii. Legitimate business interests include attempting to protect existing customers, clients, products, services, employees, contractors, and suppliers.

iii. <u>All potential</u> customers, clients, products, services, and suppliers usually thought of as unreasonable and unenforceable.

iv. The narrower the scope or coverage, the more reasonable and the more likely to be enforced.

5. Restrictions should include:

a. Prohibitions against competing with, contacting or soliciting <u>actual</u> and targeted customers or clients.

b. Prohibition against hiring or dealing with, contacting, or soliciting <u>actual</u> employees, contractors, and suppliers.

6. Non-Compete Agreements should provide for damages in the event of a breach or default, which damages should specifically include, but not be limited to liquidated monetary damages and all costs of enforcing the agreement, including actual attorney fees.

7. Non-Compete Agreements should provide for equitable remedies, which include injunctions and restraining orders.

G. What should be avoided when using Non-Compete Agreements?

1. Like all written agreements, avoid those terms and restrictions which are unreasonable, over-reaching, and unfair.

2. Unreasonable restrictions are:

   a. Restrictions which prevent someone from:

      i. Working in the only job or industry which an individual knows or has ever known, or

      ii. Making a living, and

   b. Restrictions which injure or interfere with another's legitimate business interests.

H. What are the problems with Non-Compete Agreements?

1. Non-Compete Agreements are not a guaranty or an absolute bar from unreasonable competition.

2. Non-Compete Agreements keep only honest people more honest. They will not keep dishonest employees from acting dishonestly.

3. Non-Compete Agreements should not be overly relied upon or used as a substitute for providing quality goods and/or services.

4. Non-Compete Agreements are "double-edged" and can run in both directions.

   a. Employers must be very careful about hiring employees who may be subject to and bound by a Non-Compete Agreement.

   b. Employers must carefully review and analyze all agreements which are signed by or bind prospective employees.

I. Enforcement

1. To enforce a covenant not to compete, the plaintiff must be reasonable as to its duration, geographical area and type of employment or line of business.

2. Does signing a covenant not to compete at the beginning of an employment relationship provide sufficient consideration to make the covenant enforceable?

   Yes. See *Lowry Computer Products, Inc. v Head,* supra.

3. Does the continuation of employment constitute sufficient consideration to enforce the covenant? Yes, under certain circumstances.

   a. If a new business has acquired the old business which employed the employee. *Lowry Computer Products, Inc. v Head,* supra.

   b. If a new contract is signed with the current employer. *Robert Half International, Inc. v Van Steemis,* 784 F Supp 1263 (ED Mich 1991).

4. What are the factors that a court considers in determining the reasonableness of time and geographical restrictions?

   a. With respect to time, periods from six (6) months to three (3) years have been considered reasonable. *Superior Consulting, Inc. v Walling*, 851 F Supp 847 (ED Mich 1994).

   b. The issue is fact sensitive to industries. In certain industries (i.e., computer hardware sales) a shorter restrictive covenant period might increase the ability to enforce the covenant as written.

c. With respect to geography, the court in *Walling* held that an unlimited geographic scope is reasonable if the business at issue is international in scope.

d. Non-solicitation of any of the former employer's customers has been found to be a reasonable substitute for geographical restrictions.

5. If the covenant not to compete is too broad to render it enforceable, is the court permitted to modify the covenant to make the restriction more narrow and thus the covenant enforceable?

   Yes. Michigan courts have discretion to modify unreasonable covenants.

6. Will a single breach of a covenant not to compete be sufficient for a court to issue an injunction extending the period of the covenant?

   Normally, no. However, when a breach is continuous and systematic, courts have extended the time period of a covenant.

7. What elements do a court review to determine if an employer is entitled to obtain a preliminary injunction enforcing the covenant not to compete?

   a. The public interest will be harmed if the injunction is issued.

   b. The plaintiff will be harmed, if temporary relief is not granted, more than the opposing party.

   c. The plaintiff is likely to prevail on the merits.

   d. The plaintiff will be irreparably harmed if the relief is not granted.

   e. Granting the injunction will preserve the status quo.

8. What choice of law rule applies in determining which state law governs in determining whether to enforce a covenant not to compete?

   a. In *Lowry Computer Products, Inc. v Head*. 984 F. Supp 1111 (ED Mich 1997), a federal court in the Eastern District of Michigan stated:

      > In determining the state of applicable law in the absence of an effective choice of law by the parties pursuant to ...courts take into account the place of contracting, the place of negotiation of the contract, the place of performance, the location of the subject matter of the contract, and the domicile, residence, nationality, place of incorporation and place of business of the parties.

      Id. at 11.

II. NON-DISCLOSURE AGREEMENTS

A. What are Non-Disclosure Agreements?

1. Agreements to restrict the disclosure of certain types of business information between an employer and its employees.

2. Types.

   a. Non-disclosure agreements

   b. Confidentiality agreements

   c. Secrecy agreements

   d. Similar to, but different from, non-compete agreements

   e. May be part of other standard employment agreements, including employment manuals, employment relationship

statements, severance agreements, non-compete agreements, and release agreements.

B. Why use Non-Disclosure Agreements?

1. Non-Disclosure Agreements protect the unauthorized disclosure of legitimate business information.

2. Non-Disclosure Agreements protect business information which is:

    a. Not generally known by anyone outside of your business:

        i. Competitors.

        ii. General public.

    b. Information which is confidential, secret, and proprietary.

3. Non-Disclosure Agreements help prevent unnecessary disclosure of confidential information.

4. Non-Compete Agreements help you obtain injunctive relief and monetary damages for the unauthorized disclosure of protected business information.

5. Employees have a legal duty of honesty, loyalty and confidentiality while they are employed.

6. Employees have no legal duty or obligation of honesty, loyalty, or confidentiality after their employment, absent a specific written agreement to the contrary.

C. When and How to Use Non-Disclosure Agreements

1. Non-Disclosure Agreements should be used as standard operating procedure or as a standard method of operation.

2. Non-Disclosure Agreements should be used with all employees and with all independent contractors.

3. Non-Disclosure Agreements should be used all the time. There is almost no downside to Non-Disclosure Agreements.

4. Non-Disclosure Agreements should be used in conjunction with:

   a. Other standard employment agreements, including employment manuals, employment relationship statements, non-compete agreements, severance agreements and releases.

   b. Other common sense employment practices, which are consistent with and reinforce the desire to fully protect the confidential information.

5. Employment practices which should be used to support and reinforce the terms and intent of the Non-Disclosure Agreement:

   a. Stamping documents "Confidential," and

   b. Customizing computer software for:

      i. Log-on with special confidential acknowledgment,

      ii. Printing all confidential documents with a confidentiality statement on all pages thereof.

   c. Conducting periodic in-house training, orientation, and/or education seminars which explain the non-disclosure obligations and importance thereof.

D. What are the Elements of a Non-Disclosure Agreement?

1. Non-Disclosure Agreements should acknowledge that the employer is the sole and exclusive owner of the information.

2. Non-Disclosure Agreements should acknowledge the desire and need to retain all such business information confidential and not to disclose it to anyone whatsoever.

3. Non-Disclosure Agreements should cover and prohibit the unauthorized disclosure of all business information, which should specifically include information which is confidential and non-confidential, secret and non-secret, proprietary and non-proprietary, and generally known and not known.

4. Non-Disclosure Agreements should acknowledge that the information may only be used for the benefit of the employer and for no other person or purpose whatsoever.

5. Non-Disclosure Agreements should require the return of all such business information upon termination of employment or demand.

6. Non-Disclosure Agreements should provide for injunctive remedies and monetary damages for a breach or default of the restrictions, which should specifically include, but not be limited to liquidated monetary damages in a specific dollar amount and all costs of enforcing the agreement, including actual attorney fees.

E. What Should be Avoided When Using Non-Disclosure Agreements?

1. Like all written agreements, avoid those terms and provisions which are unreasonable, unrealistic, or unfair.

2. With Non-Disclosure Agreements, there is nothing to avoid. Every employer needs to have them and use them.

3. Typical exclusions or omissions may include:

   a. Information which is generally available or known in the public.

b. Information legally obtained from other sources or third parties, and not the employer.

c. Information which the employee had knowledge of prior to employment.

F. What are the Problems With Non-Disclosure Agreements?

1. Non-Disclosure Agreements are not a guaranty or an absolute bar from the disclosure of confidential business information.

2. Non-Disclosure Agreements keep only honest people more honest. They will not keep dishonest employees from acting dishonestly.

3. Non-Disclosure Agreements should not be overly relied upon.

4. Non-Disclosure Agreements are "double-edged" and can run in both directions.

a. Employers must be very careful about hiring employees who may be subject to and bound by a Non-Disclosure Agreement.

b. Employers must carefully review and analyze all agreements which are signed by or bind prospective employees.

III. TRADE SECRETS

A. Uniform Trade Secrets Act ("UTSA").

1. Broader than Michigan trade secret law insofar as it covers programs, methods and techniques as well as employee know how.

2. UTSA applies to any wrongful misappropriation where Michigan law focuses on the deterrence of unethical business practice and conduct.

B. Michigan Law.

1. Up to 1985, Michigan trade secret law was developed in accordance with the State's covenant not to compete statute.

2. For information to be protected, it must be secret. Secrecy alone is not sufficient to establish a trade secret but without this element, a plaintiff may be unable to prevail.

3. In *Kubik, Inc. v Hull*, 56 Mich App 335 (1974) (a pre-Michigan Antitrust Reform Act case), the court determined the following factors to be relevant in evaluating a secrecy case:

   a. The existence or absence of an express agreement concerning disclosure

   b. The nature and extent of security precautions used to prevent disclosure to unauthorized third parties

   c. The circumstances surrounding disclosure to the employee so that the employee understood the significance of not disclosing to others

   d. The degree to which the information is in the public domain or readily ascertainable by or through patent applications or product marketing

C. Enforcement.

1. Seeking injunctive relief is frequently the remedy that an injured plaintiff attempts.

2. Much like covenant not to compete cases, a party may seek actual damages sustained as a result of the violation of the Michigan

Antitrust Reform Act, including interest from the date of the complaint, costs and reasonable attorney fees. MCL 445.778(2).

3. If the violation is "flagrant" a trier of fact may award damages up to three times the amount of actual damages sustained. Id.

D. Is there a criminal statute that defines trade secrets?

1. Yes. MCL 752.772 states:

> Any person who, with intent to deprive or withhold from the owner thereof the control of a trade secret, or with an intent to appropriate a trade secret to his own use or to the use of another, steals or embezzles an article representing a trade secret or without authority makes or causes to be made a copy of an article representing a trade secret, is guilty of a misdemeanor and shall be fined not more than $1,000.00 or imprisoned for not more than 1 year, or both.

2. Trade secret is defined as "the whole of any portion or phase of any scientific or technical information, design, process, procedure, formula or improvement which is secret and of value; and a trade secret is considered to be secret when the owner thereof takes measures to prevent it from becoming available to persons other than those selected by the owner to have access thereto for limited purposes."

IV. NEW HIRES AND OLD EMPLOYMENT AGREEMENTS

A. G – R – A – P – E – S

1. Get the employment agreement.

2. Review the employment agreement.

3. Affirm the employment agreement's restrictions with the employee if applicable.

4. Prevent data migration.

5. Explore negotiations with the former employer.

B. S – N – A – P

1. Study your employment agreement.

2. Notify the new employer of the employment agreement.

3. Acquire as much information as possible.

4. Prevent reliance by employee upon “deep pockets.”

AFFORABLE CARE ACT – REPORTING AND RECORDKEEPING REQUIREMENTS

By: Marc S. Wise

The IRS issued guidance and draft forms regarding the required reporting for the Affordable Care Act ("ACA"). Although the required filing is not due until early 2016, employers and their advisors will need to have systems in place to obtain the information necessary to make a good faith filing.

Code Section 6055 requires health insurance issuers and employers that sponsor self-insured health plans to report information concerning the type and period of coverage to the IRS and to the covered individuals. Section 6055 reporting is intended to serve as verification that the individual has minimum essential coverage ("MEC") for purposes of enforcing the ACA's individual responsibility requirements.

Code Section 6056 requires large employers to provide information to the Internal Revenue Service (IRS) about whether MEC is offered to their FTEs and their dependents. This information will be used by the IRS to determine whether an employer owes a shared responsibility payment under Code Section 4980H and whether an employee is eligible for a premium tax credit on a Marketplace Exchange.

I. REPORTING BY HEALTH COVERAGE PROVIDERS (SECTION 6055)

A. Basics of Provider Reporting

1. **What are the information reporting requirements for providers of health coverage?** The Affordable Care Act added section 6055 to the Internal Revenue Code, which provides that every provider of minimum essential coverage will report coverage information by filing an information return with the IRS and furnishing a statement to individuals. The information is used by the IRS to administer and

individuals to show compliance with the individual shared responsibility provision in Code section 5000A.

2. **When do the information reporting requirements go into effect?** The information reporting requirements are first effective for coverage provided in 2015. Thus, health coverage providers will file information returns with the IRS in 2016, and will furnish statements to individuals in 2016, to report coverage information in calendar year 2015.

   Employers that sponsor an HRA that provides minimum essential coverage that is not integrated with the employer's group health plan must also report that coverage to the covered individuals on the plan and to the IRS.

3. **Is relief available from penalties for incomplete or incorrect returns filed or statements furnished to employees in 2016 for coverage provided in calendar year 2015?** Yes. In implementing new information reporting requirements, short-term relief from reporting penalties frequently is provided. This relief generally allows additional time to develop appropriate procedures for collection of data and compliance with the new reporting requirements.

   Accordingly, the IRS will not impose penalties under Code sections 6721 and 6722 for 2015 returns and statements filed and furnished in 2016 on reporting entities that can show that they have made good faith efforts to comply with the information reporting requirements. Specifically, relief is provided from penalties under Code sections 6721 and 6722 for returns and statements filed and furnished in 2016 to report coverage in 2015 for incorrect or incomplete information reported on the return or statement.

B. **Who Is Required To Report**

1. **Who must report under Code section 6055?** Any person that provides minimum essential coverage to an individual must report to the IRS and furnish statements to individuals, including the following:

   a. Health insurance issuers, or carriers, for insured; and

   b. Plan sponsors of self-insured group health plan coverage; and

   c. The executive department or agency of a governmental unit that provides coverage under a government-sponsored program.

2. **What is minimum essential coverage?** In most situations that you may see, minimum essential coverage includes the following:

   a. Eligible employer-sponsored coverage, including self-insured plans, COBRA coverage and retiree coverage;

   b. Coverage purchased in the individual market, including a qualified health plan offered by the Health Insurance Marketplace;

   c. Medicare Part A coverage and Medicare Advantage plans;

   d. Children's Health Insurance Program (CHIP) coverage.

3. **What is eligible employer-sponsored coverage?** Eligible employer-sponsored coverage is:

   a. A self-insured group health plan under which coverage is offered by or on behalf of an employer to an employee, or

b. Group health insurance coverage offered by or on behalf of an employer to an employee that is:

   i. A governmental plan,

   ii. A plan or coverage offered in the small or large group market within a state, or

   iii. A grandfathered health plan offered in a group market.

Eligible employer-sponsored coverage includes COBRA coverage and retiree coverage.

4. **Is an employer required to report under Code section 6055 if it sponsors a health plan that provides coverage by purchasing insurance from a health insurance issuer?** No. An employer that sponsors an insured health plan (a health plan that provides coverage by purchasing insurance from a health insurance issuer) will not report as a provider of health coverage under Code section 6055. The health insurance issuer or carrier is responsible for reporting that health coverage.

   However, if the employer is subject to the employer shared responsibility provisions in Code section 4980H, it is responsible for reporting information under Code section 6056 about the coverage it offers to its full-time employees.

5. **How do the reporting requirements under Code section 6055 apply to reporting entities that are part of a controlled group?** Plan sponsors in a controlled group that is not an applicable large employer under Code section 4980H, and providers (such as issuers) that are not reporting as employers, may report under

Code section 6055 as separate entities, or may have one entity report for the controlled group.

6. **Must a health coverage provider report under Code section 6055 for arrangements that provide benefits in addition or as a supplement to an arrangement that is minimum essential coverage?** If the additional or supplemental benefits are not minimum essential coverage (for example, if they are excepted benefits like coverage at an on-site medical clinic), no reporting is required for the additional or supplemental benefits. In addition, no reporting is required under Code section 6055 for additional or supplemental benefits that are minimum essential coverage if the primary and supplemental coverages have the same plan sponsor or the coverage supplements government-sponsored coverage such as Medicare.

C. What Information Must Providers Report

1. **What information must a health coverage provider report to the IRS?** The information that a provider must report to the IRS includes the following:

   a. The name, address, and employer identification number (EIN) of the provider;

   b. The responsible individual's name, address, and TIN, or date of birth if a TIN is not available. If the responsible individual is not enrolled in the coverage, providers may, but are not required to, report the TIN of the responsible individual;

   c. The name and TIN, or date of birth if a TIN is not available, of each individual covered under the policy or program and the months for which the individual was enrolled in coverage and entitled to receive benefits; and

d. For coverage provided by a health insurance issuer through a group health plan, the name, address, and EIN of the employer sponsoring the plan and whether the coverage is a qualified health plan enrolled in through the SHOP and (except for 2014 coverage reported in 2015) the SHOP's identifier.

2. **Will a health coverage provider collect TINs from individuals, including dependents, covered under its plan or policy?** Yes. Reporting of TINs for all covered individuals is necessary for the IRS to verify an individual's coverage without the need to contact the individual.

If health coverage providers are unable to obtain a TIN after making a reasonable effort to do so, the covered individual's date of birth may be reported in lieu of a TIN

D. **How and When to Report the Required Information**

1. **When must a health coverage provider file the information return with the IRS?** A health coverage provider must file the information return and transmittal form with the IRS on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which it provided minimum essential coverage to an individual. Because Notice 2013-45 provides transition relief for Code section 6055 reporting for 2014, the first Code section 6055 returns required to be filed are for the 2015 calendar year and must be filed no later than February 29, 2016 (the 28th is a Sunday), or March 31, 2016, if filed electronically. Regulations under Code section 6081 address extensions of time to file information returns.

2. **What type of return must a health coverage provider file with the IRS?** Generally, a health coverage provider must file Form 1094-B and Form 1095-B (or other form that IRS designates, or a substitute form). However, if the provider is also an applicable large employer member as defined in the employer shared responsibility provisions under Code section 4980H and provides coverage to its employees through a self-insured group health plan, the provider must file Form 1094-C and Form 1095-C (or other form that IRS designates, or a substitute form), instead of Forms 1094-B and 1095-B, to report information with respect to its employees

3. **Must a health coverage provider file the return with the IRS electronically?** A health coverage provider that is required to file 250 or more Forms 1095-B or 250 or more Forms 1095-C during the calendar year must file the returns electronically. The 250 return threshold applies separately to each type of return required to be filed. Only Forms 1095-B or 1095-C are counted in applying the 250 return threshold for Code section 6055 reporting. However, if the 250 return threshold applies, Forms 1094-B and 1094-C also must be filed electronically. A provider that is required to file 250 or fewer Forms 1095-B or Forms 1095-C may file on paper or electronically.

4. **To whom must a health coverage provider furnish the statement?** A health coverage provider must furnish the statement to a responsible individual. The responsible individual generally is the person who enrolls one or more individuals, which may include him or herself, in minimum essential coverage. The responsible individual may be the primary insured, employee, former employee, uniformed services sponsor, parent, or other related person named on the coverage application.

5. **When must a health coverage provider furnish the statement to the responsible individual?** A health coverage provider must furnish the statement to the responsible individual on or before January 31 of the year following the calendar year in which minimum essential coverage is provided. If the provider applies to the IRS in writing and shows good cause, the IRS may grant an extension of time up to 30 days for the provider to furnish the statement.

6. **How must a health coverage provider furnish the statement to the responsible individual?** A health coverage provider generally must mail the statement to the responsible individual's last known permanent address or, if no permanent address is known, to the individual's temporary address. A provider's first class mailing to the last known permanent address, or if no permanent address is known, the temporary address, discharges the provider's requirement to furnish the statement.

   A health coverage provider also may furnish the statement electronically to the responsible individual if the responsible individual affirmatively consents to it.

7. **Does an employer that must file returns under Code section 6055 as a provider of self-insured health coverage to its employees and under Code section 6056 as an applicable large employer file combined information returns and statements?** Yes. An applicable large employer member, as defined in the employer shared responsibility provisions under Code section 4980H, that provides self-insured coverage is subject to the reporting requirements of both Code section 6055 and Code section 6056. To streamline and prevent duplication under each reporting requirement, applicable large employer members with

self-insured coverage will combine Code section 6055 and Code section 6056 reporting. An applicable large employer member with self-insured coverage will report on Form 1095-C, completing separate sections to report the information required under Code sections 6055 and 6056.

II. REPORTING OF OFFERS OF HEALTH INSURANCE COVERAGE BY EMPLOYERS (Code Section 6056)

Information reporting under Code section 6056 was voluntary for calendar year 2014. Reporting is first required in early 2016 with respect to calendar year 2015.

A. Basics of Employer Reporting

1. **What are the information reporting requirements for employers relating to offers of health insurance coverage under employer-sponsored plans?** The Affordable Care Act added section 6056 to the Internal Revenue Code ("Code"), which requires applicable large employers to file information returns with the IRS and provide statements to their full-time employees about the health insurance coverage the employer offered.

    a. Under the regulations implementing Code section 6056, an applicable large employer may be a single entity or may consist of a group of related entities (such as parent and subsidiary, brother-sister or other affiliated entities). In either case, these reporting requirements apply to each separate entity and each separate entity is referred to as an applicable large employer member (ALE member).

    b. The IRS will use the information provided on the information return to administer the employer shared responsibility provisions of Code section 4980H. The IRS and the

employees of an ALE member will use the information provided as part of the determination of whether an employee is eligible for the premium tax credit under Code section 36B.

c. ALE members that sponsor self-insured group health plans also are required to report information under Code section 6055 about the health coverage they provide. Those ALE members that sponsor self-insured group health plans file with the IRS and furnish to employees the information required under Code sections 6055 and 6056 on a single form. The IRS and individuals will use the information provided under Code section 6055 to administer or to show compliance with the individual shared responsibility provisions of Code section 5000A.

2. **When do the information reporting requirements go into effect?** The information reporting requirements under Code section 6056 are first effective for coverage offered (or not offered) in 2015. An ALE member must file information returns with the IRS and furnish statements to employees beginning in 2016, to report information about its offers of health coverage to its full-time employees for calendar year 2015.

3. **Is relief available from penalties for incomplete or incorrect returns filed or statements furnished to employees in 2016 for coverage offered (or not offered) in calendar year 2015?** Yes. In implementing new information reporting requirements, short-term relief from reporting penalties frequently is provided. This relief generally allows additional time to develop appropriate procedures for collection of data and compliance with the new reporting requirements. Accordingly, the IRS will not impose penalties under

Code sections 6721 and 6722 on ALE members that can show that they have made good faith efforts to comply with the information reporting requirements.

B. Who is Required to Report

1. **Who is required to report under Code section 6056?** Applicable large employers that are subject to the employer shared responsibility provisions under Code section 4980H are required to report under Code section 6056.

   An applicable large employer is an employer that employed an average of at least 50 full-time employees on business days during the preceding calendar year. A full-time employee generally includes any employee who was employed on average at least 30 hours of service per week and any full-time equivalents (for example, 40 full-time employees employed 30 or more hours per week on average plus 20 employees employed 15 hours per week on average are equivalent to 50 full-time employees).

   For purposes of the reporting requirements under Code section 6056, an ALE member is any person that is an applicable large employer or a member of an aggregated group (determined under Code section 414(b), 414(c), 414(m) or 414(o)) that is determined to be an applicable large employer.

2. **Are nonprofit and government entities required to report under Code section 6056?** Yes. Code section 6056 applies to all employers that are ALE members, regardless of whether the employer is a tax-exempt or government entity (including federal, state, local, and Indian tribal governments).

3. **If two or more related companies together are an applicable large employer under Code section 4980H, how do they**

comply with the information reporting requirements? For purposes of the information reporting requirements under Code section 6056, each ALE member must file an information return with the IRS and furnish a statement to its full-time employees, using its own EIN. All persons treated as a single employer under Code section 414(b), (c), (m), or (o) are treated as one employer for purposes of determining applicable large employer status under Code section 4980H. Under those rules, companies will be combined and treated as a single employer for purposes of determining whether or not the employer has at least 50 full-time employees (including full-time equivalents) and together will be an applicable large employer. Each of the companies that is combined is referred to as an ALE member.

When the combined total of full-time employees (including full-time equivalents) meets the threshold, each separate company or ALE member is subject to the employer shared responsibility provisions even if a particular company or companies individually do not employ enough employees to meet the 50-full-time-employee threshold.

For purposes of Code section 6056 reporting, government entities, churches, and a convention or association of churches should use the same interpretation of Code section 414(b), (c), (m) and (o) as that used for purposes of Code section 4980H in determining whether a person or group of persons is an applicable large employer and whether a particular entity is an ALE member.

4. **Who is not required to report under Code section 6056?** Employers that are not subject to the employer shared responsibility provisions of Code section 4980H are not required to report under Code section 6056. Thus, employers that employed

fewer than 50 full-time employees (including full-time equivalents) during the prior year are not subject to the reporting requirements.

However, any employer that sponsors a self-insured health plan is required to report under Code section 6056, even if the employer has fewer than 50 full-time employees.

C. **Methods of Reporting**

1. **Are different methods available to ALE members for reporting required information to the IRS and furnishing statements to employees?** Yes. The regulations provide a general method that all ALE members may use for reporting to the IRS and for furnishing statements to full-time employees, and also provide alternative reporting methods for eligible ALE members. If an ALE member cannot use the alternative reporting methods for certain employees, the ALE member must use the general method for those employees. In any case, the alternative reporting methods are optional so that an employer may choose to report for all of its full-time employees using the general method even if an alternative reporting method is available.

   In an effort to simplify the Code section 6056 reporting process, certain information required to be reported to the IRS and furnished to full-time employees may be reported through the use of indicator codes rather than by providing more detailed information.

2. **What is the general method of reporting?** The regulations provide that, as a general method, each ALE member may satisfy the requirement to file a Code section 6056 return by filing a Form 1094-C (transmittal) and, for each full-time employee, a Form 1095-C (employee statement), or other forms the IRS may designate. An ALE member that maintains a self-insured plan also uses a Form

1095-C to satisfy the reporting requirements under Code section 6055. The Form 1095-C will have separate Code sections to allow ALE members that sponsor self-insured group health plans to combine reporting to satisfy both the Code section 6055 reporting requirements and the Code section 6056 reporting requirements, as applicable, on a single return.

Under the general method, the Code section 6056 return (and, if the employer maintains a self-insured plan, the Code section 6055 return) also may be made by filing a substitute form but the substitute form must include all of the information required on Forms 1094-C and 1095-C or any other forms the IRS designates and satisfy all form and content requirements as specified by the IRS.

3. **What are the alternative methods of reporting?** The regulations contain two alternative methods of reporting under Code section 6056 that were developed to minimize the cost and administrative tasks for employers, consistent with the statutory requirements to file an information return with the IRS and furnish an employee statement to each full-time employee. The alternative reporting methods, in certain situations, may permit employers to provide less detailed information than under the general method for reporting. These simplified alternative reporting methods and the conditions for using them are described in detail in subsections A through D of the preamble to the Code section 6056 regulations. The alternative reporting methods are:

   a. Reporting Based on Certification of Qualifying Offers

   b. Option to Report Without Separate Identification of Full-Time Employees if Certain Conditions Related to Offers of Coverage Are Satisfied (98 Percent Offers)

The information provided to the IRS and the employee pursuant to Code section 6056 is important for administering Code section 4980H and the premium tax credit. However, in some circumstances, only some of the information required under the general method is necessary.

4. **For the methods of reporting, including reporting facilitated by a third party, may an ALE member file more than one Form 1094-C?** Yes. A separate Code section 6056 transmittal (Form 1094-C) must be filed with any Forms 1095-C filed by each ALE member. If more than one Code section 6056 transmittal is being filed for an ALE member, one of those transmittals must be a Code section 6056 authoritative transmittal reporting aggregate employer-level data for all full-time employees of the ALE member, in accordance with forms and instructions.

5. **May an ALE member satisfy its reporting requirements for an employee by filing and furnishing more than one employee statement that together provide the necessary information?** No. There must be only one Code section 6056 employee statement (Form 1095-C) for each full-time employee with respect to that full-time employee's employment with the ALE member, so that all information for a particular full-time employee of the ALE member is reflected on a single Form 1095-C.

D. **What Information Must ALE Members Report**

1. **What information must an ALE member report to the IRS to satisfy Code section 6056?** The regulations provide, under the general method of reporting, that an ALE member must file a separate Form 1095-C (or other form the IRS designates, or a substitute form) for each of its full-time employees, and a transmittal on Form 1094-C (or any other form the IRS designates,

or a substitute form) for all of the returns filed for a given calendar year.

2. **What information must an ALE member furnish to its full-time employees to satisfy Code section 6056?** The regulations provide that under the general method, an ALE member generally must furnish to each full-time employee a written statement showing:

    a. The name, address, and EIN of the ALE member;

    b. The information required to be shown on the Code section 6056 return with respect to the full-time employee (and his or her spouse and dependents).

3. **May an employer combine reporting under Code sections 6055 and 6056?** The regulations under Code sections 6055 and 6056 provide for combined reporting for employers that are subject to both reporting provisions (generally ALE members that sponsor self-insured group health plans). To allow these employers to satisfy both the Code section 6055 and 6056 reporting requirements on a single return Form 1095-C will have separate Code sections for reporting under Code section 6055 and for reporting under Code section 6056.

E. **How and When to Report the Required Information**

1. **When must an ALE member file the required information return with the IRS?** ALE members must file the return for each employee (Form 1095-C or another form that IRS designates, or a substitute form) and a transmittal form (Form 1094-C or another form that IRS designates, or a substitute form) with the IRS on or before February 28 (March 31 if filed electronically) of the year immediately following the calendar year for which the offer of

coverage information is reported. Because transition relief applies for Code section 6056 reporting for 2014 (see Notice 2013-45), the first Code section 6056 returns required to be filed are for the 2015 calendar year and must be filed no later than February 29, 2016 (the 28th is a Sunday), or March 31, 2016, if filed electronically.

2. **When must an ALE member furnish the statements to full-time employees?** ALE members must furnish the statement to each full-time employee on or before January 31 of the year immediately following the calendar year to which the information relates. This means that the first Code section 6056 employee statements (the statements for 2015) must be furnished to employees no later than February 1, 2016 (January 31, 2016 is a Sunday).

3. **Must an ALE member file the return with the IRS electronically?** The regulations require electronic filing with the IRS of Code section 6056 information returns except for an ALE member filing fewer than 250 Code section 6056 returns (employee statements) during the calendar year. Each Code section 6056 return for each full-time employee is counted as a separate return, and only Code section 6056 returns are counted in applying the 250-return threshold for Code section 6056 reporting.

4. **Must an ALE member furnish the employee statements to full-time employees electronically?** The regulations permit, but do not require, employers to furnish electronically the Code section 6056 employee statements to full-time employees if notice, consent, and hardware and software requirements modeled after existing rules are met. The regulations require that with respect to each full-time employee to whom the information is furnished, the ALE member must obtain consent from the employee before the

Code section 6056 employee statement may be furnished electronically.

5. **Are ALE members required to report information with respect to a full-time employee who is not offered coverage during the year?** Yes. An ALE member is required to report information about the health coverage, if any, offered to its full-time employees, including whether an offer of health coverage was (or was not) made. This requirement applies to all ALE members, regardless of whether they offered health coverage to all, none, or some of their full-time employees. For each of its full-time employees, whether health coverage was or was not offered to the employee, the ALE member is required to file a return with the IRS and furnish a statement to the employee reporting on whether an offer of health coverage was or was not made to the employee, and, if an offer was made, reporting the required information about the offer. Therefore, even if an ALE member does not offer coverage to any of its full-time employees, it must file returns with the IRS and furnish statements to each of its full-time employees to report information specifying that coverage was not offered.

III. INFORMATION EMPLOYERS MUST MAINTAIN AND DRAFT IRS FORMS

A. **General Information.** The IRS has issued draft forms that must be filed in early 2016 relating to the health care benefits provided in 2015.

1. Employers with under 50 FTEs and Fully Insured Health Plan.

   a. The insurance company is required to file a Form 1094-B and a Form 1095-B with the IRS.

   b. Form 1094-B - Transmittal of Health Coverage Information Returns.

c. Form 1095-B – Health Coverage (for each individual).

2. Employers with 50 or more FTEs.

   a. Form 1094-C – Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns.

   b. Form 1095-C – Employer-Provided Health Insurance Offer and Coverage (for each individual).

3. Employers with 50 or more FTEs use Forms 1094-C and 1095-C to report the information required under Code Sections 6055 and 6056.

   a. Form 1094-C is used to report to the IRS summary information for the employer and to transmit the Forms 1095-C to the IRS.

   b. Form 1095-C is used to report information about each applicable employee.

4. A large employer subject to the employer shared responsibility provisions under Code Section 4980H must file one or more Form(s) 1094-C and must file a Form 1095-C (or substitute) for each employee who was an FTE of the employer (and for each other employee who has MEC through the employer's plan, even if not an FTE) for any calendar month during the year.

   a. Each employer member of the controlled group with employees must separately file.

   b. If an employer provides coverage through an insured plan, part of Form 1095-C will be left blank. The insurance company will separately report on MEC for those individuals enrolled in fully insured plan options.

The IRS has released draft forms and instructions to be used for Section 6055 and 6056 reporting.

B. **When to File.** Forms 1094-C and 1095-C for the 2015 year (with 2015 data) must be filed by February 29, 2016 (if paper filing) and by March 31, 2016 (if filing electronically). For calendar year 2015, Form 1095-C must be furnished to employees by February 1, 2016. Employers filing 250 or more Forms 1095-C must file electronically.

C. **Simplified Safe Harbor Offer Methods.** The IRS has provided a simplified reporting method for large employers that make qualifying offers of coverage to FTEs, their spouse and their dependents for all 12 calendar months of the reporting year. A simplified alternative that allows the employer to report without identifying or specifying the number of FTEs is also available for employers that offered ("qualifying offer"), for all 12 months of the calendar year, affordable health coverage (under IRS safe harbors), providing minimum value to at least 98 percent of its employees and dependents for whom it is filing a Form 1095-C.

D. **2015 Special Rule**. During 2015 only, an organization makes a "qualifying offer" to at least 95 percent of its full-time employees and their spouse and dependents, then it can furnish a statement in lieu of the general reporting form. As with the qualifying offer requirement above and pending further clarification in the instructions, the employer may only have to report the employee's name, Social Security number, address, and using an indicator code report whether a qualifying offer was made for all 12 months of the year.

If you use this 2015 method, the simplified report can be sent to employees who did not receive a qualifying offer for all 12 months of the year. But after 2015, employees who do not receive a qualifying offer during all 12 months will have to receive the general report instead of the simplified report.

E. **Simplified reporting for employers offering coverage to 98 percent of full-time workers.** Under this method, employers need not identify on the reporting form whether a particular employee is a full-time employee nor report the total number of its full-time employees for the reporting year. To be eligible to use this method, the employer must certify on its transmittal form that it offered minimum essential coverage that also meets the minimum value requirement and is affordable to at least 98 percent of the employees who are included in the section 6056 returns, which must include at least all full-time employees, but it could also include part-time employees who are offered coverage. Coverage is "affordable" if the cost of employee-only coverage satisfies any of the affordability safe harbors in the final employer responsibility regulations.

Whether the employer uses a simplified method or the general method of reporting, the reporting must include all employees who were full-time at least one month of the year in the reporting. If the employer fails to include all full-time employees in the reporting, the employer may be subject to the same kind of penalties that apply for failure to provide a W-2, generally $100 per missing report.

F. **Form 1095-C Review – Information Needed – Fully Insured Plans.**

1. **Who Must File.**

a. **Employees Working in 2 or More Divisions.** For each full-time employee of an employer, there must be only one Form 1095-C for employment with that employer. For example, if an employer separately reports for the full-time employees of its two divisions, the employer must combine the information for any employee who worked at both divisions during the calendar year so that there is only a single Form 1095-C for that employee which reports information for all twelve months of the calendar year.

b. **Employees Working for 2 or More Members of the Controlled Group.** In contrast, a full-time employee who works for more than one employer that is a member of the same Aggregated ALE Group (that is, works for two separate ALE Members) must receive a separate Form 1095-C from each employer.

c. **Large Employers Only.** An employer subject to the employer shared responsibility provisions under Code section 4980H must file one or more Forms 1094-C (including an Authoritative Transmittal, whether or not filing multiple Forms 1094-C), and must file a Form 1095-C (or a substitute form) for each employee who was a full-time employee of the employer for any month of the calendar year.

d. **Aggregated Employers.** Each employer has its own reporting obligation related to the health coverage the employer offered (or did not offer) to each of its full-time employees. An employer subject to the employer shared responsibility provisions under section 4980H generally refers to an employer with 50 or more full-time employees (including full-time equivalent employees) during the prior calendar year.

G. **Note Regarding Self-Insured Plans.**

1. An employer that provides health coverage through an employer-sponsored self-insured health plan must also complete Form 1095-C, Part III, for any individual (including any full-time employee, non-full-time employee, employee family members, and others) who enrolled in the self-insured health plan. If an employer offers health coverage through a health plan, and some of the enrollment options

under the plan are employer-sponsored self-insured health arrangements while others are not (for example, some of the enrollment options are insured arrangements), the employer must only complete Form 1095-C, Part III, for the employees who enrolled in the self-insured enrollment option(s) under the plan.

2. A separate Form 1095-C must be filed for each employee for whom information is required. Part I of the draft version of the Form 1094-C requires identifying information for the employee and applicable large-employer member. According to the draft instructions, an applicable large-employer member must furnish a separate Form 1095-C to each of its full-time employees and, if the employer's plan is self-insured, to each employee (whether or not full-time) who enrolls in employer-sponsored coverage. Although the form is filed annually, most of the information must be reported separately for each calendar month, unless an exception applies.

3. To satisfy Code section 6056, Part II requires information for each calendar month regarding the type of coverage offered. The form and instructions rely heavily on the use of indicator codes to describe the coverage offered by an applicable large-employer member (for example, whether coverage was offered to the employee's spouse and dependents and whether it provided minimum value) and to ascertain the employer's potential Code section 4980H liability with respect to the offered coverage (for example, whether the employee was in a limited non-assessment period and whether the employer relied on an affordability safe harbor). Applicable large-employer members must also report the employee's share of the lowest-cost monthly premium for minimum value self-only coverage (by month). To satisfy Code section 6055, Part III is to be used only by applicable large-employer members

providing self-insured coverage to report information for all covered individuals by month.

4. Employers should note that all information for employment with a single applicable large-employer member must be included on a single Form 1095-C. For example, if an applicable large-employer member separately reports for the full-time employees of its two divisions, the employer must combine the information for any employee who worked at both divisions during the calendar year so that there is only a single Form 1095-C for that employee which reports information for all 12 months of the calendar year. In contrast, a full-time employee who works for more than one applicable large-employer member that is a member of the same aggregated ALE group (that is, works for two separate applicable large-employer members) must receive a separate Form 1095-C from each employer.

IV. W-2 REPORTING REQUIREMENTS FOR EMPLOYER-PROVIDED HEALTH COVERAGE

The Affordable Care Act requires employers to report the cost of coverage under an employer-sponsored group health plan. To allow employers more time to update their payroll systems, Notice 2010-69 made this requirement optional for all employers in 2011. IRS Notice 2011-28 provided further relief by making this requirement optional for certain smaller employers for 2012 Forms W-2 (meaning the Forms W-2 for calendar year 2012 generally furnished to employees in 2013). Notice 2012-9, issued in January 2012, restates and clarifies guidance in Notice 2011-28.

A. **Does the cost of an employee's health care benefits shown on the Form W-2 mean that the benefits are taxable to the employee?** No. There is nothing about the reporting requirement that causes or will cause excludable employer-provided health coverage to become taxable.

B. **When will employers have to start reporting the cost of health care coverage on the Form W-2?** Reporting for the 2011 calendar year (meaning the Form W-2 generally required to be furnished to employees in January 2012) was optional. For the 2012 calendar year and for future years, employers generally are required to report the cost of health benefits provided on the Form W-2. Special transitional rules are available.

C. **Which employers are subject to this reporting requirement?** Except as provided below, all employers that provide "applicable employer-sponsored coverage" under a group health plan are subject to the reporting requirement. This includes federal, state and local government entities.

Churches, religious organizations, and certain other employers, to the extent they provide group health benefits under a self-insured plan, are not subject to the COBRA continuation coverage requirements, are not subject to this W-2 reporting requirement.

Third-party sick-pay providers that provide the Forms W-2 to the employees of the employers with which they have contracted do not have to report the cost of coverage. However, a Form W-2 provided by the employer to the employee must report the cost of coverage regardless of whether that Form W-2 includes sick pay or whether a third-party sick pay provider is furnishing a separate Form W-2 reporting the sick pay.

D. **What transition relief is the IRS currently providing?** Certain employers and certain types of coverage listed below will not have to provide the requested information at this time. The IRS has stated that the reporting for these types of employers and benefits will not apply for future calendar years until the IRS publishes guidance giving at least six months of advance notice of any change to the transition relief.

The transition relief applies to the following:

1. Employers filing fewer than 250 Forms W-2 for the previous calendar year (for example, employers filing fewer than 250 2014 Forms W-2 (meaning Forms W-2 for the calendar year 2014, which generally are filed with the SSA in early 2015) will not be required to report the cost of coverage on the 2014 Forms W-2.

   For purposes of this relief, the number of Forms W-2 the employer files includes any forms it files itself and any filed on its behalf by an agent under Code section 3504.

In addition, for purposes of this relief, the employer is determined without the application of any aggregation rules;

2. Multi-employer plans;

3. Health Reimbursement Arrangements;

4. Dental and vision plans that either:

   a. are not integrated into another group health plan; or

   b. give participants the choice of declining the coverage or electing it and paying an additional premium (excepted benefits);

5. Self-insured plans of employers not subject to COBRA continuation coverage or similar requirements;

6. Employee assistance programs, on-site medical clinics, or wellness programs for which the employer does not charge a premium under COBRA continuation coverage or similar requirements; and

7. Employers furnishing Forms W-2 to employees who terminate before the end of a calendar year and request a Form W-2 before the end of that year.

E. **What amount should the employer report on the Form W-2 for health coverage? The amount the employer paid? The amount the employee paid? Or both?** In general, the amount reported should include both the portion paid by the employer and the portion paid by the employee. In the case of a health FSA, the amount reported should not include the amount of any salary reduction contributions.

F. **Where on the Form W-2 should the employer report the cost of these health care benefits?** The cost of these health care benefits will be reported in box 12 of the Form W-2, with Code DD to identify the amount.

G. **What amount of health benefits should be reported on the Form W-2 for employees that terminated employment during the year and had employer-provided coverage both before and after termination?** Under the interim rules, the employer may use any reasonable method for inclusion of the coverage provided after termination, so long as that method is applied consistently. See Notice 2012-9, Q&A-6, for examples.

H. **What amount of health benefits should be reported on the Form W-2 for an employee that leaves during the year and requests a W-2 before the end of the year?** If an employee makes such a request in writing, the employer must provide the W-2 within 30 days. However, under the interim rules, the employer will not be required to report any amount of health benefits in box 12, Code DD.

I. **Will employers be required to issue a Form W-2 to retirees or other former employees to whom the employer would not otherwise issue a Form W-2?** No.

J. **We are a business that issued 150 W-2s in 2014; our wholly owned subsidiary, B Corp, issued 200 W-2s in 2014. Is our business covered by transition relief from the requirement to report the value of coverage on the 2014 Forms W-2 because neither business filed**

more than 250 W-2s? In other words, do the Code section 414 controlled group rules apply such that we are considered one employer and not eligible for the transition relief? Transition relief from the requirement to report the value of coverage on the 2014 Form W-2 is available to the parent company and its subsidiaries because each filed fewer than 250 Forms W-2 for the preceding calendar year. For purposes of applying this relief, the W-2 count is determined without application of any entity aggregation rules for related employers.

K. **Calculation Period.** The reported cost is based on the calendar year. Employers with fiscal year health plans will need to take into consideration the premium cost changes occurring during the calendar year. In addition, the changes in benefits (buy-up to a better health plan or the addition or subtraction of dependents) occurring during the calendar year will also need to be reflected.

V. WHAT INFORMATION EMPLOYERS MUST MAINTAIN ON ITS EMPLOYEES.

Although IRS reporting will not be required until the first quarter of 2016, employers will need to determine how it will comply with the future requirements.

A. Tracking hours will be mandatory for employers with many variable hour employees, either for assessing who must be offered coverage and/or the affordability of the coverage. In addition, the information may be necessary for the IRS Form 1095-C.

B. As to regular full-time employees if they are otherwise eligible for the employer-sponsored health program.

C. If the decision is made not to track hours and, the filing of the Form 1095 triggers an assessment of a Code Section 4980H(b) penalty (the $3,000 penalty per employee who receives subsidized exchange coverage) because coverage was not affordable for a certain employee, the employer will have to defend itself against the imposition of the penalty by

proving that the employee in question was not "full-time". Thus, the employer will need to retroactively recreate the records and track hours for that employee in order to defend against a claim that the employee was "full-time."

D. Tracking systems should be instituted in 2015 in order to comply with these requirements in order to properly file the necessary forms in the first quarter of 2016.

E. Large employer status for 2015 is determined based on the employee census for 2014.

VI. WHAT INFORMATION MUST BE DISCLOSED TO THE EMPLOYEE?

A. **IRS Form 1095-B and C.**

1. Filers of Form 1095-B and Form 1095-C must furnish a copy of any form filed to the person identified as the "responsible individual/employee" on the form. The Form must be furnished on or before January 31st of the year following the calendar year the coverage is provided. Thus, the first distribution will occur by January 31, 2016 (Actually, February 1st since January 31, 2016 is a Sunday).

2. The draft IRS instructions provide that the copy must be furnished on paper by mail, unless the recipient affirmatively consents to receive the statement in an electronic format. Employers that want to avoid mailing the forms will have to obtain affirmative consent from its employees to distribute the forms electronically.

B. **W-2 Reporting.**

1. Employers with 250 or more Forms W-2 must report the aggregate cost of employer-sponsored coverage on an employee's Form W-2. To comply with this requirement, employers must:

a. Determine the applicable employer-sponsored coverage that is provided to each employee;

b. Calculate the aggregate cost of such coverage for each employee; and

c. Report that cost on each employee's Form W-2.

C. **ERISA Summary Plan Description**

1. ERISA health and welfare benefit plans (other than governmental plans and church plans) must distribute an SPD to each participant covered under the plan.

2. 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.

3. 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.

4. Among the many required disclosures are the following:

a. 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 90 days) before a participant is eligible to participate, the ACA measurement and stability periods, and the class or classes of eligible participants (such as all full-time, salaried employees).

b. 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.

c. Plan benefits and exclusions;

d. 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;

e. In addition, SPDs must include the following:

f. 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.

g. 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

h. a summary of any plan provisions governing the allocation and disposition of assets of the plan upon termination as well as any ongoing dividends or premium rebates received.

i. 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.

j. 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.

k. 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).

l. ERISA Rights — All SPDs must include the statement of ERISA rights.

m. Health Insurance Company Booklets do not generally comply with the ERISA SPD requirements.

MARRIED COUPLES AND JOINT TRUSTS: HAS PORTABILITY OBVIATED THE NEED FOR SEPARATE TRUSTS?

By: Geoffrey N. Taylor

I. PLANNING LANDSCAPE

A. Prior to the introduction of estate tax portability, if a married couple had or were likely to have a combined net worth in excess of the amount of the exemption from federal estate tax, practitioners typically prepared separate, revocable trusts for them. The trust of the first spouse to die would divide the trust assets between a "family" or "credit shelter" trust, funded with an amount equal to the deceased spouse's remaining exemption from estate tax, and a "marital" trust, funded with the remaining trust assets, if any. The surviving spouse generally was provided as much access to and control over the family trust as possible without having the family trust assets included in the surviving spouse's taxable estate. Sometimes called "A/B Trust" planning, this approach helped insure full utilization of each spouse's estate tax exemption.

For example, if the estate tax exemption was $1 million, the estate tax rate was 50%, and a couple had a combined worth of $2 million, each spouse would create and fund a separate trust with $1 million. Upon the death of the first spouse, the deceased spouse's estate tax exemption was fully utilized by allocating the entire $1 million to the family trust. The surviving spouse benefits from the family trust but in a manner that avoids inclusion of the family trust assets in the surviving spouse's estate. The surviving spouse's exemption would offset the other $1 million leaving the entire $2 million to their beneficiaries free of estate tax. Conversely, under an "I love you" estate plan whereby everything passes outright to the surviving

spouse, the exemption of the first spouse to die is wasted, the surviving spouse is taxed on the entire $2 million, and $500,000 of estate tax (50% times excess of $2 million over surviving spouse's $1 million exemption) was needlessly incurred.

For this reason, most practitioners used joint trusts only when the combined wealth of both spouses was clearly less than the estate tax exemption.

B. Portability. In January 2013 estate tax exemption "portability" was made permanent. With portability, any unused estate tax exemption of the first spouse to die can be carried over to and used by the surviving spouse for gift and estate tax purposes.

C. Larger Future Application, Maybe. With the greatly increased $5 million federal estate tax exclusion (adjusted for inflation), more and more married couples do not need tax-oriented estate planning. They can leave everything to the surviving spouse without fear of incurring estate tax at the survivor's death, thanks to portability. In short, they can use a single, joint trust. The adoption of portability and the $5 million exclusion means most married couples no longer need estate tax planning and therefore are candidates for a joint trust.

D. Basic Provisions.

1. During the lifetimes of both grantors the joint trust is revocable and amendable. Generally, both must agree to amend and revoke the trust. Both grantors benefit from the entire trust.

2. After the death of the first grantor to die, the surviving grantor is generally entitled to benefit from all the trust assets and can amend or revoke the trust.

3. In its basic form, the joint trust really is the trust version of the simple will that leaves everything to the surviving spouse, and if there is no surviving spouse, then all goes to the children.

II. WHEN AND WHEN NOT TO USE

A. Psychology. Most couples own assets jointly and find comfort knowing each spouse has the right to use and benefit from the jointly-held assets both during their lives and after the death of the first spouse to die. Similarly, the assets of a joint trust are commingled and separate shares are not created. This is not the case with separate trusts, where the spouses are advised to separate their assets when funding. Therefore, couples often prefer joint trusts.

B. Stability of Marriage. Typically, assets in a joint trust are accessible by one spouse alone. Also, the first spouse to die generally has a testamentary general power of appointment. Such a power could be used to disinherit beneficiaries, including the surviving spouse (subject, however, to the survivor's elective share rights). As such, the spouses must have absolute faith in each other and a joint trust should not be used if the marriage is troubled.

C. Unblended Family. For couples whose only children are from their relationship, a joint trust can be a good planning technique. It is generally not a good planning option when the couple has children from a previous marriage or relationship because of the flexibility and control granted to the surviving spouse on the first death. In extreme cases, this control may result in the spouse disinheriting a child from a previous marriage or relationship.

D. Existence of Separate Property. If a spouse has or may receive significant separate, non-marital property, using a joint trust may result in the conversion of the property from separate to marital. In this case

a preferred approach may be to have separate trusts for separate property and a joint trust for the marital property.

E. Ensure Ultimate Disposition. Sometimes spouses want assurance that the remainder beneficiaries' interests are protected during the lifetime of the surviving spouse. In this case the trust agreement should become irrevocable upon the death of the first spouse to die and, perhaps, the surviving spouse can be given a limited testamentary power of appointment exercisable in favor of the spouses' intended beneficiaries.

F. No Asset Protection. Assets spouses own jointly as tenants by the entireties are protected from creditors during their joint lifetimes. If both spouses are alive and the judgment is against only one spouse, a lien, other than a federal tax lien, does not attach to entireties property and the property is exempt from execution. If spouses fund a joint trust with entireties property, this asset protection is lost. Many clients may wish to create a joint trust and fund it with assets that cannot be held as entireties property, such as checking accounts and other forms of personal property. The clients would keep entireties property in joint name with the spouse for purposes of asset protection.

G. Stock in Professional Corporation. Michigan law prohibits the sale or transfer of stock in a professional corporation except to eligible licensed persons, which may include the personal representative or estate of a deceased or legally incompetent licensed shareholder or a trust if the trustee and current income beneficiary is a licensed person. There is no specific guidance regarding whether the stock can be transferred to a joint trust where one spouse is licensed and the other is not. However, the transfer arguably should not present a problem if the trust agreement prohibits a nonlicensed trustee from participating in decisions regarding the provision of professional services by the

professional corporation. An estate may only own the stock for a reasonable period and may not participate in professional services decisions. There are no similar provisions regarding ownership by a trust after the licensed grantor/trustee dies, although logic suggests the successor trustee would have the same power to dispose of the stock as the personal representative of the estate.

III. GIFT, ESTATE, GENERATION SKIPPING TRANSFER TAX AND INCOME ISSUES

A. There are significant tax issues presented by the terms and administration of joint trusts. Many of these potential pitfalls have not yet received IRS attention, so unfortunately there are not many definitive cases or rulings to provide guidelines. Estate planners therefore cannot guarantee to their clients that the intended tax results will be achieved.

B. The following summarizes some of the gift, estate, and generation skipping transfer tax issues for joint trusts:

1. Gift on Funding. Transfers of assets to the trust (i.e., funding) may be taxable gifts which may not qualify for the gift tax marital deduction.

a. To the extent that property contributed to a joint trust by the spouses is unequal in value, a taxable gift may be considered to have occurred. Even if the value of the property contributed by each spouse is equal, the spouse with the shorter life expectancy may be considered to have made a gift to the spouse with the longer life expectancy because the actuarial value of the second spouse's interest in the trust is larger.

b. The spouses' retained right to revoke the trust does not necessarily make a gift incomplete because a donor is not considered to have retained a right to revoke if that right is exercisable jointly with, or only with the consent of, a person who has a substantial adverse interest (i.e., someone who has an economic interest in not agreeing to revoke the trust).

c. Further, if a gift is considered to have been made by one spouse to the other on the creation and funding of a joint trust, that gift might not qualify for the gift tax marital deduction because (1) the interest is terminable because the donor-spouse will receive an interest in the property if the donor-spouse survives the donee-spouse, and (2) the interest does not qualify as a qualified terminable interest because the trustees are authorized to distribute trust principal to the donor-spouse during the donee-spouse's lifetime (i.e., the gift does not meet the "QTIP" requirements).

d. To avoid the immediate gift on funding the joint trust problem, the trust provisions can give each spouse the power to withdraw from the trust any property which the spouse contributed to the trust, or property into which the original contribution has been converted, without the consent of the other spouse. This power should prevent the completion of potential gifts. Careful records of contributions and what new investments were made with the proceeds of sale of any of the original trust property must be maintained for this unlimited withdrawal power to succeed in rendering a potential gift incomplete.

e. Another way to avoid a chance that a complete gift occurred on funding the trust is giving each spouse the right to revoke the trust without the consent of the other spouse. This may cause problems if the marriage falters after the joint trust has been created and funded.

f. A third way to avoid a gift tax problem is to give each spouse a general power of appointment over all trust assets and/or the right to withdraw all trust principal without the consent of the other spouse.

2. Gift on Distribution During Grantors' Lifetimes. Assuming the gift on funding is incomplete for one or more of the reasons stated above. In this case a distribution during the grantors' lifetimes will result in a completed gift from the nonrecipient spouse to the recipient spouse to the extent the property received was not contributed by the recipient spouse. However, the gift should qualify for the marital deduction

3. Inclusion in Taxable Estate on Death of First Spouse to Die. At the death of the first spouse, it is unclear whether one-half of the value of the trust is included in his estate or the entire trust is included. There are different approaches the IRS can take in determining how much of the trust is includable in the estate of the first spouse to die.

a. The IRS can include just those assets (including the proceeds therefrom) contributed to the trust by the deceased spouse.

b. The IRS can treat a joint trust as similar to a qualified joint interest, in which case only one-half the value of the

trust would be included in the estate of the first spouse to die.

c. The IRS can assume the trust assets were commingled during its administration so that it is not possible to trace which assets had originally been contributed by the surviving spouse. In this case, the IRS would include the entire value of the trust in the estate of the first spouse to die.

Whatever approach the IRS takes, the amount included in the deceased spouse's estate should qualify for the marital deduction provided the surviving spouse can withdraw all trust principal and/or revoke the trust.

C. Generation Skipping Transfer Tax. A joint trust is not an appropriate vehicle in (rare) instances where both spouses need or want to use all or substantially all of their exemptions from generation skipping transfer tax because portability does not apply to generation skipping transfer tax.

D. Income Tax. The trust will be taxed as a grantor trust for federal income tax purposes during the spouses' joint lifetimes and during the life of the surviving spouse provided the surviving spouse can revoke the trust. The main income tax issue for joint trusts is basis of the trust assets after the death of the surviving spouse.

1. Code Section 1014(a) provides that the basis of property in the hands of a person acquiring the property from a decedent is the fair market value of the property at the date of the decedent's death (or alternate valuation date). The "step-up" in basis is disallowed, however, if appreciated property is acquired by the decedent by gift during the one-year period before the

decedent's death and the property is acquired from the decedent by, or passes from the decedent to, the donor of such property. Under such scenario, the basis is the adjusted basis of the property in the hands of the decedent immediately before the death of the decedent.

2. When the joint trust gives the predeceasing spouse a testamentary general power of appointment, the surviving spouse is deemed to make a gift of all assets to the predeceasing spouse immediately before the death of the predeceasing spouse. Therefore, only the assets contributed by the predeceasing spouse to the joint trust are eligible for a basis step-up. This is because the surviving spouse's contribution of assets do not constitute a completed gift occurring at least one year prior to the date of the predeceasing spouse's death. Although the IRS private letter rulings on point specifically do not address the issue of asset tracing, as a practical matter, to ensure proper step-up in basis of the assets of the predeceasing spouse, it is imperative that the origin of the assets to the joint trust on funding be ascertainable. Ideally, each grantor should contribute 50% of each of the assets to the joint trust. Otherwise, tracing the origins of the assets could be administratively burdensome to ensure that the maximum amount of step-up in basis is achieved on the death of the predeceasing spouse.

3. Although some commentators have dismissed the utility of the joint revocable trust based on the disallowance of a full step-up in basis for all of the trust assets, as occurs in community property jurisdictions, the grantors are in no worse position for having contributed the assets to a joint revocable trust as opposed to a traditional trust because the permissible step-up

in basis is limited to assets deemed to be held in the individual's sole name.

ROUNDUP OF RECENT TAX DEVELOPMENTS

By: William E. Sigler

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I. FEDERAL

A. 2014 Inflation Adjustments. The IRS on October 31, 2013, announced inflation adjustments to more than 40 tax benefits for tax year 2014, as well as tax rate schedules and other changes.

- The 39.6 percent marginal tax rate will affect single filers with annual income exceeding $406,750 ($457,600 for married couples filing jointly), up from $400,000 and $450,000, respectively, in tax year 2013. Changes to the other marginal tax brackets -- 10 percent, 15 percent, 25 percent, 28 percent, 33 percent, and 35 percent -- are detailed in the release (Rev. Proc. 2013-35; 2013-47 IRB 1).

- The standard deduction for singles and married couples filing separately in tax year 2014 will rise to $6,200 (from $6,100 in tax year 2013), and to $12,400 for married couples filing jointly (from $12,200 a year ago). The standard deduction for heads of household will rise to $9,100 from $8,950.

- The limit on itemized deductions claimed on tax year 2014 returns begins with incomes of $254,200 for singles and $302,050 for married couples filing jointly.

- The personal exemption will rise to $3,950, from $3,900 in 2013. However, the exemption will begin phasing out at adjusted gross incomes of $254,200 ($305,050 for married couples filing jointly), and phases out completely at $376,700 ($427,550 for married couples filing jointly).

- The alternative minimum tax exemption for tax year 2014 will be $52,800 ($82,100 for married couples filing jointly), up from $51,900 and $80,800, respectively, last tax year.

- The maximum earned income tax credit will be $6,143 for taxpayers filing jointly who have three or more qualifying children. That's up from $6,044 in tax year 2013.

B. Final and Proposed Net Investment Income Regulations Released. On November 26, 2013, the IRS released final regulations and a notice of proposed rulemaking regarding the net investment income tax (T.D. 9644).

1. <u>General Rules on Net Investment Income Tax</u>. As part of the Patient Protection and Affordable Care Act (commonly known as Obamacare), Congress instituted a new 3.8% tax on "net investment income," which became effective January 1, 2013. This tax applies to individuals, trusts and estates that have net investment income and income over certain statutory threshold amounts. "Net investment income" is generally described in three categories: (i) gross income from interest, dividends, annuities, royalties and rents, other than income derived in the ordinary course of a nonpassive trade or business; (i) income from a passive activity or a trade or business of trading in financial instruments or commodities; and (iii) net gain

attributable to the disposition of property other than property held in a nonpassive trade or business. For this purpose, a determination of a trade or business as passive or nonpassive is made under Code section 469, which generally requires a taxpayer to "materially participate" in the business to avoid characterization as a passive activity.

2. Guidance Under Final Regulations. The final net investment income tax regulations are effective for tax years beginning after December 31, 2013. However, taxpayers may choose to rely on the final regulations in preparing their 2013 income tax returns, which allows taxpayers to take advantage of the significant changes discussed below.

a. Self-Rental Property. The final regulations provide that rental income is deemed derived in the ordinary course of a trade or business if it is treated as nonpassive because of either (i) the self-rental recharacterization rule or (ii) appropriate grouping of the rental activity with a trade or business activity. As such, the rental income should not be subject to the 3.8% tax. Further, any gain or loss from the assets associated with the rental activity that are treated as nonpassive gain or loss will also be treated as gain or loss attributable to the disposition of property held in a nonpassive trade or business.

b. Real Estate Professionals. The final regulations contain a safe harbor for real estate professionals. The safe harbor provides that if a real estate professional participates in rental real estate activities for more than 500 hours per year or for more than 500 hours in five of the last ten years, the rental income and any gain or loss from the sale of property is deemed to be derived from the ordinary course of a trade or business. For purposes of the 500-hour requirement, a taxpayer is able to aggregate all rental activities that it has elected to group together pursuant to a grouping election. If a taxpayer does not qualify for this safe harbor, the IRS will consider facts and circumstances to determine if rental income is derived in the ordinary course of a trade or business.

c. Self-Charged Interest. The final regulations provide that, with respect to self-charged interest a taxpayer receives from a nonpassive entity, the individual taxpayer may exclude from net investment income an amount equal to the individual's allocable share of the flow-through entity's deduction related to the loan.

d. Net Operating Losses. In a reversal from the proposed regulations, the final regulations provide that a taxpayer may deduct a portion of a net operating loss deduction in determining net investment income.

3. Open Questions. The final regulations address many concerns raised by the proposed regulations, but additional guidance on certain issues has yet to be finalized.

a. Gain on Disposition of Partnerships and S Corporation Interests. The final regulations reject the proposed regulation's calculation of gain or loss on the disposition of interests in partnerships and S corporations. In acknowledging

the complexity and burden of the proposed regulations, which required a five-step process, the IRS issued new proposed regulations that provide two methods for calculating gain or loss includible in net investment income—a primary method and an optional simplified reporting method.

b. Material Participation by Trusts and Estates. In response to the proposed regulations, practitioners requested guidance on how to determine material participation of trusts and estates. The final regulations fail to provide additional guidance, but the IRS has recognized the concern, is studying the issue and may issue further regulations under Code section 469.

4. Regrouping Activities in 2013 May Save on Net Investment Income Tax. Under Section 469, deductions from passive trade or business activities, to the extent they exceed income from all passive activities (exclusive of portfolio income), may not be deducted against other income. Regulations provide that if a taxpayer's original grouping was clearly inappropriate (or a material change in the facts and circumstances has occurred that makes the original grouping clearly inappropriate) the taxpayer must regroup the activities. The 2012 NII proposed reliance regulations provided taxpayers with the opportunity to regroup their activities in the first tax year beginning after December 31, 2012. The IRS retained the regrouping provision in the final regulations. A regrouping may occur only during the first tax year beginning after December 31, 2012 in which the taxpayer meets the applicable income threshold under Section 1411 and has NII. The IRS rejected calls for a "fresh start" for all individuals (and estates and trusts) regardless of whether they have NII income or modified adjusted gross income above the applicable thresholds. The IRS explained that if a taxpayer does not have NII tax liability, there is no reason for regrouping. A taxpayer can regroup on an amended return but only if (i) the taxpayer was not subject to Section 1411 on his or her original return or previously amended return, and (ii) if, because of a change to the original return, the taxpayer owed tax under Section 1411 for that tax year. However, regrouping is void if the taxpayer subsequently determines that he or she is not subject to Section 1411 in that year. The final regulations include two exceptions to voided elections and examples of the amended return grouping rules. The IRS acknowledged concerns from S corporations and partnerships that they should be permitted to change their groupings in light of application of Section 1411 in any tax year that begins during 2013 or 2014. However, the IRS cautioned that if it would allow regrouping by S corporations and partnerships, taxpayers with no Section 1411 liability would indirectly be allowed to regroup.

C. Transferor Must Recognize Undistributed Profit or Loss From Non-Vested Partnership Interest. In *Crescent Holdings LLC et al. v. Commissioner*, 141 T.C. No. 15; Nos. 23756-11, 23757-11, the Tax Court held that an individual received a capital interest in a partnership in exchange for the performance of services and that the undistributed profit or loss attributed to the individual's non-vested capital interest should be recognized as income to the transferor of the interest. Arthur Fields served as CEO of Crescent Holdings, a limited liability company that was treated as a partnership for federal tax purposes. He received a 2 percent interest in the company that would vest three years after the date of the formation agreement if Fields remained with the

company. However, Fields resigned before the expiration of the three-year period. Before his resignation, undistributed income had been attributed to Field. The IRS issued a notice of final partnership adjustment to Crescent, and Fields sought a readjustment in a petition filed as a partner other than the tax matters partner. Judge Robert P. Ruwe held that Section 83, which governs the timing of recognition of property transferred for services, applied in this case. Ruwe found that under the terms of the partnership agreement, Fields would have received a share of the proceeds if the partnership was liquidated before the vesting of his interest and that, therefore, his interest was a capital interest. The court further held that the capital interest was property within the meaning of Section 83 and rejected the argument of the intervening tax matters partner that Section 83 was inapplicable. Ruwe then addressed an issue of first impression for the court: whether the transferor or the transferee of a non-vested partnership capital interest must include in gross income the undistributed partnership profit or loss allocations attributable to the partnership capital interest. The court held that the transferor of the capital interest was required to recognize the undistributed profit or loss attributed to the non-vested capital interest. This holding was based on Fields's interest being subject to substantial risk of forfeiture. Ruwe noted Section 83's purpose of deferring income that is subject to a substantial risk of forfeiture and found that Fields's resignation resulted in his loss of rights to any economic benefit of his partnership interest. The court concluded that any economic benefit was received by the remaining partners and that the income adjustments related to Fields's 2 percent interest should be allocated to them.

D. Final Repair Regulations Finally Released. The final regulations (T.D. 9636) address the capitalization of tangible assets and affect many taxpayers. At the same time Treasury and the IRS released the final repair regulations, they released proposed regulations (REG-110732-13) regarding general asset accounts and dispositions of property under Section 168.

1. Background. The repair regulations had their genesis in Notice 2004-6, 2004-1 C.B. 308, in which the IRS asked for comments on the application of Sections 162 and 263 to expenditures paid or incurred to repair, improve, or rehabilitate tangible property. In 2006 Treasury released proposed regulations (REG-168745-03) that laid out a basic framework that would be repeated in the subsequent iterations of the rules. The three major areas covered by the regulations were amounts paid for materials and supplies, costs to acquire tangible property, and costs to maintain or improve tangible property. In 2008 Treasury reproposed the regulations under Sections 162 and 263. Those regulations, like their predecessors, described the factors for determining whether an expenditure results in a betterment or restoration of the property. They included an unpopular casualty loss provision. The 2008 proposed regulations were revised in temporary and proposed regulations issued in 2011 (T.D. 9564) and again in the final regulations. The IRS issued Notice 2012-73, 2012-51 IRB 713, to alert taxpayers that the final regulations were coming in 2013, and that they would likely revise the de minimis rule, the disposition rules, and the safe harbor for routine maintenance.

2. Major Changes.

a. The de minimis rule allows a taxpayer to deduct some amounts paid for tangible property if the taxpayer had an applicable financial statement, had written accounting procedures for expensing amounts paid for that property under specified dollar amounts, and had treated those amounts as expenses on its applicable financial statement. If a taxpayer has an applicable financial statement, the taxpayer may rely on the de minimis rule only if the amount paid for property does not exceed $5,000 per invoice, or per item as substantiated by the invoice. IRS exam teams retain discretion to allow a taxpayer whose policy exceeds $5,000 to use the deduction. The final regulations eliminate the temporary regulations' ceiling to the de minimis rule and provide that amounts properly expensed under a taxpayer's financial accounting policies are deductible for tax purposes. Taxpayers without applicable financial statements may qualify for a de minimis rule if they have a threshold of $500 per invoice or item.

b. The rules in the proposed regulations represent a new approach to the treatment of dispositions of depreciable tangible property. Comments on the prior temporary regulations chiefly focused on dispositions of structural components of a building, dispositions of assets in a general asset account, and the determination of the unadjusted depreciable basis of a disposed asset in a multiple asset or general asset account. The proposed regulations included buildings, condominiums, and cooperatives, as well as their structural components, as assets for disposition purposes. The proposed regulations adopted the suggestion in the comments that taxpayers not electing general asset account treatment should have the same flexibility to forgo a loss upon the disposition of a structural component as taxpayers that elect that treatment. The proposed rules allow partial disposition elections for property that is not in a general asset account.

c. The safe harbor for routine maintenance in the final regulations expanded on the one in the temporary regulations. The rules provide that the costs of performing some routine maintenance activities for property need not be capitalized as an improvement. The final regulations included buildings within the scope of property eligible for the safe harbor, but require that the maintenance activities be performed at least twice within 10 years. Taxpayers believed that the safe harbor was too limited but welcomed the expansion to buildings.

d. The final regulations included a safe harbor election for building property held by taxpayers with gross receipts of $10 million or less, which was a welcome change for smaller taxpayers.

e. A taxpayer may elect to treat amounts paid during the tax year for repair and maintenance to tangible property as amounts paid to improve that property and as an asset subject to the allowance for depreciation, as long as the taxpayer incurs the amounts in carrying on a trade or business and the taxpayer treats the amounts as capital expenditures on the books and records used for regularly computing income. The rules for materials and supplies were also expanded and

clarified. Provisions on betterments and restorations generally reflected the temporary regulations, but with some refinements and additional examples.

3. Transition Guidance. Taxpayers are still waiting for transition guidance from the IRS, which is expected to come in the form of two revenue procedures.

E. Proposed Regulations on Allocation of Partnership Liabilities. The IRS has published proposed regulations (REG-136984-12) under section 752 relating to recourse liabilities of a partnership and the special rules for related persons. The proposed regulations provide guidance on when and to what extent a partner is treated as bearing the economic risk of loss for a partnership liability when multiple partners bear the economic risk of loss for the same partnership liability. The regulations also address situations in which a partner that is related to another partner in the partnership has a payment obligation for a liability or makes a nonrecourse loan to the partnership and no other partner bears the economic risk of loss for that liability. For purposes of determining a partner's share of a recourse partnership liability when there is overlapping economic risk of loss, the proposed regulations specify that the amount of the partnership liability is taken into account only once. If the aggregate amount of the economic risk of loss that all partners are determined to bear for a partnership liability exceeds the amount of that liability, the economic risk of loss borne by each partner for the liability equals the amount determined by multiplying the amount of the liability by the fraction obtained by dividing the amount of the economic risk of loss that each partner is determined to bear for that liability by the sum of the amounts for all partners.

The existing regulations allocate a recourse liability of a lower-tier partnership to an upper-tier partnership if either the upper-tier partnership or one of its partners bears the economic risk of loss for the liability. However, the current regulations do not provide guidance on how the lower-tier partnership should allocate the liability between the upper-tier partnership and the partner when a partner of the upper-tier partnership is also a partner in the lower-tier partnership and that partner bears the economic risk of loss for a liability of the lower-tier partnership. The IRS and Treasury believe the lower-tier partnership should allocate the liability directly to the partner. Accordingly, the proposed regulations modify the tiered-partnership rules to prevent a liability of a lower-tier partnership from being allocated to an upper-tier partnership when a partner of both the lower-tier and upper-tier partnerships bears the economic risk of loss for the liability.

Regarding related parties, the proposed regulations reflect the belief of Treasury and the IRS that partners in a partnership, when the partnership owns stock in a corporation that is a lender to the partnership or has a payment obligation for a liability of its partnership owner, should not be treated as related, through ownership of the partnership, to the corporation. The proposed regulations also remove the greatest percentage rule and provide that if a person is a lender or has a payment obligation for a partnership liability and is related to more than one partner, those partners share the liability equally. Under the proposed regulations, the related partner exception only applies when a partner bears the economic risk of loss for a liability of the partnership because the partner is a lender or has a payment obligation for the partnership liability.

Lastly, the proposed regulations clarify that an indirect interest in a partnership is an indirect interest through one or more partnerships.

F. Government Attempts to Regulate Paid Tax Return Preparers Dealt Another Blow. Judge Brett M. Kavanaugh, writing for the court in *Loving v. IRS*, Dkt. 13-5061 (D.C. Cir. 2014), said the IRS's interpretation of its statutory authority to establish standards for paid tax return preparers was unreasonable and an attempt to "unilaterally expand its authority." The IRS adopted final tax return preparer regulations in May 2011 (T.D. 9527) in an attempt to improve accountability in the paid tax return preparer market. The regulations modified Circular 230 to broaden the term "tax return preparer" in Section 7701(a)(36), stipulating that any individual who is paid to prepare all or substantially all of a document submitted to the IRS is engaged in practice subject to Circular 230. The regulations created a new registered tax return preparer designation and required preparers to obtain preparer tax identification numbers and annual continuing education credits, and to undergo competency testing and suitability checks. The IRS relied on 31 U.S.C. Section 330, which "authorizes the Secretary of the Treasury to regulate the practice of representatives before the Treasury Department," as a basis to pass the final regulations. Section 330 was originally enacted in 1884 and had never been previously interpreted to authorize the regulation of tax return preparers. Three independent return preparers challenged the regulations in the U.S. District Court for the District of Columbia. The court in January 2013 held in favor of the return preparers, saying that the "statutory text and context unambiguously foreclose the IRS's interpretation of 31 U.S.C. Section 330." The IRS appealed the decision. "It might be that allowing the IRS to regulate tax-return preparers more stringently would be wise as a policy matter. But that is a decision for Congress and the President to make if they wish by enacting new legislation," the court wrote. Because the *Loving* decision does not disturb the rules requiring all paid preparers to obtain a PTIN, those individuals must still register with the IRS.

G. Severance Payments Subject to FICA Taxes. In a unanimous 8-0 decision, the Supreme Court held March 25, 2014, that the broad definition of wages under FICA encompasses severance payments made to employees involuntarily terminated as part of their employer's Chapter 11 bankruptcy. The Court largely followed the broad definition of wages (and employment) for FICA purposes under Code Sections 3121(a) and (b), and its prior precedents, *Social Sec. Bd. V. Nierotko*, 327 US 358 (1946) (service means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer) and *Rowan Cos. v. United States*, 452 US 247 (1981) (wages should generally be the same for income tax withholding and for FICA purposes) to support its decision. It also expressly rejected the argument that the special income tax withholding provision under Code section 3402(o) (which was enacted to address a narrow, specific income tax issue) would alter this result. *United States v. Quality Stores*, Sup. Ct. Dkt. No. 12-1408 (2014).

H. Individual Denied Vehicle Expenses for Lack of Substantiation. The Tax Court, in a summary opinion, has held that an individual failed to meet the substantiation requirements of Section 274(d) for vehicle expenses related to his

recycling business. *Michael E. Houchin v. Commissioner*, T.C. Summ. Op. 2014-29; No. 30985-12S. On Schedule C, Profit or Loss From Business, petitioner reported gross income of $1,274, office expense of $142, and car and truck expenses of $17,978, for a net loss of $16,846. The examination division of the IRS disallowed all of petitioner's truck expenses. Because of the disallowed car and truck expenses, petitioner's business had a net profit for 2010. Accordingly, the IRS calculated and included self-employment tax of $160 and a self-employment tax deduction of $80 based upon this business income. On or about August 14, 2012, petitioner submitted his 2009-10 mileage log to the IRS examination division to substantiate his truck expenses. The IRS examination division was unpersuaded by petitioner's mileage log because the entries did not reflect a business purpose or the places where petitioner's business activity occurred. The IRS asked that petitioner provide information regarding the places where he went. On or about September 18, 2012, petitioner resubmitted his mileage log, having modified it by writing in the places where he guessed he may have gone. Again unpersuaded, the IRS sent to petitioner a notice of deficiency, dated October 30, 2012, reflecting its adjustments to his tax return. The Tax Court held that even though the petitioner provided his 2009-10 mileage log, he nevertheless failed to provide any corroborating receipts or other records that substantiated the statements made in the log. The petitioner's mileage log did not address the business purpose of each trip. Guessing as to where he may have gone in 2010, petitioner added the places of business travel to his log in 2012. The log was thus not contemporaneous, and the reconstruction was not reliable. Although the Tax Court said that it believed the petitioner had business travel expenses in relation to his recycling business, Section 274(d) precludes estimates. See *Sanford v. Commissioner*, 50 T.C. 823, 827 (1968), aff'd per curiam, 412 F.2d 201 (2d Cir. 1969); sec. 1.274-5T(a)(4), Temporary Income Tax Regulations., 50 Fed. Reg. 46014 (Nov. 6, 1985). Because petitioner failed to substantiate the claimed expenses as required by section 274(d), the Tax Court said that his deductions must be disallowed.

I. Tax Consequences of Guaranteeing LLC Debt. In generic legal advice, the IRS examined the tax consequences under Section 465 that arise when a member of a limited liability company classified as a partnership or disregarded entity for federal tax purposes guarantees debt of the LLC.

1. Section 465(a)(1) allows losses incurred by an individual engaged in a trade or business activity or an activity for the production of income only to the extent of the amount by which the individual is at risk for the activity at the close of the tax year. A taxpayer's amount at risk for an activity includes the amount of money and the adjusted basis of other property contributed by the taxpayer to the activity, and amounts borrowed for purposes of the activity. For borrowed amounts, the taxpayer must be personally liable for repayment or must have pledged property, other than property used in the activity, as security for the borrowed amount (to the extent of the net fair market value of the taxpayer's interest in the property).

2. The IRS determined that when a member of an LLC classified as a partnership or disregarded entity guarantees the LLC's debt, the member is at risk for the amount of the guaranteed debt, without regard to whether the member waives any

right to subrogation, reimbursement, or indemnification from the LLC. This waiver applies only to the extent that the member has no right of contribution or reimbursement from persons other than the LLC, the member is not otherwise protected against loss within the meaning of section 465(b)(4), and the guarantee is bona fide and enforceable by creditors of the LLC under local law.

3. The IRS also said that if the LLC member guarantees qualified nonrecourse financing of the LLC, the member's amount at risk is increased by the amount guaranteed. This increase applies only to the extent the debt was not previously taken into account by that member, the guaranteeing member has no right of contribution or reimbursement from persons other than the LLC, the guaranteeing member is not otherwise protected against loss within the meaning of section 465(b)(4), and the guarantee is bona fide and enforceable by creditors of the LLC under local law.

4. However, when a member of an LLC guarantees qualified nonrecourse financing of the LLC, the amount of the guaranteed debt no longer meets the definition of qualified nonrecourse financing under section 465(b)(6)(B) if the guarantee is bona fide and enforceable by creditors of the LLC under local law, and the amount of the guaranteed debt will no longer be includable in the at-risk amount of the other non-guarantor members of the LLC, the IRS concluded.

J. Failed Like Kind Exchange. In *Frank J. Blangiardo v. Commissioner*, T.C. Memo. 2014-110, the Tax Court held that an individual whose son acted as an intermediary in an intended like-kind exchange could not treat the transaction as a tax-deferred exchange under Section 1031 and that the individual wasn't entitled to increase his basis in the sold property by settlement payment amounts made to two former wives incident to divorce. The taxpayer acknowledged that there was no direct exchange of like-kind property. Property A was sold and property B was purchased with proceeds from the sale of property A. The taxpayer also acknowledged that the intermediary used in the transaction was his son. However, the taxpayer asserted that his son met the requirements of the regulation's safe harbor because (i) his son is an attorney; (ii) the funds from property A were held in an attorney trust account; and (iii) the real estate documents refer to the transaction as a section 1031 exchange. The court did not accept the taxpayer's argument. The court stated that a lineal descendant is a disqualified person, and the regulation makes no exception based on his/her profession. Consequently, the taxpayer's disposition of property A and subsequent acquisition of property B was not a deferred exchange within the purview of section 1031, and he must recognize income on the gain from the sale of property A.

K. Sixth Circuit Affirms Business Expense Deduction for Lease Buyout. In *ABC Beverage Corp. v. United States,* No. 13-1701, the Sixth Circuit, affirming a district court, held that a beverage distribution corporation was entitled to claim a business expense deduction for a lease buyout it paid when it purchased property, finding that Section 167(c)(2) doesn't prohibit the deduction and no Supreme Court decision has modified a prior Sixth Circuit decision on the issue.

L. Fact Sheet Provides Income, Filing Information for Offshore Accounts. The IRS has released a fact sheet (FS-2014-7) advising taxpayers who have offshore bank accounts of their obligation to file foreign bank account reports and provide information to tax professionals who prepare and electronically file FBARs. In most cases, taxpayers must file Schedule B with their tax returns and may have to file Form 8938, "Statement of Foreign Financial Assets." Additional filing requirements apply to those with foreign trusts and those with foreign accounts whose aggregate value exceeds $10,000 at any time during the year. The FBAR is not filed with a federal tax return and must be filed by June 30 each year. Failure to report the existence of offshore accounts or pay taxes on these accounts can lead to civil and criminal penalties.

M. IRS Lets U.S. Residents Use OVDP Streamlined Program. The IRS announced on June 18, 2014, that it will permit resident U.S. taxpayers to participate in its streamlined offshore voluntary disclosure program. The change was one of several made to the Service's offshore voluntary disclosure program, including increasing the miscellaneous offshore penalty from 27.5 percent to 50 percent. The IRS provided updated frequently asked questions and transition rules for the streamlined program on its website. The IRS announced the streamlined program, which was designed to aid U.S. taxpayers living abroad to come into compliance with reporting obligations, in June 2012. Eligibility was limited to nonresident taxpayers who could demonstrate a low level of compliance risk and who did not owe more than $1,500 of tax for each of the three years covered by the program. Practitioner response to the streamlined program was initially positive but they soon raised questions about the program's usefulness to taxpayers. In addition to permitting resident U.S. taxpayers to use the streamlined program, the IRS has also eliminated the $1,500 tax threshold and the risk questionnaire. Taxpayers must certify that previous compliance failures were not willful. Under the revised program, all penalties will be waived for nonresident U.S. taxpayers and resident taxpayers will be subject only to a miscellaneous offshore penalty equal to 5 percent of the foreign financial assets that gave rise to the tax compliance issue.

N. IRS Eyeing S Corps for Worker Misclassification Issues. The IRS will be auditing more S corporations because many are not properly classifying their workers, according to Gerry Kelly-Brenner, senior stakeholder liaison for the IRS Small Business/Self-Employed Division. At the IRS-San Jose State University Small Business Tax Institute in San Jose, California, on June 18, 2014, an audience member asked whether a part-time officer at a corporation could be considered an independent contractor. Kelly-Brenner responded with an emphatic no, saying a corporate officer is always an employee, whether part time or full time. "I can't tell you how many times this becomes a huge issue, and the IRS is looking more and more at this," Kelly-Brenner said. By contrast, Kelly-Brenner said that a member of a corporate board of directors could be either an independent contractor or an employee, depending on the facts and circumstances. Kelly-Brenner was promoting the IRS's voluntary classification settlement program (VCSP), which was first introduced in 2011 and allows employers to properly reclassify their workers as employees while paying minimal back taxes and avoiding interest and penalties.

O. Federal Tax Liens Survived State Tax Sale of Property. In *First Northern Bank & Trust Co. et al.* v. United States, No. 3:13-cv-01446, a U.S. district court, in a bank's suit to quiet title to property purchased in a state tax sale, held that the tax sale was a judicial sale under Section 7425(a) and the IRS was not given proper statutory notice of the sale, which resulted in the survival of two federal tax liens that were on the property before the tax sale.

P. Office Manager Liable for $2.9 Million in Trust Fund Recovery Penalties. In *Bruce A. Miller v. United States et al.*, No. 3:13-cv-00728, a district court held an office manager liable for $2.9 million in trust fund recovery penalties plus interest, finding she was a responsible person at her company and arranged to pay the company's creditors over a four-year period even though she knew the company had not paid employment taxes.

Q. IRS Addresses Cancellation of Mortgage Debt. On June 27, 2014, the IRS responded to questions on the expiration of the Mortgage Forgiveness Debt Relief Act of 2007, addressing when a state's anti-deficiency statute would cause a loan to be treated as a nonrecourse loan, the cancellation of which on disposition of property does not result in cancellation of indebtedness income. INFO 2014-0015. In the letter, the IRS states: "If under a state's anti-deficiency statute a lender cannot under any circumstance pursue the homeowner for the deficiency between the outstanding amount of the purchase-money home loan and the lesser amount received on the sale of the home (whether a foreclosure sale or short sale), then we would consider that loan a nonrecourse loan . . . The cancellation of a nonrecourse loan upon disposition of property does not result in the cancellation of indebtedness income."

R. R&D Credit Opportunity. The Credit for Increasing Research Activities ("R&D credit") is generally calculated by multiplying the difference between the current year qualified research expenses and the base amount by 20 percent. Calculating the base amount is sometimes burdensome because it often requires businesses to dig up gross receipts and qualified research expenses from many years prior. In contrast, the Alternative Simplified Credit ("ASC") allows taxpayers to calculate the R&D credit by only considering the qualified research expenses from the prior three years. Previously, taxpayers were required to elect to claim ASC on an original return and were therefore limited in how often they could claim it. Treasury recently issued T.D. 9666, which contains final and temporary regulations that allow taxpayers to elect to claim ASC on an amended return. However, Treasury has included some caveats. A taxpayer who has previously claimed a regular R&D credit for a tax year, whether on an amended or original return, may not make an ASC election for that tax year on an amended return. Additionally, a taxpayer that is a controlled group member for a tax year may not elect to claim ASC on an amended return if any member of the controlled group for that year has already claimed the regular R&D credit for that tax year. These regulations apply to ASC elections with respect to taxable years ending on or after June 3, 2014. Additionally, taxpayers may rely on these regulations to make elections for tax years ending prior to June 3, 2014 if the taxpayer makes the election before the statute of limitations for assessment for that year expires.

S. End of Circular 230 Disclaimers. The IRS issued final regulations (T.D. 9668) that eliminate the requirement to include Circular 230 disclaimers in documents and transmissions and provide other changes to practice standards under Circular 230. The new regulations adopt a single standard for all written tax advice. Practitioners must base all written advice on reasonable factual and legal assumptions, exercise reasonable reliance, and consider all relevant facts the practitioner knows (or should know). The regulations also provide a number of other changes, including a new competence standard for tax practitioners and new responsibilities for firm managers overseeing Circular 230 compliance. The final regulations are effective as of June 12, 2014.

T. Self-Employment Tax Exemption for Partners. In a project buried among the 317 listed on the 2014-2015 joint Treasury-IRS priority guidance plan 2014 TNT 166-15: Other IRS Documents released August 26, 2014, the agencies announced they have decided to tackle guidance on the application of section 1402(a)(13) to limited liability companies. Back in 1997, Treasury issued proposed regulations (REG-209824-96 97 TNT 14-11: IRS Proposed Regulations (PRO)) providing that an individual can qualify as a limited partner and avoid paying self-employment tax on his income only if he participated 500 hours or less per year in the partnership's trade or business. With the help of then-House Speaker Newt Gingrich and radio host Rush Limbaugh, Steve Forbes, president and CEO of Forbes Inc. and two-time presidential candidate, pulled together a coalition of business groups to lobby against the rule, resulting in the imposition of a 12-month moratorium stripping Treasury of its authority to issue guidance on the definition of limited partner under Section 1402(a)(13). Treasury subsequently decided that it did not want to do anything further unless Congress was going to act, and Congress never acted. It is intellectually possible for an individual to assert that he is an actively participating state law limited partner. One case in which taxpayers took that position was *Renkemeyer, Campbell & Weaver LLP v. Commissioner*, 136 T.C. 137 (2011), in which the Tax Court held that individuals who were partners of a Kansas limited liability partnership -- notably not an LLC -- could not rely on Section 1401(a)(13) to argue that their income is not subject to self-employment taxes. *Renkemeyer* is in one respect a trigger for this. But, so is the 0.9 percentage point increase in the Section 3101(b)(2) Medicare hospital insurance tax which has increased people's interest in taking aggressive positions to avoid imposition of either the self-employment tax or the 3.8 percent net investment income tax under Section 1411. It would not be surprising if Treasury came up with some guidance that would essentially close one of these gaps and say, "You're either a self-employed person paying self-employment tax or you're a passive investor paying net investment income tax." Earlier this summer, Curtis Wilson, IRS associate chief counsel (passthroughs and special industries), told a group of Texas tax lawyers that the IRS occasionally has spoken with people on Capitol Hill about reinstituting the 1997 regulations, adding that he thinks they set forth "a pretty good rule."

U. Tax Court Denies Innocent Spouse Relief to Husband. In *Virgil V. Work Jr. v. Commissioner,* T.C. Memo. 2014-190, No. 2214-11, The Tax Court held that a husband was not entitled to innocent spouse relief under section 6015(b) because he should have known of the understatement of tax reported on the joint return filed by his

wife; nor under section 6015(c) because the couple is still married; nor under section 6015(f) because it would not be inequitable to deny him relief.

V. Couple Didn't Realize Cancellation of Debt Income. In *Howard W. Mylander et ux. v. Commissioner*, T.C. Memo. 2014-191, No. 22283-12, the Tax Court sustained an accuracy-related penalty and the disallowance of continuing education and some rental real estate expenses a couple claimed but, finding they received no valuable consideration in exchange for a guaranty, held that they didn't realize cancellation of debt income when part of the debt was forgiven.

W. Procedures Modified for Tangible Asset Accounting Method Changes. The IRS has issued Rev. Proc. 2014-54 that modifies the procedures regarding some changes in methods of accounting for dispositions of tangible depreciable property. The IRS recently issued final regulations (T.D. 9689) under Treas. Reg. section 1.168(i)-1, which provides rules for general asset accounts, 1.168(i)-7, which provides rules for accounting for property depreciated under section 168 (MACRS property), and 1.168(i)-8, which provides rules for dispositions of MACRS property. Rev. Proc. 2014-54, effective September 18, 2014, provides the procedures by which a taxpayer may obtain automatic consent to change to the accounting methods provided in Treas. Reg. section 1.168(i)-1, 1.168(i)-7, and 1.168(i)-8. The guidance also allows a late partial disposition election under Treas. Reg. section 1.168(i)-8 to be treated as a change in method of accounting for a limited period of time. Rev. Proc. 2014-54 modifies the appendix of Rev. Proc. 2011-14 regarding a change to the method of accounting described in Rev. Proc. 2014-16 for amounts paid to acquire, produce, or improve tangible property. Rev. Proc. 2014-54 also provides charts that summarize the changes in methods of accounting that may be made under Rev. Proc. 2011-14 for dispositions of MACRS property. Lastly, the guidance describes transition rules that may apply when a taxpayer requests consent for a change in method of accounting before September 18, 2014.

X. Liability as Transferee for Unpaid Corporate Taxes. In *RIchard H. Cullifer v. Commissioner*, T.C. Memo. 2014-208, No. 20177-11, the Tax Court held that an individual was liable as a transferee under Section 6901 for a corporation's unpaid tax liabilities after engaging in an intermediary transaction. The transactions in this case have been described by the Commissioner as an intermediary transactions tax shelter (intermediary transaction). See Notice 2001-16, 2001-1 C.B. 730, clarified by Notice 2008-111, 2008-51 I.R.B. 1299. Transactions that are the same or substantially similar to those described in Notice 2001-16, supra, are identified as "listed transactions" for the purposes of section 1.6011-4(b)(2), Income Tax Regulations., effective January 19, 2001. See Notice 2001-16, [*38] supra; Notice 2008-111, Sections. 1, 6, 2008-51 I.R.B. at 1299, 1301. Intermediary transactions have also been referred to as "Midco" transactions. See, e.g., *Diebold Found., Inc. v. Commissioner*, 736 F.3d 172, 175 (2d Cir. 2013), vacating and remanding *Salus Mundi Found. v. Commissioner*, T.C. Memo. 2012-61. Ordinarily, shareholders of a C corporation can dispose of their interests in two ways: an asset sale or a stock sale. In an asset sale, the C corporation triggers the built-in gain in its appreciated assets under Section 1001, and upon a liquidating distribution to the shareholders, triggers the built-in gain in the stock itself under Sections 331 and

1001. In addition, the corporation's payment of the corporate level tax reduces the amount of cash available for distribution to the shareholders. In a stock sale, the shareholders sell their stock to a third party, the C corporation continues to own its appreciated assets, and the corporate-level built-in gain is not triggered. Generally, buyers prefer to purchase assets and receive a new basis equal to the purchase price under Section 1012, whereas sellers disfavor the sale of assets because of the attendant corporate level tax. Because a stock sale merely defers the corporate level tax liability, however, a stock sale generally commands a lower sale price than an asset sale. The Court of Appeals for the Second Circuit has described one variation of a Midco transaction as follows: "Midco transactions" or "intermediary transactions" are structured to allow the parties to have it both ways: letting the seller engage in a stock sale and the buyer engage in an asset purchase. In such a transaction, the selling shareholders sell their C Corp stock to an intermediary entity (or "Midco") at a purchase price that does not discount for the built-in gain tax liability, as a stock sale to the ultimate purchaser would. The Midco then sells the assets of the C Corp to the buyer, who gets a purchase price basis in the assets. The Midco keeps the difference between the asset sale price and the stock purchase price as its fee. The Midco's willingness to allow both buyer and seller to avoid the tax consequences inherent in holding appreciated assets in a C Corp is based on a claimed tax-exempt status or supposed tax attributes, such as losses, that allow it to absorb the built-in gain tax liability. See I.R.S. Notice 2001-16, 2001-1 C.B. 730. If these tax attributes of the Midco prove to be artificial, then the tax liability created by the built-in gain on the sold assets still needs to be paid. In many instances, the Midco is a newly formed entity created for the sole purpose of facilitating such a transaction, without other income or assets and thus likely to be judgment-proof. The IRS must then seek payment from the other parties involved in the transaction in order to satisfy the tax liability the transaction was created to avoid. *Diebold Found., Inc. v. Commissioner*, 736 F.3d at 175-176. In this case, the petitioner did not argue that he was a transferee under Section 6901. In addition, the court found the petitioner to fall within the expansive definition of transferee set forth in Section 6901. With respect to a special dividend and the other pre-stock-sale asset distributions, the court found the petitioner to also be a distributee. Finally, with respect to the proceeds from the sale of stock, the court found the petitioner to be a transferee of a distributee of Neches. Because liability under section 6901 is several, the court found that the IRS may proceed against any or all transferees. Accordingly, the IRS may seek to collect from petitioner the lesser of: (i) the amount of fraudulent transfers under State law that petitioner received, directly or indirectly, and (ii) the amount of the deficiencies, penalties, and interest. See *Kreps v. Commissioner*, 42 T.C. 660, 670 (1964), aff'd, 351 F.2d 1 (2d Cir. 1965); *Feldman v. Commissioner*, T.C. Memo. 2011-297, 102 T.C.M. (CCH) 612, 621 (2011) ("Transferee liability under section 6901 includes related additions to tax, penalties, and interest owed by the transferors."); see also *Schussel v. Werfel*, 758 F.3d 82 (1st Cir. 2014) (pertaining to the calculation of prejudgment interest on transferee liability.)

Y. Economic Substance Doctrine Guidance. Notice 2014-58, 2014-44 IRB 1 amplifies Notice 2010-62, 2010-40 IRB 411 by providing guidance on the definition of transaction and the meaning of "similar rule of law" under section 6662(b)(6) for the accuracy-related penalty imposed when a transaction lacks economic

substance. Generally, Section 7701(o) codifies the economic substance doctrine by treating transactions as having economic substance only if the transaction has a substantial purpose and changes in a meaningful way the taxpayer's economic position, apart from federal income tax effects. That section does not provide a definition of transaction, though as the guidance notes, that term has been defined in the analogous context of reportable transactions, which includes any series of steps carried out as part of a plan. According to the notice, when a plan that generated a tax benefit involves "interconnected steps with a common objective," the transaction is aggregated when making a determination of its economic substance. But aggregation may not be appropriate when a transaction includes a tax-motivated step that is not necessary to achieve a nontax objective. The notice states that the facts and circumstances of each case will determine whether the economic substance doctrine is relevant and whether a transaction should be disaggregated. "For example, if transfers of multiple assets and liabilities occur and the transfer of a specific asset or assumption of a specific liability was tax-motivated and unnecessary to accomplish a non-tax objective, then the economic substance doctrine may be applied solely to the transfer or assumption of that specific asset or liability," the notice states. Some commentators have Called this example of disaggregation "cherry-picking," and a repudiation of *Shell Petroleum Inc. v. United States*, No. 4:05-cv-02016 (S.D. Tex. 2008), in which both productive and unproductive assets were transferred.

II. MICHIGAN

A. 2014 BUSINESS PERSONAL PROPERTY CHANGES. Beginning December 31, 2013 eligible personal property is exempt from taxation. *See,* State Tax Commission Bulletin 11 of 2013.

1. Eligible Personal Property. In order to be eligible personal property and qualify for the exemption, the personal property must meet ALL of the following conditions:

a. The exemption must be properly claimed on Form 5076;

b. The personal property must be classified as industrial or commercial personal property as defined in MCL 211.34c or would be classified as such if not exempt;

c. The property is not leased to or used by a person that previously owned the property or a person that, directly or indirectly controls, is controlled by, or under common control with the person that previously owned the property; and

d. The combined true cash value is less than $80,000. This total includes all industrial or commercial personal property in an individual community that is: (i) owned by the entity claiming the exemption, (ii) leased by the entity claiming the exemption, or (iii) in possession of the owner or a related entity claiming the exemption (combined true cash value includes the value of leased equipment).

2. Taxpayer Responsibilities.

a. In order to claim the exemption, the owner of the eligible personal property must annually file an affidavit with the Assessing Department not later than February 10th each tax year the exemption is claimed. If an affidavit is filed, the owner is not required to file a personal property statement in that tax year. The affidavit (Form 5076) is available at www.michigan.gov/taxes.

b. Taxpayers are required to maintain books and records for four years after filing an affidavit claiming the exemption. They have to provide access to those books and records if requested by your local Assessing Department, County Equalization, or the Department of Treasury for the four years immediately after filing the exemption.

c. The Assessing Department must deny exemptions which do not qualify. Any individual who fraudulently claims an exemption is guilty of a misdemeanor punishable by not less than 30 days and not more than 6 months in jail and a fine of not less than $500 or not more than $2,500 or both.

d. If a taxpayer does NOT qualify, then the taxpayer must file the 2014 Personal Property Statement by February 20, 2014.

B. Uncapping Law. *Anderson v. Chocolay Twp.*, MTT Docket No. 433005 (December 18, 2013) was decided by the Michigan Tax Tribunal on December 18, 2013 and clarified several aspects of Michigan's Property Tax Uncapping rule (MCL 211.27a). The case held that two types of transfer do not result in uncapping: (i) a transfer where the original owner retains a life estate coupled with an unlimited power of appointment (i.e. ladybird deed); and (ii) an unequal joint tenancy the Tax Tribunal determined satisfies the joint tenancy exemption to uncapping in mcl 211.27a(7)(h).

C. Audit Procedures Amended. P.A. 35, effective March 20, 2014, provides that a taxpayer who has been audited by the Michigan Department of Treasury or a taxpayer whose books, records, and papers have been examined by the Department must, upon request, be provided a complete copy in printed or electronic format of the complete audit work papers and the audit report of findings. The bill provides that any audit performed by the Department under Mich. Comp. Laws Ann.§ 205.3(a) must be performed in accordance with auditing standards which must include, but are not limited to, confidentiality, technical training, independence, due professional care, planning, supervision, understanding of the entity audited including internal control and an assessment of risk, audit evidence and documentation, sampling and sampling projections, and elements of the audit report of findings. The bill requires the Department to issue administrative rules on audit standards within one year of the date of enactment of the bill.

D. Taxpayer Protections Signed Into Law.

1. P.A. 3, effective February 6, 2014, amends the provisions relating to the tax liability of a purchaser of a business, to require the Department of Treasury,

within 60 days of receipt of the request, to release to a purchaser a business's known or estimated tax liability for the purposes of establishing an escrow account; to allow the Department to estimate tax liability based on prior returns and payments; and to provide that the purchaser of a business will not be held liable for more than the known or estimated tax liability disclosed by the Department and held in escrow if the purchaser or succeeding purchasers of a business or its stock of goods comply with the statutory escrow requirements.

2. The bill amends provisions relating to the extension of the statute of limitations.

a. The statute of limitations will be extended by the following: (i) the period pending a final determination of tax; (ii) a period of 90 days after the issuance of a decision and order from an informal conference; (iii) a period of 90 days after the issuance of a court order resolving an appeal of a decision of the Department in a case in which a final assessment was not issued prior to appeal; (iv) for the period of an audit that started after September 30, 2014, and was conducted within a specified time frame established by law; and (v) for the period in which the taxpayer and the state have consented to extend the statute of limitations.

b. The legislation strikes references in the law to suspending the statute of limitations and instead provides that the statute of limitations is extended for the periods currently stipulated in the law as well as the additional time periods. The four-year statute of limitations also applies to taxpayers claiming refunds.

3. The bill also amends the definition of a "responsible person"—who is liable for a business's failure to pay tax—to mean an officer, member, manager of a manager-managed limited liability company, or partner for the business who controlled, supervised, or was responsible for the filing of returns or payment of any tax during the time period of default, and who willfully failed to file a return or pay the tax due.

a. The Act requires the Department to provide a responsible person of a business with notice of any amount collected by the Department from any other responsible person.

b. The Department may not assess a responsible person more than four years after the date of the assessment issued to a business.

c. Before assessing a responsible person as liable for a tax assessed to a business, the Department must first assess a purchaser or succeeding purchaser of the business who is personally liable. However, the Department may assess a responsible person notwithstanding the liability of a purchaser or succeeding purchaser if the purchaser or succeeding purchaser fails to pay the assessment for sales and use taxes, tobacco products tax, motor fuel tax, motor carrier fuel tax, income tax withholding, and any other tax that a person is required to collect on behalf of a third person.

4. Effective for audits commenced after September 30, 2014, the bill establishes deadlines for the Department of Treasury to complete fieldwork and provide a written audit determination, as well as for final assessments when the taxpayer does not protest the notice of intent to assess.

a. For audits which start after September 30, 2014, Treasury must complete the audit within one year and must assess the audit deficiency within nine months after the completion of the audit.

b. The one year requirement to complete an audit can be extended by mutual agreement between the taxpayer and the state.

c. The nine month period to assess a tax deficiency is extended if the taxpayer asks for a reconsideration of the preliminary audit determination or an informal conference.

E. Notice Required to Authorized Representative. In *Fradco, Inc. v. Department of Treasury*, 494 Mich. 104 (2014), the Michigan Supreme Court held that the Department of Treasury is obligated to give a taxpayer notice of any assessment, decision, or order. The notice "shall be given either by personal service or by certified mail addressed to the last known address of the taxpayer." MCL 205.28(1)(a). In 1993, the Legislature enacted a Taxpayer Bill of Rights, including MCL 205.8, which states: "If a taxpayer files with the department a written request that copies of letters and notices regarding a dispute with that taxpayer be sent to the taxpayer's official representative, the department shall send the official representative, at the address designated by the taxpayer in the written request, a copy of each letter or notice sent to that taxpayer. A taxpayer shall not designate more than one official representative under this section for a single dispute."

F. No Automatic Use Tax Exemption. In *Andrie, Inc. v Department of Treasury*, Docket No. 145557, Decided June 23, 2014, the Michigan Supreme Court reversed the Court of Appeals on the issue whether a purchaser bears the burden of proving entitlement to the use tax exemption for purchases from a Michigan seller. The sales tax prohibits Michigan sellers from advertising that there is no sales tax charged on a transaction. A seller can either state the tax separately or not, but it cannot advertise that there is no tax due. In April 2012, the Court of Appeals held that this provision gave purchasers an automatic exemption from the use tax on purchases from Michigan sellers, and that Treasury's only recourse was to demand payment of sales tax from the Michigan seller. In reversing the Court of Appeals, the Supreme Court construed the language of the statute, which grants an exemption where the tax was "due and paid" on the retail sale. The Court held that the purchaser has to substantiate the payment of the tax to the seller, irrespective of the sales tax provision placing ultimate responsibility on sellers. Substantiation can come in the form of a receipt showing the tax as part of the price paid or in the form of an affidavit from the seller stating either that the transaction includes sales tax or that the seller paid sales tax to Treasury. In the Michigan Supreme Court's view, there is no double taxation, because

the power remains in the purchaser's hands to prove prior payment of the tax and eligibility for the exemption.

G. Michigan Offer-In-Compromise Program. 2014 PA 240 amends the Revenue Act to (i) establish an offer-in-compromise program, which authorizes the state treasurer to compromise the payment of a tax, an unpaid account, or an amount due the state subject to administration under the act if doubt existed regarding liability or collectability or if there were a substantial probability that a compromise would further the fair and efficient administration of the tax; (ii) provide that a taxpayer's federal compromise of tax is prima facie evidence that the taxpayer was entitled to a compromise of a comparable Michigan tax liability; (iii) allow the Department of Treasury to revoke a compromise if it were induced by fraud or perjury or if the taxpayer failed to comply with any tax payment agreement within 5 years after the compromise was made; (iv) require the state treasurer to file a written report if a tax liability were compromised, unless the compromise related to a civil case involving less than $25,000; (v) require the state treasurer, within 180 days after the effective date, to establish guidelines for the program, administrative procedures, procedures for an independent administrative review of the rejection of a proposed offer-in-compromise, procedures for the appeal of a rejection, application fees, and procedures to allow for payment plans; and (vi) require the Department of Treasury to disclose return information to the public as necessary to permit inspection of any accepted offer-in-compromise (HB 4003; eff. 6/27/14). While the statute has immediate effect, the compromise provision does not go into effect until January 1, 2015. Under the program, the Treasury may compromise all or any part of a payment of tax if one or more of the following exists:

1. A doubt exists as to the liability.

2. A doubt exists as to the collectability if the taxpayer established both of the following:

    a. The amount offered in payment is the most that can be expected to be paid or collected from the taxpayer's present assets or income, and

    b. The taxpayer does not have reasonable prospects of acquiring increased income or assets that would enable the taxpayer to satisfy a greater amount of the liability that the amount offered, within a reasonable period of time.

3. A federal compromise of tax under IRC §7122 has been granted for the same tax years.

H. Apportionment of Tax Base. Only July 14, 2014, the Michigan Supreme Court held in *International Business Machines Corp. v. Department of Treasury*, Docket No. 146440, July 14, 2014, that International Business Machines Corporation ("IBM") was entitled to apportion its tax base to Michigan using a three-factor apportionment formula for purposes of the Michigan Business Tax ("MBT"). IBM argued that because Michigan was a signatory member of the Multistate Tax Compact ("MTC") when the

MBT was in effect and because Michigan had not expressly repealed the MTC, IBM was permitted to elect to use the equally weighted, three-factor apportionment method provided under the MTC. IBM also argued that the three-factor apportionment could be used to calculate its tax base for both the gross receipts tax ("GRT") and business income tax ("BIT") portions of the MBT because both were considered "income taxes". The Michigan Department of Treasury ("Department") argued that the MTC was repealed by implication because the statutory provisions that governed the MBT instructed taxpayers to calculate their Michigan apportionment using a mandatory single sales factor method. The Department also argued that the GRT portion of the MBT was a gross receipts tax, as the name implies, and not an income tax. The Michigan Supreme Court, in a 4-3 decision, ruled in favor of IBM and held that the MTC's elective three-factor apportionment formula was valid for both the GRT and BIT tax components of the MBT because both fit within the broad definition of "income tax" under the MTC. The legislature subsequently passed legislation intending to prevent other out-of-state companies from availing themselves of the same strategy used by IBM.

I. COD Income under the Michigan Business Tax (MBT). Before its repeal, the MBT imposed a modified gross receipts tax of 0.8% on a taxpayer's gross receipts. Under the statute, the definition of "gross receipts" did not explicitly exclude income realized by a taxpayer from the cancellation of its debt by a creditor. The Department of Treasury's position has been that such cancelled debt income is included in "gross receipts" for purposes of the MBT's modified gross receipts tax. This has been changed by the passage of Senate Bill 156 which was signed into law on September 11, 2014. Among other things, the new law provides that if a taxpayer has overpaid MBT as a result of including cancelled debt income in gross receipts for any tax year after 2009, the taxpayer may file a claim for refund of the overpayment in 2015. Refund claims will be paid in equal installments over six years beginning in 2016.

J. Principal Residence Exemption. In *Schellenberg v. County of Leelanau*, an unpublished Michigan Court of Appeals decision, The court held that the Michigan Tax Tribunal erred as a matter of law in upholding the County's determination that the petitioners were not allowed to claim the principal residence exemption on the property at issue "because Michigan law does not require both spouses to be residents in order for one spouse to claim the principal residence exemption." The court was "troubled by the Michigan Tax Tribunal's lack of any citation to any authority for imposing a 74% principal residence exemption. Arguably, the Michigan Tax Tribunal was relying on another portion of MCL 211.7dd(c) that states that a '[p]rincipal residence includes only that portion of a dwelling . . . that is subject to ad valorem taxes and that is owned and occupied by an owner of the dwelling . . . .'" However, "without any reference to what statute it was relying on," the court was left to speculate. It "is inadequate for the Michigan Tax Tribunal to simply rely on the mere fact that '[r]espondent testified that the subject would have received a 74% exemption.'" It is the Michigan Tax Tribunal 's "responsibility to apply the correct law." The case has been remanded to determine whether Schellenberg used the property as her principal residence during the relevant tax years.

III. EMPLOYEE BENEFITS

A. Pension Plan Limits for the Tax Year 2014.

1. COLA Adjustments. On October 31, 2013 the IRS announced cost of living adjustments affecting dollar limitations for pension plans and other retirement-related items for tax year 2014. Some pension limitations such as those governing 401k plans and IRAs will remain unchanged because the increase in the Consumer Price Index did not meet the statutory thresholds for their adjustment. However, other pension plan limitations will increase for 2014. Highlights include the following:

- The elective deferral (contribution) limit for employees who participate in 401k, 403(b), most 457 plans, and the federal government's Thrift Savings Plan remains unchanged at $17,500.

- The catch-up contribution limit for employees aged 50 and over who participate in 401k, 403(b), most 457 plans, and the federal government's Thrift Savings Plan remains unchanged at $5,500.

- The limit on annual contributions to an Individual Retirement Arrangement (IRA) remains unchanged at $5,500. The additional catch-up contribution limit for individuals aged 50 and over is not subject to an annual cost-of-living adjustment and remains $1,000.

- The deduction for taxpayers making contributions to a traditional IRA is phased out for singles and heads of household who are covered by a workplace retirement plan and have modified adjusted gross incomes (AGI) between $60,000 and $70,000, up from $59,000 and $69,000 in 2013. For married couples filing jointly, in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, the income phase-out range is $96,000 to $116,000, up from $95,000 to $115,000. For an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered, the deduction is phased out if the couple's income is between $181,000 and $191,000, up from $178,000 and $188,000. For a married individual filing a separate return who is covered by a workplace retirement plan, the phase-out range is not subject to an annual cost-of-living adjustment and remains $0 to $10,000.

- The AGI phase-out range for taxpayers making contributions to a Roth IRA is $181,000 to $191,000 for married couples filing jointly, up from $178,000 to $188,000 in 2013. For singles and heads of household, the income phase-out range is $114,000 to $129,000, up from $112,000 to $127,000. For a married individual filing a separate return, the phase-out range is not subject to an annual cost-of-living adjustment and remains $0 to $10,000.

- The AGI limit for the saver's credit (also known as the retirement savings contribution credit) for low- and moderate-income workers is $60,000 for married couples filing jointly, up from $59,000 in 2013; $45,000 for heads of household, up from $44,250; and $30,000 for married individuals filing separately and for singles, up from $29,500.

2. <u>Details on Changed and Unchanged Limits</u>.

- Section 415 of the Internal Revenue Code provides for dollar limitations on benefits and contributions under qualified retirement plans. Section 415(d) requires that the Secretary of the Treasury annually adjust these limits for cost of living increases. Other limitations applicable to deferred compensation plans are also affected by these adjustments under Section 415. Under Section 415(d), the adjustments are to be made pursuant to adjustment procedures which are similar to those used to adjust benefit amounts under Section 215(i)(2)(A) of the Social Security Act.

- Effective January 1, 2014, the limitation on the annual benefit under a defined benefit plan under Section 415(b)(1)(A) is increased from $205,000 to $210,000. For a participant who separated from service before January 1, 2014, the limitation for defined benefit plans under Section 415(b)(1)(B) is computed by multiplying the participant's compensation limitation, as adjusted through 2013, by 1.0155.

- The limitation for defined contribution plans under Section 415(c)(1)(A) is increased in 2014 from $51,000 to $52,000.

- The Code provides that various other dollar amounts are to be adjusted at the same time and in the same manner as the dollar limitation of Section 415(b)(1)(A). After taking into account the applicable rounding rules, the amounts for 2014 are as follows:

- The limitation under Section 402(g)(1) on the exclusion for elective deferrals described in Section 402(g)(3) remains unchanged at $17,500.

- The annual compensation limit under Sections 401(a)(17), 404(l), 408(k)(3)(C), and 408(k)(6)(D)(ii) is increased from $255,000 to $260,000.

- The dollar limitation under Section 416(i)(1)(A)(i) concerning the definition of key employee in a top-heavy plan is increased from $165,000 to $170,000.

- The dollar amount under Section 409(o)(1)(C)(ii) for determining the maximum account balance in an employee stock ownership plan subject to a 5 year distribution period is increased from $1,035,000 to $1,050,000, while the dollar amount used to determine the lengthening of the 5 year distribution period is increased from $205,000 to $210,000.

- The limitation used in the definition of highly compensated employee under Section 414(q)(1)(B) remains unchanged at $115,000.

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

- The annual compensation limitation under Section 401(a)(17) for eligible participants in certain governmental plans that, under the plan as in effect on July 1, 1993, allowed cost of living adjustments to the compensation limitation under the plan under Section 401(a)(17) to be taken into account, is increased from $380,000 to $385,000.

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

- The limitation under Section 408(p)(2)(E) regarding SIMPLE retirement accounts remains unchanged at $12,000.

- The limitation on deferrals under Section 457(e)(15) concerning deferred compensation plans of state and local governments and tax-exempt organizations remains unchanged at $17,500.

- The compensation amount under Section 1.61 21(f)(5)(i) of the Income Tax Regulations concerning the definition of "control employee" for fringe benefit valuation purposes is increased from $100,000 to $105,000. The compensation amount under Section 1.61 21(f)(5)(iii) is increased from $205,000 to $210,000.

- The Code also provides that several pension-related amounts are to be adjusted using the cost-of-living adjustment under Section 1(f)(3). After taking the applicable rounding rules into account, the amounts for 2014 are as follows:

- The adjusted gross income limitation under Section 25B(b)(1)(A) for determining the retirement savings contribution credit for married taxpayers filing a joint return is increased from $35,500 to $36,000; the limitation under Section 25B(b)(1)(B) is increased from $38,500 to $39,000; and the limitation under Sections 25B(b)(1)(C) and 25B(b)(1)(D) is increased from $59,000 to $60,000.

- The adjusted gross income limitation under Section 25B(b)(1)(A) for determining the retirement savings contribution credit for taxpayers filing as head of household is increased from $26,625 to $27,000; the limitation under Section 25B(b)(1)(B) is increased from $28,875 to $29,250; and the limitation under Sections 25B(b)(1)(C) and 25B(b)(1)(D) is increased from $44,250 to $45,000.

- The adjusted gross income limitation under Section 25B(b)(1)(A) for determining the retirement savings contribution credit for all other taxpayers is increased from $17,750 to $18,000; the limitation under Section 25B(b)(1)(B) is increased from $19,250 to $19,500; and the limitation under Sections 25B(b)(1)(C) and 25B(b)(1)(D) is increased from $29,500 to $30,000.

- The deductible amount under Section 219(b)(5)(A) for an individual making qualified retirement contributions remains unchanged at $5,500.

- The applicable dollar amount under Section 219(g)(3)(B)(i) for determining the deductible amount of an IRA contribution for taxpayers who are active participants filing a joint return or as a qualifying widow(er) is increased from $95,000 to $96,000. The applicable dollar amount under Section 219(g)(3)(B)(ii) for all other taxpayers (other than married taxpayers filing separate returns) is increased from $59,000 to $60,000. The applicable dollar amount under Section 219(g)(3)(B)(iii) for a married individual filing a separate return is not subject to an annual cost-of-living adjustment and remains $0. The applicable dollar amount under Section 219(g)(7)(A) for a taxpayer who is not an active participant but whose spouse is an active participant is increased from $178,000 to $181,000.

- The adjusted gross income limitation under Section 408A(c)(3)(B)(ii)(I) for determining the maximum Roth IRA contribution for married taxpayers filing a joint return or for taxpayers filing as a qualifying widow(er) is increased from $178,000 to $181,000. The adjusted gross income limitation under Section 408A(c)(3)(B)(ii)(II) for all other taxpayers (other than married taxpayers filing separate returns) is increased from $112,000 to $114,000. The applicable dollar amount under Section

408A(c)(3)(B)(ii)(III) for a married individual filing a separate return is not subject to an annual cost-of-living adjustment and remains $0.

- The dollar amount under Section 430(c)(7)(D)(i)(II) used to determine excess employee compensation with respect to a single-employer defined benefit pension plan for which the special election under Section 430(c)(2)(D) has been made is increased from $1,066,000 to $1,084,000.

3. <u>Historical Limits</u>.

401k Plan Limits for Plan Year	2014	2013	2012	2011	2010	2009	2008
401k Elective Deferrals	$17,500	$17,500	$17,000	$16,500	$16,500	$16,500	$15,500
Annual Defined Contribution Limit	$52,000	$51,000	$50,000	$49,000	$49,000	$49,000	$46,000
Annual Compensation Limit	$260,000	$255,000	$250,000	$245,000	$245,000	$245,000	$230,000
Catch-Up Contribution Limit	$5,500	$5,500	$5,500	$5,500	$5,500	$5,500	$5,000
Highly Compensated Employees	$115,000	$115,000	$115,000	$110,000	$110,000	$110,000	$105,000
Non-401k Related Limits							
403(b)/457 Elective Deferrals	$17,500	$17,500	$17,000	$16,500	$16,500	$16,500	$15,500
SIMPLE Employee Deferrals	$12,000	$12,000	$11,500	$11,500	$11,500	$11,500	$10,500
SIMPLE Catch-Up Deferral	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500
SEP Minimum Compensation	$550	$550	$550	$550	$550	$550	$500
SEP Annual Compensation Limit	$260,000	$255,000	$250,000	$245,000	$245,000	$245,000	$230,000
Social Security Wage Base	$117,000	$113,700	$110,100	$106,800	$106,800	$106,800	$102,000

B. Rollovers as Business Start-Ups ("ROBS")

1. <u>Payment of Compensation to Taxpayer's from Business Owned by Taxpayer's IRA Resulted in Prohibited Transaction</u>. In *Ellis*, TC Memo 2013-245, the Tax Court ruled that an investment of a husband's IRA into a newly established LLC was not a prohibited transaction, but the payment of compensation to the husband by the LLC constituted a prohibited transaction that caused an inclusion of the deemed distribution of the IRA's assets in the his income and imposition of a 10-percent early distribution tax. Mr. Ellis caused the creation of the LLC where the founding members were his IRA, with a 98-percent membership interest, and a third party, with a 2-percent interest. Subsequently, Mr. Ellis created his IRA with funds distributed from his 401(k) plan with his former employer, after which the IRA made the initial capital contribution to the LLC. This LLC was formed so that Mr. Ellis could sell used cars. He transferred $319,000 from his 401(k) account to fund the LLC business. Even though Mr. Ellis was a fiduciary of his IRA and, thus, a disqualified person with respect to the plan, he did not engage in a prohibited transaction under Code Sec. 4975 by causing his IRA to invest in the LLC. He organized the LLC without taking any ownership interest. In addition, the LLC had no outstanding owners or ownership interests before the initial capital contribution by the IRA and, therefore, could not be a disqualified person at the time of

the investment by the IRA. However, he engaged in a prohibited transaction when he caused the LLC to pay him compensation. Since Mr. Ellis, as a fiduciary of his IRA, was the beneficial owner of 98 percent of the outstanding LLC membership interests, the LLC was a disqualified person for purposes of Code Sec. 4975. The compensation was paid to him in his capacity as a general manager. In addition, the amounts paid came from the IRA's assets because the LLC was funded almost exclusively by the IRA's assets and the IRA's assets consisted only of its LLC membership interest. Thus, by causing the LLC to pay him compensation, Mr. Ellis engaged in the transfer of plan income or assets for his own benefit in violation of Code Sec. 4975(c)(1)(D). Furthermore, in authorizing and effecting this transfer, Mr. Ellis dealt with the income or assets of his IRA for his own interest or for his own account in violation of Code Sec. 4975(c)(1)(E). Since he engaged in a prohibited transaction for the tax year in issue, the entire amount converted from his 401(k) plan into the IRA was deemed distributed on the first day of that year and was includible in his gross income under Code Sections 408(d)(1) and 72(a). In addition, Mr. Ellis was liable for a 10-percent additional tax for the early distribution under Code Sec. 72(t) since he had not attained the age of 59-1/2 by the first day of the tax year in issue and no other exemptions were shown to exist. He was also subject to an accuracy-related penalty under Code Sec. 6662 for the tax year at issue as he did not present evidence of reasonable cause.

2. Taxpayer's Guarantee of Loan Made to Business Owned by Taxpayer's IRA Resulted in Prohibited Transaction. In *Lawrence F. Peek et ux. et al. v. Commissioner*; 140 T.C. No. 12; Nos. 5951-11, 6481-11, the Tax Court, sustaining accuracy-related penalties, held that two individuals engaged in prohibited transactions by personally guaranteeing loans to a company owned by their IRAs and that as a result, the accounts that held the company's stock ceased to be IRAs and the individuals were liable for taxes on the gain from the sale of the company's stock. Lawrence Peek and Darrell Fleck participated in a joint business venture to purchase a fire safety company. Peek and Fleck each established IRAs into which they rolled over funds from other retirement accounts. In 2001 they set up a new corporation, the FP Co., and their IRAs each acquired 50 percent of the shares of the new corporation. FP Co. then purchased the fire safety company, in part with loans that were personally guaranteed by Peek and Fleck. In 2003 and 2004, Peek and Fleck rolled over their FP Co. stock into Roth IRAs. In 2006 the Roth IRA sold the FP Co. stock at a gain. The IRS sent Peek and Fleck notices of deficiency finding them liable for accuracy-related penalties and taxes on the gain they received from the stock sale. Tax Court Judge David Gustafson found that Peek and Fleck engaged in prohibited transactions under section 4975(c)(1)(B), which prohibits any direct or indirect extension of credit between a retirement plan and a disqualified person. The court held that the loan guarantees made on behalf of FP Co. were indirect extensions of credit by Peek and Fleck -- disqualified persons -- to the IRAs through FP Co. The court further held that the IRAs ceased to qualify as IRAs when the prohibited transaction occurred in 2001 and that the prohibited transactions continued because a loan guarantee persists until the loan is repaid. When Peek and Fleck attempted to convert the IRAs to Roth IRAs, the Roth IRAs also failed to qualify because of the prohibited transactions. The court concluded that the gain from the sale of FP Co. stock was taxable as capital gain to Fleck and Peek as the creators and beneficiaries of the accounts. The court also held Peek and

Fleck liable for accuracy-related penalties on the resulting tax underpayments, finding that they were negligent in failing to report the gain on the stock sale because they were advised that prohibited transactions could result in the disqualification of the accounts as IRAs. The court further found that they had not reasonably relied on their accountant's advice or acted in good faith in failing to report the gains.

C. **IRS Guidance Permits Carryover for Health FSAs.** Under IRS Notice 2013-71, issued on October 31, 2013, a cafeteria plan may permit up to $500 in an employee's health FSA remaining unused at the end of a plan year to be carried over and used to reimburse medical expenses incurred in the entire following year. This is a change to the long-standing "use-or-lose" rule that restricted employees from carrying over amounts to a subsequent year. The change comes as a result of comments the IRS received after the release of Notice 2012-40, which provides guidance on the $2,500 maximum limit on the amount of salary deferrals an employee may contribute to a health FSA. Adding the carryover feature will require (i) an amendment to the plan, (ii) elimination of the grace period feature if the cafeteria plan has one, and (iii) notice to participants about the changes as soon as possible if they are being implemented for 2014.

D. **IRS Finalizes Safe Harbor Reduction Regulations.** On November 14, 2013, the Internal Revenue Service issued final regulations that permit employers to suspend or reduce safe harbor nonelective contributions under a 401(k), 401(m), or 403(b) plan during the plan year. The final regulations also revise the requirements that apply to mid-year suspensions or reductions of safe harbor matching contributions. The final regulations are generally effective for plan amendments adopted after May 18, 2009, while the new requirements that apply to safe harbor matching contributions are effective for plan years beginning on or after January 1, 2015. Under the originally issued final regulations, employers could terminate a safe harbor plan mid-year, or they could suspend or reduce safe harbor matching contributions mid-year for any reason if certain other conditions were met. However, employers were not permitted to suspend or reduce safe harbor nonelective contributions during a plan year. In 2009, the IRS issued proposed regulations allowing employers to suspend or reduce safe harbor nonelective contributions if the employer experienced a "substantial business hardship." For this purpose, a "substantial business hardship" was comparable to a substantial business hardship under the IRC section 412 funding rules. Factors used to determine whether an employer had suffered a "substantial business hardship" included (i) whether the employer was operating at an economic loss, (ii) whether there was substantial unemployment or underemployment in the employer's trade or business, (iii) whether the sales and profits of the employer's industry were depressed or declining, and (iv) whether it was reasonable to expect that the plan would only be continued if relief was granted. The final regulations modify the proposed regulations by loosening the standards under which nonelective contributions may be suspended or reduced, and by imposing new, similar restrictions on the suspension or reduction of safe harbor matching contributions. The final regulations modify the "substantial business hardship" standard for suspending or reducing safe harbor nonelective contributions, replacing that standard with an "operating at an economic loss" standard. The economic loss standard is intended to be more objective and avoid the factual uncertainty of some of

the "substantial business hardship" requirements. The final regulations also allow an employer to suspend or reduce safe harbor nonelective contributions for any reason if the employer provides participants with notice before the beginning of the plan year that discloses the possibility that contributions may be suspended or reduced during the plan year. This notice must explain that participants will receive a supplemental notice if the suspension or reduction does occur, and that the suspension or reduction will not apply until at least 30 days after the supplemental notice is provided. The following additional conditions, which remain unchanged from the conditions that applied to safe harbor matching contributions in the original final regulations, must also be met:

- Employees are given a supplemental notice describing the suspension or reduction;
- The suspension or reduction becomes effective no earlier than the later of (i) 30 days after the supplemental notice is provided, or (ii) the date the amendment is adopted;
- Employees are given a reasonable opportunity and period of time before the suspension or reduction takes effect to adjust their deferral elections;
- The plan is amended to provide that it will satisfy the ADP and/or the ACP test, using the current year testing method, for the full plan year; and
- The plan satisfies the safe harbor contribution requirement through the amendment's effective date.

In order to achieve uniformity between the rules that apply to a mid-year suspension or reduction of safe harbor matching contributions and a mid-year suspension or reduction of safe harbor nonelective contributions, the final regulations also modify the rules that apply to mid-year suspensions or reductions of safe harbor matching contributions. Safe harbor matching contributions can still be suspended or reduced for any reason, but effective January 1, 2015, the employer must provide participants with notice before the beginning of the plan year which discloses the possibility that contributions may be suspended or reduced mid-year. Suspensions or reductions as a result of operating at an economic loss are also permitted. The additional requirements described above will continue to apply to a suspension or reduction of matching contributions. The chart below highlights the main differences before and after the new final regulations:

Provision	Before New Final Regulations	After New Final Regulations
Mid-year changes to nonelective contributions	Permitted if the employer incurs a substantial business hardship, as described under IRC section 412(c)(2). Mid-year changes for other reasons not permitted.	Permitted if the employer is operating at an economic loss, as described under IRC section 412(c)(2)(A). Permitted for any reason, provided participants receive notice before the beginning of the plan year disclosing the possibility that contributions may be suspended or reduced. Effective for amendments adopted on or after May 18, 2009.
Mid-year changes to matching contributions	Permitted for any reason, including economic hardship (no requirement to provide participants notice before the beginning of the plan year).	Permitted if the employer is operating at an economic loss, as described under IRC section 412(c)(2)(A). Permitted for any reason, provided participants receive notice before the beginning of the plan year disclosing the possibility that contributions may be suspended or reduced. Effective for plan years beginning on or after January 1, 2015.

E. Guidance for In-Plan Roth Rollovers.

1. Background. On December 11, 2013, the IRS issued Notice 2013-74, providing expanded guidance on the conversion of retirement plan assets from a non-Roth to a designated Roth account within retirement plans. Such transactions are referred to as in-plan Roth rollovers (IRRs), and may be available as options within 401(k), 403(b) and governmental 457(b) plans. IRRs were first made possible by the Small Business Jobs Act of 2010 (SBJA) and were restricted to amounts satisfying any permissible distribution triggering event, regardless of whether the triggering event was allowed by a plan. With the enactment of the American Taxpayer Relief Act of 2012 (ATRA), IRR availability was expanded to include any vested amount in a plan, effective January 1, 2013. In other words, assuming the plan permits, any vested amount can be converted from a non-Roth to a Roth account without a participant having satisfied a distribution triggering event under the law.

2. Amounts Not Satisfying Distribution Trigger. Following are the key provisions of Notice 2013-74 pertaining to IRRs involving amounts that do not satisfy any permissible distribution triggering events:

- Only those amounts that are 100 percent vested can be converted to a Roth account by an ATRA IRR. An ATRA IRR must be completed by direct rollover and no notice regarding eligible rollover distributions (commonly known as a 402(f) notice) is required.
- ATRA IRR amounts and their earnings must remain subject to the distribution requirements that applied to such amounts before conversion to a Roth account.

- Neither mandatory nor voluntary withholding may be applied to an ATRA IRR because there is no distribution triggering event permitting money to leave a plan. Participants are encouraged to consider altering their wage withholding, or make estimated tax payments, if they wish to prepay an anticipated tax obligation to avoid a potential under-withholding penalty.

- Plans that allow ATRA IRRs must amend by December 31, 2014, or the last day of the plan year in which the ATRA IRRs become effective, whichever is later. The effective date of the amendment must be the date the plan first operates under the amendment's terms. This general deadline applies to non-safe harbor 401(k) plans, governmental 457(b) plans, and certain 403(b) plans as described immediately below.

- Many 403(b) plans qualified for an extension of time (remedial amendment period) to correct any document or form defects related to previously-issued final 403(b) regulations. Plans that allow ATRA IRRs must amend by the last day of the 403(b) remedial amendment period, which will be announced by the IRS in the future. If later, the amendment must be made by the last day of the plan year in which the ATRA IRR feature becomes effective. (403(b) plans not qualifying for the remedial amendment period must meet the general amending deadline described above.)

- Although most mid-year changes to 401(k) safe harbor plans are prohibited, plans that wish to add ATRA IRRs mid-year may do so for 2013 or 2014 if the amendment is executed no later than December 31, 2014 (no exception is granted for non-calendar 2014 plan years). Beyond this deadline, 401(k) safe harbor plans will generally be required to modify plan provisions for IRRs prospectively.

The above deadlines also apply to amendments permitting Roth deferrals, rollovers into Roth accounts, and IRRs of amounts that satisfied a distribution triggering event. For example, employers that have plans that do not currently allow Roth deferrals and who want to allow participants to make ATRA IRRs can make all necessary Roth amendments to accomplish their objective as long as the amendments are completed by the deadlines described above.

3. All IRRs. Following are the key provisions of Notice 2013-74 pertaining to all IRRs, including ATRA IRRs:

- Plans are allowed to restrict the kinds of contributions eligible for IRR treatment and the frequency of IRRs. For example, a plan could restrict IRRs to deferral contributions and limit participants to one IRR each year.

- Plans that allow IRRs are permitted to eliminate them if doing so does not discriminate significantly in favor of current or former highly compensated employees.

- ➢ An IRR that is a participant's first Roth contribution will start the five-year clock necessary for a qualified, tax-free distribution as of the first day of the first taxable year such IRR is completed.

- ➢ A participant that receives a lump-sum distribution in a single tax year may be eligible for special tax treatment pertaining to the net unrealized appreciation (NUA) on employer securities. An IRR, whether completed in a direct or indirect (60-day) rollover, is treated as a distribution when determining if a lump-sum distribution occurs within one taxable year.

- ➢ When calculating participant account balances to determine a plan's top-heavy status, an IRR is treated like any "related rollover" made between plans of the same employer. It is generally counted in the participant's account balance used in the top-heavy determination.

- ➢ If an excess deferral, excess contribution (ADP test amount), or excess aggregate contribution (ACP test amount) attributable to a participant is converted by an IRR, a corrective distribution to the participant must be made even if such amount has not satisfied a distribution triggering event. While the ability to make such a correction may seem intuitive, the IRS has made it clear that an IRR does not affect the requirement to make such corrective distributions.

F. Cafeteria Plans, Flexible Spending Arrangements, and Health Savings Accounts -- Elections and Reimbursements for Same-Sex Spouses. Under IRS Notice 2014-1, a cafeteria plan may treat a participant who was married to a same-sex spouse as of the date of the Windsor decision (June 26, 2013) as if the participant experienced a change in legal marital status for purposes of Treas. Reg. 1.125-4(c). Accordingly, a cafeteria plan may permit such a participant to revoke an existing election and make a new election in a manner consistent with the change in legal marital status.

G. Temporary Relief for Frozen Defined Benefit Plans. On December 13, 2013, the IRS issued Notice 2014-5, which provides temporary nondiscrimination relief for certain "closed" defined benefit pension plans. This notice permits certain employers that sponsor a closed defined benefit plan and a defined contribution plan to demonstrate that the aggregated plans comply with nondiscrimination requirements on the basis of equivalent benefits for the 2014 and 2015 plan years.

H. Cash Balance Plans. In IRS Announcement 2014-4, the Service indicated that it intends to add cash balance plans to the pre-approved defined benefit plan program. As part of this announcement, the IRS has stated that it will extend the pre-approved defined benefit plan submission deadline from January 31, 2014 to February 2, 2015. However, the IRS has reserved the right to specify a separate (presumably later) deadline date for submitting preapproved drafts of PPA DB specimen documents that have a cash balance feature. It may be able to avoid future cash balance determination letter submissions. If the employer and prototype

sponsor/volume submitter practitioner sign IRS Form 8905 indicating an intention to adopt a pre-approved plan, then the deadline to submit the plan will be based on the 6-year cycle for pre-approved plans. The form must be adopted by the last day of the otherwise applicable deadline that applies to the plan.

I. **The New myRA**. The Treasury Department, as ordered by the President without the need for Congressional approval, is developing the myRA (my Retirement Account) to give people the opportunity to save in what they say should be a simple and straightforward manner. The myRA (and note, Treasury says it is not pronounced "Myra") is intended to supplement Social Security and other possible savings. It is not expected to be the primary source of retirement income for Americans. In many respects, it looks like a payroll reduction Roth account for small savings amounts:

- Looks and feels like a Roth IRA with the same tax treatment (after-tax contributions, tax-free growth) with annual income eligibility limits beginning at $129,000 for an individual and $191,000 for a couple, both of which will be subject to COLA adjustments.
- It is a no-load arrangement, i.e., there will be no fees for the investments (although a White House fact sheet hints that there could be some other costs).
- A myRA can be opened with as little as $25, and direct salary reduction of at least $5 can be funded into the myRA.
- The account balance will never go down in value.
- Security for a myRA will be the full faith and credit of the United States – in other words, myRAs will be invested in U.S. savings bonds and other Treasury instruments while earning interest at the variable rate that is the Government Securities Investment Fund rate in the Thrift Savings Plan for Federal employees, i.e., a very low rate of return.
- There will be no employer contributions.
- There will be no requirement for employers to participate – but Treasury believes that participation by employers will help them attract and retain employees at little or no cost (just the cost of processing and transmitting the contributions) and that doing so will be an easy way for them to assist employees in improving their financial situations through saving.
- Once an employer agrees to participate, employees will sign up online. Details will need to be provided in order to coordinate the employee enrollment with the employer payroll system.
- myRA is fully portable.
- myRA contributions can be withdrawn at any time on a tax-free basis .

- Earnings in a myRA will be tax-free unless withdrawn before the saver is 59½.

- Savers can build their account for 30 years or until the myRA reaches $15,000. Once the first of these is reached, the myRA will rollover to a private-sector Roth IRA. Treasury will promulgate rollover rules.

- myRAs are not intended to replace other savings arrangement like 401(k) plans and 403(b) plans. myRAs are intended to benefit those employees who do not have access to an employer sponsored plan.

- Treasury expects myRAs to be available in late 2014.

J. PBGC proposed rule aims to reduce administrative burden on multiemployer plans. On January 28, 2014, the PBGC issued a proposed rule as part of its ongoing effort to eliminate unnecessary administrative costs that reduce multiemployer plan assets. Specifically, the PBGC proposed to (1) allow valuations every three years, instead of annually, for plans that are terminated by mass withdrawal but are not insolvent, where the actuarial value of the plan's nonforfeitable benefits is $25 million or less; (2) eliminate the requirement to provide annual updates to a terminated plan's notice of insolvency; and (3) shorten the notice period for multiemployer plan mergers from 120 to 45 days.

K. One Rollover Per Year Limitation. The United States Tax Court rendered a decision that conflicts with previous IRS guidance on an IRA rollover limitation. In *Bobrow v. Commissioner*, T.C. Memo. 2014-21 (Jan. 28, 2014), the Tax Court ruled that each taxpayer is limited to one IRA distribution eligible for rollover per 12-month period, regardless of the number of IRAs the taxpayer may have. This conflicts with very detailed information and examples in IRS Publication 590, Individual Retirement Arrangements (IRAs), which is what the IRS model IRA documents refer taxpayers to for an understanding of IRA operational requirements. Publication 590 clearly states that each IRA owned by a taxpayer (not including beneficiary IRAs) is entitled to one rollover-eligible distribution per 12-month period. The Tax Court's ruling also conflicts with previous oral guidance from the IRS and with language in many document providers' model-based and prototype IRA document disclosure statements.

L. IRA Rollover Limit Will Be Applied on an Aggregate Basis. The IRS formally indicated in Announcement 2014-15 that it will interpret section 408(d)(3)(B), which provides that an individual is permitted to make only one IRA rollover in any one-year period, as imposing the limitation on an aggregate basis rather than on an IRA-by-IRA basis. However, the IRS will not apply this interpretation of the statute to any rollover that involves an IRA distribution occurring before January 1, 2015.

M. Personal Liability to a Multiemployer Plan. A recent federal district court concluded that the founders and sole officers of a cleaning company violated their fiduciary duties under ERISA by failing to remit contributions to a multiemployer plan. The plan's collection policy specifically provided that "all money owed to the trust, which

money (whether paid, unpaid, segregated or otherwise traceable, or not) becomes a trust asset on the due date." Because of that statement, the court determined that the contributions became trust assets from the date they were owed and that the officers of the company who chose to pay other company obligations were personally liable for the delinquent contributions. That liability attached even though the business was operated in corporate form. *Trustees of the Construction Industry and Laborers Health and Welfare Trust et al v. Sheryl Archie et al.*, Nevada District Court No. 2:2012cv00225 (March 3, 2014).

N. New Two-Year Period to Adopt Restated Pre-approved DC Plans. In Announcement 2014-16, the IRS indicated that employers using pre-approved defined contribution plan documents must adopt plan documents restated for the 2010 Cumulative List by April 30, 2016. An employer who adopts a master & prototype plan (standardized or non-standardized) or volume submitter plan may not apply for its own determination letter on Form 5307, Application for Determination for Adopters of Master or Prototype or Volume Submitter Plans, as has been the common practice. Instead, the employer must rely on the letter issued to the plan sponsor. However, an adopting employer who made limited modifications to its volume submitter plan may apply for a determination letter on Form 5307. If the modifications are extensive, causing the plan to be treated as an individually designed plan, the employer must instead file Form 5300, Application for Determination for Employee Benefit Plan.

O. Safe Harbor Procedures for Rollovers. The IRS has issued guidance in Rev. Rul. 2014-9 providing two streamlined safe harbor due diligence procedures under which it is reasonable, absent evidence to the contrary, for a plan administrator to conclude that an amount is a valid rollover contribution.

1. In the first scenario described in the guidance, an employee requests a distribution from a retirement plan maintained by her prior employer (prior plan) into a qualified profit-sharing plan maintained by her current employer. The employee delivers the check -- along with a check stub identifying the prior plan as the source of the funds -- to the profit-sharing plan administrator. In the second scenario, the employee requests a distribution of her traditional IRA account balance in the form of a direct payment to the profit-sharing plan. The employee delivers the check, including a check stub identifying the IRA as the source of the funds, to the profit-sharing plan administrator.

2. In the first scenario, the plan administrator for the prior plan did not indicate on Form 5500 that the prior plan was a "plan not intended to be qualified." Thus, the IRS determined that the plan administrator made a representation -- and it's reasonable for the profit-sharing plan administrator to conclude -- that the prior plan is intended to be a qualified plan. The prior plan's trustee issued a check payable to the profit-sharing plan's trustee for the benefit of the employee, which indicates that the plan administrator for the prior plan treated the distribution as an eligible rollover distribution to be directly rolled over. Accordingly, the IRS ruled that, absent evidence to the contrary, it is reasonable for the profit-sharing plan administrator to conclude that the potential rollover contribution is an eligible rollover distribution from the prior plan and a

valid rollover contribution to the profit-sharing plan. Thus, for example, if the distribution had occurred during or after the year in which the employee had attained age 70-1/2, it would be reasonable for the profit-sharing plan administrator to conclude that the prior plan distributed the required minimum amount under section 401(a)(9) for the year before making the direct rollover.

3. In the second scenario, the IRA's trustee issued a check payable to the profit-sharing plan's trustee for the benefit of the employee, which indicates that the IRA's trustee treated the distribution as a rollover contribution paid directly to the profit-sharing plan. Because the check stub indicates that the distributing account is titled "IRA of Employee A," the profit-sharing plan administrator can reasonably conclude that the source of the funds is a traditional, non-inherited IRA. The employee also certified that the distribution included no after-tax amounts and that she will not attain age 70-1/2 by the end of the year of the transfer. Therefore, it is reasonable for the profit-sharing plan administrator to conclude that the distribution from the IRA is a distribution that can be rolled over. If the employee had attained age 70-1/2 or older by the end of the year in which the check was issued, the profit-sharing plan administrator could not reasonably conclude that the potential rollover contribution was a valid rollover contribution, absent additional information indicating that section 408(a)(6) or (b)(3) had been satisfied for the IRA in the year in which the check was issued.

4. According to the guidance, the results would be the same in both scenarios if there had been no check stub identifying the source of the funds as long as the check itself identified the source of the funds. The results also would be the same if the rollover had been accomplished through a wire transfer or other electronic means as long as the plan administrator or trustee for the prior plan or IRA had communicated to the profit-sharing plan administrator the same information regarding the source of the funds.

P. Time to Amend Plans to Cover Same-Sex Spouses. On April 4, 2014, the IRS released Notice 2014-19, which provides a series of Q&As regarding the application of the U.S. Supreme Court's decision in *United States v. Windsor* and the IRS's prior guidance in Revenue Ruling 2013-17 to qualified retirement plans. On the same day, the IRS posted additional, related Q&As on its website. The new guidance provides that qualified retirement plans must recognize same-sex spouses as of June 26, 2013, the date of the *Windsor* decision, while plans may, but are not required to, recognize same-sex spouses before that date. The Notice also clarifies when plan amendments may be required. The Windsor decision invalidated, on equal protection grounds, the Defense of Marriage Act (DOMA) which limited marriage to opposite-sex couples for purposes of federal law. Following the decision, the IRS issued Revenue Ruling 2013-17, which held that same-sex marriages legally entered into in any state that recognizes such marriages would be recognized for federal tax purposes as of September 16, 2013, the date of the Ruling. The Ruling also held that the law of the state in which a same-sex couple entered into their marriage, and not the state of their domicile, would control for federal tax purposes. Notice 2014-19 says that qualified retirement plans must recognize same-sex spouses as of the date of the Windsor decision (June 26, 2013); however, plans will not be disqualified for failing to recognize

same-sex spouses before that date. Operationally, qualified retirement plans must: (i) recognize a same-sex spouse as of June 26, 2013, if the same-sex couple was legally married and resided in a state that recognized same-sex marriages; and (ii) recognize a same-sex spouse as of September 16, 2013, if the same-sex couple is legally married, regardless of where they reside. The Notice also provides that qualified retirement plans may choose to recognize same-sex spouses before June 26, 2013, although the IRS noted that this may be difficult to administer and may trigger unintended consequences. As a result, a plan is free to recognize same-sex spouses before June 26, 2013, for certain purposes, but not others. For example, a plan may choose to recognize same-sex spouses solely with respect to the QJSA and QPSA rules before June 26, 2103, and solely with respect to annuity starting dates or dates of death on or after a certain date. The Notice states that plan amendments are only required if the plan's terms are inconsistent with the Windsor decision. For example, a plan that defines a marital relationship by reference to DOMA requires an amendment, while a plan that defines a marital relationship by reference to "any legally married spouse" does not. Additionally, if a plan wishes to recognize same-sex spouses before June 26, 2013, an amendment is required. Regardless of plan language, the Notice states that a clarifying amendment may be useful for purposes of plan administration. Plans generally must be amended by December 31, 2014, or, if later, the due date of the employer's tax return for the tax year that includes the amendment's effective date. Although the Notice only refers to qualified plans, the additional Q&As on the IRS website note that the Notice is generally applicable to 403(b) plans. Different amendment deadlines, however, apply to 403(b) plans, which must be amended by the end of the 403(b) remedial amendment period.

Q. Form 5500 – Small Welfare Plan Filing Requirment. A small welfare plan is exempt from filing a Form 5500 if the plan (i) covers fewer than 100 participants at the beginning of the plan year, and (ii) is unfunded, fully insured or a combination of insured and unfunded. However, commencing with filings for the 2013 plan year, a small welfare plan that provides benefits wholly or partially through a Multiple Employer Welfare Arrangement (MEWA) as defined in ERISA §3(40) must file a Form 5500 unless otherwise exempt (government, top-hat, etc.). Accordingly, plans required to file a Form M-1, Report for Multiple Employer Welfare Arrangements (MEWAs) and Certain Entities Claiming Exception (ECEs) are not eligible for the small welfare plan filing exemption. Such plans must file regardless of their size or funding. If a welfare plan fails to file a Form 5500, the plan sponsor is subject to DOL late filing penalties.

R. SSA Letter-Forwarding Program Discontinued. The Social Security Administration (SSA) has announced the end of its letter-forwarding program, a locator service that has been available to the public since 1945. The service ceased on May 19, 2014. Under the program, letters could be submitted for forwarding to the most recent address on file for the addressee. Submissions were free of charge for "humanitarian" searches, which included situations where the health or welfare of an individual was at risk or where reconnection between immediate family members was sought. For "monetary" searches, where the person being looked for was due something of value, there was a charge of $35 for each forwarded letter. Both this program and the curtailed IRS program were mainstays for attempting to locate missing plan participants,

an effort required of plan administrators under ERISA's fiduciary duty rules. For example, when a terminating 401(k) plan needs to provide notices and distributions to participants that are no longer at the last known address the plan has on file, DOL guidance sets out four mandatory search methods to be used, including the SSA letter-forwarding program (and the now-curtailed IRS letter-forwarding program). The IRS's EPCRS program for correcting plan mistakes also requires that reasonable actions be taken to locate missing participants, calling out this now-eliminated program as one method for doing so (see our article). Until these pieces of DOL and IRS guidance are updated, plans might consider supplementing the remaining required methods with additional mechanisms suggested by the agencies, such as Internet searches, commercial locator services, and credit-reporting agencies. If the cost of these additional search options will be charged to participants' accounts, plan fiduciaries must consider the size of a participant's account in relation to the cost of the search when deciding whether the search option is appropriate for that participant.

S. Form 5500 Penalty Relief and Pilot Program.

1. Notice 2014-35. The IRS has announced relief from late-filing penalties relating to the filing of Form 5500, Form 5500-SF, and Form 8955-SSA or the filing of required actuarial reports with respect to a year for which filing of such a form is required on a person who: (i) is eligible for and satisfies the requirements of the Labor Department's Delinquent Filer Voluntary Compliance (DFVC) program with respect to a delinquent Form 5500 series return for the tax year; and (ii) files separately with the IRS, in the form and within the prescribed time (i.e., generally 30 calendar days after the filer completes the DFVC filing or December 1, 2014, if later), a Form 8955-SSA with any information required to be filed under section 6057 for the year to which the DFVC filing relates (to the extent that the information has not previously been provided to the IRS). Thus, Notice 2014-35 provides relief from the penalties applicable under the Code for the late filing of Forms 5500 and 5500-SF, but only if any applicable Form 8955-SSA is also filed for the year at issue. The late filer need not file a separate application for relief with the IRS.

2. Rev. Proc. 2014-32. The IRS has established a one-year pilot program providing penalty relief to plan administrators who fail to timely file Form 5500 EZ. Rev. Proc. 2014-32 offers relief from penalties imposed for late annual reporting by "one-participant plans" and certain foreign plans. The relief from penalties for a failure to timely comply with annual reporting requirements is available to filers who are eligible to participate under the provisions of Rev. Proc. 2014-32 and who file returns and satisfy other requirements under today's revenue procedure by no later than June 2, 2015. Rev. Proc. 2014-21 provides that in lieu of the relief provided, filers may continue to file for the relief under the current "reasonable cause" standard.

T. Retirement Plan Payments for Accident, Health and Disability Insurance. Final regulations (T.D. 9665) state that payments from a qualified defined contribution plan to pay a participant's (i) accident and health insurance premiums are taxable distributions to the participant unless a statutory exception applies (Internal Revenue Code Sections 72 and 402(a)), and (ii) disability insurance premiums are not

taxable distributions if they meet certain conditions. The regulations finalize the 2007 proposed regulations and add the exception for disability insurance coverage; they are effective January 1, 2015, but may be applied earlier.

1. Accident and Health Insurance. The 2007 proposed regulations stated the general rule that payments from a qualified plan to pay a participant's accident or health insurance premiums are taxable distributions unless they're paid from a qualified retiree health account (IRC Section 401(h)), or for qualified public safety officers (IRC Section 402(l)).

2. Disability Insurance. The final regulations include an exception for disability insurance premiums being taxed to participants if the following conditions are met:

a. Premiums for the disability insurance contract are paid directly from the plan;

b. The plan receives the benefit payments as required by the disability insurance contract;

c. Benefit payments under the contract are paid because of an employee's inability to continue employment with the employer because of disability; and

d. The benefit payments to a participant's account are not more than a reasonable expectation of what the participant would have received as an annual contribution during the disability period, reduced by any other contributions.

If these conditions are satisfied, the disability insurance is considered a plan investment, and the plan's premium payments and the insurance's benefit payments to the plan aren't taxable to the participant. If the disability insurance premiums aren't paid by the plan, the insurance benefits paid to the plan aren't a return on a plan investment. Instead, these payments are contributions to the plan governed by qualified plan contribution rules (generally, IRC Section 415(c), which limits employer contributions to a defined contribution plan). If an employer self-insures this disability coverage (or doesn't finance it through third party insurance), the amount paid to the plan because of the employee's disability is also considered a contribution to the plan governed by the general qualified plan contribution rules.

U. Inherited IRA Not Exempt From Bankruptcy. In a unanimous opinion written, the U.S. Supreme Court held that funds from an inherited IRA were not retirement funds that were exempt from the debtor's bankruptcy estate. *Clark v. Rameker*, No. 13-299 (U.S. 6/12/14), aff'g 714 F.3d 559 (7th Cir. 2013). The taxpayers in the case filed for Chapter 7 bankruptcy and sought to exclude approximately $300,000 in an inherited IRA from the bankruptcy estate on the grounds that the money was "retirement funds" under Section 522(b)(3)(C) of the Bankruptcy Code (11 U.S.C. §522(b)(3)(C)). Bankruptcy Code Section 522(b)(3)(C) excludes retirement funds from a bankruptcy estate to the extent those funds are in a fund or account that is exempt from

taxation under Sec. 401, 403, 408, 408A, 414, 457, or 501(a). However, as the Supreme Court explained, although traditional retirement accounts, such as IRAs or Roth IRAs, are included in this definition, inherited IRAs are not because they do not operate as retirement accounts. The Supreme Court pointed to three legal characteristics of inherited IRAs that led it to conclude they are not retirement accounts. First, inherited IRA owners may not make additional contributions to the account. Second, owners must withdraw funds from their accounts, regardless of how many years they are from retirement. Third, owners are not subject to any age-related penalties for withdrawals from their accounts. Taking all of these characteristics together, the Supreme Court agreed with the Seventh Circuit that "[f]unds held in inherited IRAs accordingly constitute 'a pot of money that can be freely used for current consumption,' ... not funds objectively set aside for one's retirement". According to the Supreme Court, allowing debtors to protect funds in traditional retirement accounts, but not inherited IRAs, permits the Bankruptcy Code to achieve a balance between debtors and creditors. Debtors are assured that they will be able to meet their basic needs during their retirement years. Allowing bankruptcy exemptions for funds that are not restricted to use for retirement, as inherited IRAs are not, would allow debtors to use those funds for current consumption after bankruptcy proceedings are complete, changing the Bankruptcy Code's "'fresh start' into a 'free pass'". The Court rejected the debtor's argument that, because the account was originally a retirement account when the debtor's mother created it, it retained that character after it was inherited. According to the Court, the use of the term "'retirement funds' implies that the funds are currently in an account set aside for retirement, not that they were set aside for that purpose at some prior date by an entirely different person".

V. IRA Distribution Rollover Requirement Waived. In PLR 201424029, the IRS waived the Section 408(d)(3) 60-day rollover requirement for a distribution from an IRA. Upon the advice of a financial advisor, the taxpayer took a distribution from an IRA on September 10, 2012. The taxpayer represented that she relied on the financial advisor that the distribution would be invested in another tax qualified retirement plan. The taxpayer contacted the financial advisor in mid-January 2013, after she noted that the account was not designated as an IRA account. The financial advisor provided a statement to the IRS regarding the distribution.

W. Excess Contribution to Plan Due to 'Mistake of Fact' not a Reversion. In PLR 201424032, The IRS ruled that an excess contribution to a defined benefit plan based on an incorrect asset value occurred because of a "mistake of fact" and, therefore, the amount may be returned to the company that made the initial contribution in order to terminate the plan. The return of the excess amount will not constitute an employer reversion.

X. S Corporation Distributions to ESOP Are Not Annual Additions. In PLR 201424030, the IRS ruled that proposed S corporation distributions to the accounts of participants in company's employee stock ownership plan will not constitute or be treated as an annual addition under Section 415(c)(2).

Y. Loan to ESOPs Is a Prohibited Transaction. In technical advice, the IRS ruled that a loan failed the requirements of exemption from the prohibited transaction rules for loans to employee stock ownership plans and, therefore, constituted a prohibited transaction. A Labor Department review of the plans found that the principal-only method, rather than the principal and interest method, had been used to calculate the release of shares from 1999 through 2004. The Department said failure to use the method required by the ESOP pledge agreement constituted a prohibited transaction under ERISA. The Department subsequently said that even if the principal-only method had been permitted by the plans and pledge agreement, the loan did not meet the statutory requirements needed to allow principal-only payments. The IRS concluded that the loan constituted a prohibited transaction under section 4975(c) and that the company is liable for excise taxes. It also said the actual interest rather than the prime rate should be used to determine the amount involved and the excise taxes. TAM 201425019.

Z. No Presumption of Prudence for Fiduciaries of ESOPs. In *Fifth Third Bancorp v. Dudenhoeffer*, 133 S.Ct. 1656 (2013), the Supreme Court ruled unanimously that "the law does not create a special presumption favoring ESOP fiduciaries. Rather, the same standard of prudence applies to all ERISA fiduciaries, including ESOP fiduciaries, except that an ESOP fiduciary is under no duty to diversify the ESOP's holdings". This ruling overturns the so-called Moench presumption of prudence rule that has been applied to plan fiduciaries for certain 401(k) plans investing in company stock and ESOPs. The case concerned a publicly traded company with a 401(k) plan in which the company matched employee contributions by contributing employer stock to an ESOP that was a component of the 401(k) plan. The plan document required the ESOP to invest primarily in company stock. The stock dropped precipitously and employees sued. The lower court said fiduciaries were entitled to a presumption of prudence in continuing to offer the shares and dismissed the case. Upon review, the Sixth Circuit applied a stronger test for the presumption and rejected its applicability at the pleadings stage in this case. In ESOPs in closely held companies, fiduciaries have few options. First, the law requires that ESOPs be primarily invested in company stock. Second, the only liquidity options are a company buy-back of shares, which is probably impractical if the company is already in financial distress, or a sale of the company. But a fire sale like that would mean an even lower price for plan participants. In effect, the presumption has so far not been an issue for closely held ESOP companies in court, and it may continue not to be as plaintiffs would have a hard time indicating what fiduciaries should have done. Instead, cases will continue to focus, as they have been before where there are alleged problems, on the initial sale price of the shares of the ESOP, which is determined by an outside appraiser. It is possible, however, that the *Dudenhoeffer* decision may embolden the plaintiffs' bar to initiate more lawsuits.

AA. Minimum Distribution Rules Now Permit Longevity Annuities. On July 1, 2014, the U.S. Department of the Treasury and the Internal Revenue Service issued final rules regarding longevity annuities (T.D. 9673). A longevity annuity is an income stream – a type of "deferred income annuity" – that begins at an advanced age and continues throughout the individual's life. These regulations make longevity annuities accessible to the 401(k) and IRA markets. Ordinarily, the minimum distribution

rules require these plans to begin making distributions when the employee reaches age 70 1/2 or the calendar year in which the employee retires. The regulations exempt qualifying longevity annuities from the minimum distribution rules and delay minimum distributions until the first day of the month after the account holder reaches age 85.

1. Increasing the Maximum Permitted Investment. A 401(k) or similar plan, or IRA, may permit plan participants to use up to 25 percent of their account balance or (if less) $125,000 (up from $100,000 in the proposed regulations) to purchase a qualifying longevity annuity without concern about noncompliance with the age 70 1/2 minimum distribution requirements. The dollar limit will be adjusted for cost-of-living increases more frequently than under the proposed rules (in $10,000 increments instead of the $25,000 increments under the proposed rules for adjustment of the previous $100,000 limit).

2. Allowing "Return of Premium" Death Benefit. A longevity annuity in a plan or IRA can provide that, if purchasing retirees die before (or after) the age when the annuity begins, the premiums they paid but have not yet received as annuity payments, will be returned to their accounts. This option may appeal to individuals seeking peace of mind that if they die before receiving the annuity, their initial investment can go to their heirs. The proposed regulations had permitted a life annuity payable to a designated beneficiary after the annuity owner's death, but not this type of "return of premium" upon death.

3. Protecting Individuals Against Accidental Payment of Longevity Annuity Premiums Exceeding the Limits. The final rules permit individuals who inadvertently exceed the 25 percent or $125,000 limits on premium payments to correct the excess without disqualifying the annuity purchase.

4. Providing More Flexibility in Issuing Longevity Annuities. The proposed regulations provided that a contract is not a qualifying longevity annuity contract unless it states, when issued, that it is intended to be one. In response to comments, the final rules facilitate the issuance of longevity annuities by allowing the alternatives of including such a statement in an insurance certificate, rider, or endorsement relating to a contract.

BB. Fiduciary Duties and Missing Participants in Terminated Defined Contribution Plans. On August 14, 2014, the DOL issued Field Assistance Bulletin No. 2014-01 providing guidance to fiduciaries of terminated defined contribution plans in order to help them fulfill their obligations under ERISA to locate missing participants and properly distribute the participants' account balances.

1. Background. Under the Internal Revenue Code, a plan administrator must distribute all of a plan's assets as soon as administratively feasible after plan termination. *See* Rev. Rul. 89-87, 1989-27 I.R.B. 5. Before making a distribution, the plan administrator has a responsibility to contact the plan's participants for directions on how to distribute their account balances. *See* Internal Revenue Code §402(f). This requirement extends to all participants, regardless of their length of service

or the size of their account balances. Sometimes, however, participants fail to respond to the notices (or mail sent to their addresses is returned), creating a practical dilemma for the plan administrator who has a fiduciary obligation to search for missing participants and distribute their benefits.

2. Law. Under the requirements of Section 404(a) of ERISA, a fiduciary must act prudently and solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable expenses of administering the plan. Also, under Section 404(a)(1)(D) of ERISA, fiduciaries are required to act in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of Titles I and IV of ERISA. Section 402(b)(4) of ERISA provides that every employee benefit plan shall specify the basis on which the plan makes benefit payments. Section 403(a) of ERISA generally requires that a trustee must hold the assets of a plan in trust. In the case of plan terminations, fiduciaries must also ensure that the allocation of any previously unallocated funds is made in accordance with the provisions of Section 403(d) of ERISA. Consistent with their obligations of prudence and loyalty, plan fiduciaries must make reasonable efforts to locate missing participants or beneficiaries, so that they can implement directions on plan distributions from the participants or beneficiaries. However, after a plan fiduciary reasonably determines, in accordance with this guidance, that a participant or beneficiary cannot be located, the fiduciary may distribute the missing participant's or beneficiary's benefits in the manner described below. Once a plan fiduciary properly distributes the entire benefit to which a missing participant is entitled, the distribution ends the individual's status as a participant covered under the plan and the distributed assets are no longer plan assets under ERISA. However, if the distributed benefit is reduced due to a fiduciary breach, the individual would still have standing to file suit against the breaching fiduciary under Section 502(a)(2) of ERISA.

3. Search Costs. A plan fiduciary may charge missing participants' accounts reasonable expenses for efforts to find them. The amount charged to a participant's account must be reasonable and the method of allocating the expense must be consistent with the terms of the plan and the plan fiduciary's duties under ERISA. Plan fiduciaries must be able to demonstrate compliance with ERISA's fiduciary standards for all decisions made to locate missing participants and distribute benefits on their behalf.

4. Required Search Steps. At a minimum, fiduciaries should take all of the following steps before abandoning efforts to find a missing participant and obtain distribution instructions:

a. *Certified Mail.* Certified mail is an easy way to find out, at little cost, whether the participant can be located in order to distribute benefits. The Department provided a model notice that could be used for such mailings as part of a regulatory safe harbor, but its use is not required and other notices could satisfy the safe harbor.

b. *Check Related Plan and Employer Records.* While the records of the terminated plan may not contain current address information, it is possible that the employer or another of the employer's plans, such as a group health plan, may have more up-to-date information. For this reason, plan fiduciaries of the terminated plan must ask both the employer and administrator(s) of related plans to search their records for a more current address for the missing participant. If there are privacy concerns, the plan fiduciary engaged in the search can request that the employer or other plan fiduciary contact or forward a letter for the terminated plan to the missing participant or beneficiary. The letter would request that the missing participant or beneficiary contact the searching plan fiduciary.

c. *Check With Designated Plan Beneficiary.* In searching the terminated plan's records or the records of related plans, plan fiduciaries must try to identify and contact any individual that the missing participant has designated as a beneficiary (e.g., spouse, children, etc.) to find updated contact information for the missing participant. Again, if there are privacy concerns, the plan fiduciary can request that the designated beneficiary contact or forward a letter for the terminated plan to the missing participant or beneficiary.

d. *Use Free Electronic Search Tools.* Plan fiduciaries must make reasonable use of Internet search tools that do not charge a fee to search for a missing participant or beneficiary. Such online services include Internet search engines, public record databases (such as those for licenses, mortgages and real estate taxes), obituaries and social media.

e. *Additional Search Steps.* If a plan administrator follows the required search steps, but does not find the missing participant or beneficiary, the duties of prudence and loyalty require the fiduciary to consider if additional search steps are appropriate. A plan fiduciary should consider the size of a participant's account balance and the cost of further search efforts in deciding if any additional search steps are appropriate. As a result, the specific additional steps that a plan fiduciary takes to locate a missing participant may vary depending on the facts and circumstances. Possible additional search steps include the use of Internet search tools, commercial locator services, credit reporting agencies, information brokers, investigation databases and analogous services that may involve charges.

5. Distribution Options. There will be circumstances when, despite their use of the search steps described above, the fiduciaries of terminated defined contribution plans will be unable to locate missing participants or obtain distribution directions. In such cases, the plan fiduciaries will have no choice but to select an appropriate distribution option to complete the plan's termination.

a. *Individual Retirement Plan Rollovers – Preferred Distribution Option.* Section 404(a) of ERISA requires plan fiduciaries to consider distributing missing participant benefits into individual retirement plans (i.e., an individual retirement account or annuity). An individual retirement plan is more likely to preserve funds for retirement than any other option. A distribution that qualifies as an eligible rollover

distribution from a qualified plan, which is handled by a trustee to trustee transfer into an individual retirement plan, will avoid immediate taxation. An eligible direct rollover results in the deferral of income tax, avoids 20 percent mandatory withholding, and avoids any 10 percent additional tax for early distributions that might otherwise apply based on the participant's age and related facts. Funds in the individual retirement plan continue to grow tax-free and income taxes do not need to be paid until funds are withdrawn.

b. *Alternative Distribution Options*. If a plan fiduciary cannot find an individual retirement plan provider to accept a direct rollover distribution for a missing participant or determines not to make a rollover distribution for some other compelling reason based on the particular facts and circumstances, the fiduciary may consider two other options. These two options are: (i) opening an interest-bearing federally insured bank account in the name of the missing participant or beneficiary, or (ii) transferring the account balance to a state unclaimed property fund. Before making such a decision, however, the fiduciary must prudently conclude that such a distribution is appropriate despite the potential considerable adverse tax consequences to the plan participant. Unlike tax-free rollovers into an individual retirement plan, the funds transferred to a bank account or state unclaimed property fund generally are subject to income taxation, mandatory income tax withholding and a possible additional tax for premature distributions. Moreover, any interest that accrues after the transfer generally would be subject to income taxation upon accrual. These tax consequences reduce the amount of money available for retirement. A prudent and loyal fiduciary would not voluntarily subject a missing participant's funds to such negative consequences in the absence of compelling offsetting considerations. In fact, in most cases, a fiduciary would violate ERISA section 404(a)'s obligations of prudence and loyalty by causing such negative consequences rather than making an individual retirement plan rollover distribution.

6. Miscellaneous Issues. Fiduciaries have expressed concerns about legal issues that might prevent them from establishing individual retirement plans or bank accounts for missing participants. These issues include perceived conflicts with the customer identification and verification provisions (CIP) of the USA PATRIOT Act (Act). The CIP provisions establish standards for financial institutions to verify the identity of customers who open accounts. To deal with this problem, Treasury staff, along with the staff of the other Federal functional regulators, issued helpful guidance for fiduciaries that are establishing an individual retirement plan or federally insured bank account in the name of a missing participant. This guidance was published on the regulators' web sites in a set of questions and answers, "FAQs: Final CIP Rule." *See* "FAQs: Final CIP Rule" at www.fincen.gov/finalciprule.pdf.

CC. Pension Funding Relief Extended. In August, Congress passed, and the President signed, the Highway and Transportation Funding Act of 2014 (HATFA 2014). The legislation includes an extension of 2012's Moving Ahead for Progress in the 21st Century Act (MAP-21) defined benefit plan 'funding stabilization' relief. MAP-21 put a 'floor' under valuation interest rates. The floor is equal to (1) the average of rates for a 25-year period, (2) reduced by multiplying it by a percentage beginning at 90% in 2012

and 'phasing down' to 70% by 2016 and thereafter (we will call this the 'phase-down percentage'). HATFA 2014 extends this relief by applying the 90% phase-down percentage through 2017. The following chart compares current and HATFA 2014 phase-down percentage rules:

Phase-down %	Applicable year -- current rules	Applicable year -- HATFA 2014
90%	2012	2012-2017
85%	2013	2018
80%	2014	2019
75%	2015	2020
70%	After 2015	After 2020

DD. Surviving Spouse May Roll Over Roth IRAs Payable to Trust. In PLR 201423043, the IRS determined that a surviving spouse could roll over two Roth IRAs, which were payable to a trust controlled by her, into her own Roth IRA. The taxpayer's late husband had maintained the Roth IRAs and created the trust. The taxpayer's husband had two Roth IRAs. He designated a trust as the beneficiary of the two Roth IRAs, with the provision that upon his death, his wife would become the sole trustee of the trust. The husband also directed that the trust be divided into two sub-trusts (Marital Trust and Family Trust). The husband died and the wife became the sole trustee of the trust. The wife intended to allocate the assets of the trust, except for the Roth IRAs, to Family Trust. The wife also proposed to make a distribution of both Roth IRAs to herself as beneficiary of Marital Trust. Further, the taxpayer intended to roll over the distribution into one or more IRAs set up and maintained in her own name. The taxpayer asked if both Roth IRAs would be treated as inherited IRAs and if she could roll over both IRAs into a Roth IRA maintained in her name. The IRS explained that if the proceeds of a decedent's IRA are payable to a trust, and are paid to the trustee of the trust, who then pays them to the decedent's surviving spouse as the beneficiary of the trust, the surviving spouse is treated as having received the IRA proceeds from the trust and not from the decedent. The surviving spouse, the IRS further explained, cannot roll over the distributed IRA proceeds into his or her own IRA. However, this case was different. The surviving spouse was the sole trustee of the trust and had authority under the trust to pay the IRA proceeds to herself. The IRS concluded that the wife could roll over proceeds of both Roth IRAs into a Roth IRA in her own name. The IRS also determined that the Roth IRAs were not inherited IRAs.

EE. Spouses Permitted to Rollover Inherited IRAs Through Trust to Their Own IRAs. In PLRs 201430026 and 2014130029, the IRS allowed the surviving spouses to roll their inherited IRAs through a trust to their own IRAs. Somewhat unusual from an estate planning standpoint, the trust beneficiary in each of these PLRs was the spouse's own trust, not a trust established by the deceased IRA owner. In PLR 201430026, the spouse had "the power to control and direct payments, add or remove trust property, and amend or revoke" the trust. Further, she did not need the approval of any trustee or beneficiary with regard to transactions in retirement accounts. In PLR 201430029, the spouse had similar rights. She could "modify, amend, or revoke" the trust. She also had the right to withdraw income as well as principal. In both PLRs, the IRS allowed the spouse to take a distribution of the inherited IRA from the trust and within 60 days do a rollover into an IRA in her own name. According to the IRS, the general rule will not apply in a case where the IRA has not yet been distributed and the surviving spouse as the sole trustee of the decedent's trust has sole authority and discretion under the trust to pay the IRA proceeds to him/her. In such a case, when the surviving spouse actually receives the IRA proceeds, the surviving spouse may roll over the amounts into an IRA set up and maintained in his/her name within 60 days.

FF. Bill to Amend Pension Nondiscrimination Rules. In November 2013, Senators Cardin and Portman wrote to Treasury Secretary Jack Lew expressing concern with the regulation that unfairly penalizes employers that engaged in "soft freezes" of their defined benefit pension plans. "Soft freezes" allow existing employees to continue to accrue benefits in a company's defined benefit plans, while newer employees are placed in a defined contribution plan. "Soft freezes" have the potential to cause plans to inadvertently violate the regulation mentioned above, which requires plans to comply with certain nondiscrimination testing requirements. This is because, when a defined benefit plan is "soft frozen," the number of highly-compensated employees grandfathered into that plan impermissibly rises over time, as no new employees join the defined benefit plan. The Retirement Security Preservation Act of 2014 (S. 2855) would provide that a pension plan does not fail the section 401(a)(4) nondiscrimination rules, or the minimum participation requirement in section 401(a)(26), provided the composition of the closed class of participants in the plan meets certain requirements. Those requirements include: (i) the closed class satisfied the rules as of the date the class was closed (including the nondiscrimination rules for benefits, rights, and features offered to the closed class), and (ii) after the closing date, any plan amendments that modify the closed class (or benefits, rights and features provided to the class) satisfy the nondiscrimination rules. A plan is a qualified plan only if the contributions or benefits provided do not discriminate in favor of highly compensated employees. The bill would provide special rules in the case of an amendment that does not satisfy the second requirement and for defined contribution plans that are tested with the closed plan.

GG. Second Cycle D Filing Deadline. Trustees of all multiemployer pension and annuity plans have until January 31, 2015 to submit to the Internal Revenue Service (IRS) their Cycle D determination letter requests for the second five-year staggered determination letter cycle. In the first Cycle D, multiemployer plans with off-calendar years (i.e., plan years beginning after February 1) were allowed to file in Cycle

E. Those plans, however, remain Cycle D plans and must file for a renewed determination letter by January 31, 2015, the second Cycle D deadline.

HH. Final Regulations on Market Rates of Return for Hybrid Plans. On September 19, 2014, the IRS published long-awaited final regulations on a number of issues affecting hybrid plans (generally, cash balance, pension equity, and variable annuity plans). The most significant piece of the final regulations is final rules with respect to interest crediting rates permitted under the 'market rate of return' standard. Those rules are generally effective in 2016. Together with the final hybrid regulations, IRS also published a proposed regulation to deal with the transition to the new permitted interest crediting rate rules. In the typical cash balance plan, the participant has a 'hypothetical account.' Each year, a percent of the participant's pay for that year is credited to that account – the 'pay credit.' Those pay credits earn 'interest credits,' at a rate stated in the plan. The Pension Protection Act of 2006 (PPA) generally authorized the use of any interest crediting rate that is not in excess of a 'market rate of return' – clearly contemplating the possibility that a plan might base interest credits on a non-fixed income rate, such as the rate of return on an equity fund. PPA also added a 'preservation of capital' rule, generally requiring that the participant's benefit be no less than the sum of all pay credits, thus assuring that the cumulative return cannot be below 0%. The final regulations adopt an exclusive list of permitted cash balance plan interest crediting rates. The following chart summarizes the rates permitted:

	Rate	Permitted floor
Maximum fixed rate	6%	N/A
Government bond rates + permitted margin	3-month + up to 1.75% 12-month + up to 1.50% 1-year + up to 1% 3-year + up to 0.5% 7-year + up to 0.25% 10-year (no margin) 30-year (no margin)	5% annual
Investment grade corporate bond rate	First, second, or third segment rate under the minimum funding rules, with or without adjustment for MAP-21 and HATFA	4% annual
Investment-based rates	Actual rate of return on the aggregate or a subset of plan assets; rate of return on a regulated investment company, such as a mutual fund	3% cumulative

The final regulations generally allow the use of minimum funding rules segment rates, with or without adjustment for the interest rate stabilization rules under the Highway and Transportation Funding Act (HATFA) and Moving Ahead for Progress in the 21st Century Act (MAP-21). Those segment rates generally reflect the rates on investment grade corporate bonds. The final regulations retain the 4% annual floor on interest

credits based on these rates. The proposed regulations included a provision for rates based on the actual rate of return on aggregate plan assets and the rate of return on a regulated investment company. The final regulations added a provision for interest credits based on the rate of return on a subset of plan assets. As the IRS noted in its preamble to the final regulations, this rule will permit a sponsor "to credit interest based on a rate of return that differs for different groups of participants (such as using a more conservative, or less volatile, subset of plan assets for long service employees)." The rule in effect allows a target date fund-like arrangement in a cash balance plan. With respect to investment based returns, the following rules apply:

- The plan's (or subset's) assets must be diversified so as to minimize the volatility of returns.

- Qualifying employer securities and real property in a subset may not exceed 10% of the fair market value of assets in the subset.

- The fair market value of assets in a subset must approximate the benefits related to that subset, determined using reasonable actuarial assumptions.

The return on the investment company (e.g., a mutual fund) must be reasonably expected to be not significantly more volatile than the broad United States equities market or a similarly broad international equities market. Examples of permitted types: regulated investment companies with investments that track the rate of return on the S&P 500, a broad-based 'small-cap' index (such as the Russell 2000 index), or a broad-based international equities index. The preamble to the final regulations confirms that it is acceptable to determine an investment-crediting rate based on a specified blend of multiple rates. Thus, it is apparently acceptable to determine interest crediting rate based on one-quarter of the rate of return on one specified mutual fund and three-quarters of the rate of return on another specified mutual fund, provided that each of the funds separately satisfies the asset diversification requirement. As noted, the list of permitted interest crediting rates in the final regulations is exclusive. IRS rejected requests that it allow plans to adopt other bases (e.g., 80% of trust return with a 0% annual floor), indicating that such an approach would be impractical because the IRS would have to review any number of potential interest-crediting bases to determine whether or not they are acceptable. However, the IRS did leave the door open to providing additional crediting bases in future published guidance. The final regulations do not permit a cash balance plan to allow participants to choose among different interest crediting rates.

II. IRS Notice Allows Splitting Pretax and After-Tax Amounts by Direct Rollover. The IRS's most recent model rollover notice, which was issued in 2009, suggested that participants could not direct pre-tax and after-tax amounts to separate destinations without applying the pro-rata allocation rule with respect to the amount sent to each location. In practice, however, some plan sponsors and recordkeepers allowed participants to direct pre-tax and after-tax amounts to separate destinations, despite the wording in the model rollover notice. In part, this was allowed because participants could have accomplished essentially the same result by taking a single cash

distribution, and then rolling over the pre-tax portion of the distribution into a traditional IRA within 60 days. The remaining after-tax funds could then be rolled into a Roth IRA or kept for personal use. Under Notice 2014-54, effective January 1, 2015, all simultaneous disbursements from qualified retirement plans and 403(b) or 457(b) plans will be treated as a single distribution. Therefore, participants will be able to direct pre-tax and after-tax amounts to separate destinations without requiring proration with respect to the amounts directed to each destination, subject to the following rules:

- If the pre-tax portion of the amount distributed is less than the amount the participant chooses to roll over directly, the entire pre-tax amount is allocated to the direct rollover. If amounts will be directly rolled over to more than one location, the participant can choose the pre-tax allocation between the direct rollover destinations by informing the plan administrator in advance.

- If the pre-tax portion of the amount distributed exceeds the amount the participant chooses to roll over directly, any remaining pre-tax amounts are assigned to 60-day rollovers (that is, rollovers that are not direct rollovers), if any. If pre-tax amounts are rolled over to two or more destinations in the 60-day rollovers, the participant can choose how the pre-tax amounts are allocated between the 60-day rollover destinations.

- Any pre-tax amounts remaining after any direct rollovers and 60-day rollovers (i.e., amounts taken in cash) must be included in the participant's gross income for the tax year of the distribution.

The guidance issued in Notice 2014-54 becomes effective on January 1, 2015. For periods before January 1, 2015, the Notice permits a reasonable interpretation of the statutory rollover rules, which would include allowing pre-tax and after-tax amounts to be directed to separate destinations.

JJ. Modification of the Cafeteria Plan Change in Status Rules. On September 18, 2014, the IRS released Notice 2014-55 which expanded the current rules on when an employee can modify or revoke the election to contribute to a cafeteria plan for group health plan coverage. The Notice stated that the cafeteria plan regulations will be modified to provide two additional situations where an employee could revoke his or her cafeteria plan election for group health plan coverage to allow the employee to be able to receive subsidized health care coverage under an Exchange. These two situations are:

- An employee's employment status has changed so that the employee is reasonably expected to work less than 30 hours per week (meaning that the employee is not a full-time employee under the ACA), even if the reduction does not result in the employee ceasing to be eligible for coverage under the employer's group health plan. The revocation of the election must correspond with the intended enrollment in other health coverage that is minimum essential coverage1 and the plan may rely on reasonable representations of the employee to that fact.

- An employee would like to cease coverage under the employer's group health plan and purchase coverage through an Exchange. This revocation will be allowed as long as the employee is eligible to enroll in coverage through an Exchange during a special enrollment period or during the Exchange's annual open enrollment period. This new coverage must be effective immediately after the day the original coverage was revoked. The employer may rely on the reasonable representations of the employees of these facts.

This modification of the irrevocable election rules provided by the Notice does not apply to cafeteria plan elections to contribute to a flexible spending arrangement. One thing to note is that the Notice applies to cafeteria plan elections to contribute to group health plans that provide minimum essential coverage. This means that cafeteria plan elections for stand-alone dental and vision plans or critical illness plans (which are excepted benefits and do not provide minimum essential coverage) cannot be changed based on this guidance.

IV. HEALTH CARE

A. Affordable Care Act Effective Dates.

Delayed until 2015	Who?	When?
Employer Shared Responsibility Mandate (Play or Pay)	Employers with 50 or more full-time employees	January 1, 2015
Affordability Requirement		
Minimum Value Requirement		
Limit on Out of Pocket Maximum Amounts	All group health plans	January 1, 2015
Effective in 2014	**Who?**	**When?**
Summaries of Benefits and Coverage	All employers offering medical coverage	First renewal after September 23, 2012
Marketplace Notice	All employers offering medical coverage	October 1, 2013
PPACA Fees:		
Patient Centered Outcomes Research (PCORI) Fees	Employers that are self-funded or have a Health Reimbursement Account must pay through the Form 720; Fee built into full-insured premium	Self-funded/HRA must pay July 31, 2013 for plan years ending 12/31/2012; Fully insured premiums impacted for policy years ending after September 30, 2012.
Transitional Reinsurance Fee	All employers offering medical coverage	Fully-insured premiums impacted for 2014 plan year; Self-funded plans must sent their headcounts to HHS by 11/15/2014
Health Insurance Industry Fee (HIT)	All employers offering fully insured medical, dental and vision coverage	Fully-insured premiums impacted for 2014 plan year
W-2 Reporting	Employers that issue 250+ W-2's	2012 tax year and beyond must be reported
Counting Period for Employer Mandate	Employers with 40-60 employees	Counting period throughout 2014
Measurement Period for Employer Mandate	Employers with variable hour employees	Measurement period throughout 2014
Plan Design Requirements	All group health plans	January 1, 2014
Maximum 90-day waiting period		
No limits on pre-existing conditions		
10 Essential Health Benefits		
Individual Mandate	All US citizens	January 1, 2014
Marketplaces: Public Exchanges	Available to all US citizens	January 1, 2014
Subsidies for Marketplace	Available to all US citizens with unaffordable coverage or coverage that does not meet minimum value. Applicant earns less than 400% of the federal poverty level.	January 1, 2014

B. Modification of 'Use-It-or-Lose-It' Rule. The IRS has issued guidance in Notice 2013-71 that modifies the use-or-lose rule for health flexible spending arrangements that is set forth in proposed regulations (REG-142695-05) under Section 125, and that clarifies the scope of transition relief provided in the preamble to proposed regulations (REG-138006-12) under Section 4980H for participant salary reduction elections. In 2005 Treasury and the IRS modified the use-or-lose rule by adopting a grace period rule under which a Section 125 cafeteria plan may allow an employee to use amounts remaining from the previous year to pay expenses incurred for some qualified benefits for up to 2-1/2 months immediately following the end of the plan year. The IRS requested comments in Notice 2012-40 on whether the proposed regulations under Section 125 should be modified to provide flexibility concerning the operation of the use-or-lose rule for health FSAs in addition to the 2-1/2-month grace period rule. In response to comments, Treasury and the IRS are modifying the use-or-lose rule. The changes permit Section 125 cafeteria plans to be amended to allow up to $500 of unused amounts remaining at the end of a plan year in a health FSA to be paid or reimbursed to plan participants for qualified medical expenses incurred during the following plan year, if the plan does not also incorporate the grace period rule. This carryover of up to $500 does not affect the maximum amount of salary reduction contributions that the participant is allowed to make under Section 125(i). This carryover option provides an alternative to the current grace period rule and administrative relief similar to that rule. Notice 2013-71 describes how and when to amend a Section 125 cafeteria plan document to adopt the carryover provision authorized in the guidance to health FSAs for the current Section 125 cafeteria plan year or later plan years. Treasury and the IRS intend to amend proposed reg. section 1.125-1(o) and 1.125-5(c) to reflect the guidance in Notice 2013-71. In the preamble to proposed regulations under Section 4980H, Treasury and the IRS provided transition relief from the election rules in proposed reg. section 1.125-2 for salary reduction elections under a Section 125 cafeteria plan for an employer-provided accident and health plan with a non-calendar plan year beginning in 2013. Notice 2013-71 clarifies that the relief generally is available to an employer with a Section 125 cafeteria plan non-calendar plan year beginning in 2013 whether or not the employer is an applicable large employer or applicable large employer member under Section 4980H. The guidance also clarifies that an amendment to a Section 125 cafeteria plan adopted in accordance with the transition relief may be more restrictive, but not less restrictive, than the amendments described in the transition relief. These clarifications may be applied beginning after December 27, 2012.

C. Delay of SHOP Online Enrollment. On November 27, 2013, the Department of Health and Human Services announced that online enrollment in the federal SHOP exchange for small businesses would not be available until the 2015 open enrollment period in November of 2014. The HHS announcement delays online federal SHOP enrollment. Instead of enrolling online, small employers will enroll in qualified health plan coverage through an agent or broker, or directly with an insurer. The agent or broker will also help the employer fill out a paper application for SHOP coverage which will be sent to the federal exchange. Alternatively, employers may fill out the application form themselves or call a special SHOP exchange call center. The federal SHOP will provide an eligibility notification within 3 to 5 days of receiving the

application by phone or email, or by mail if requested. One of the goals of the SHOP provisions was to allow employee choice — that is, to allow an employer to pick a tier of coverage (bronze, silver, gold, or platinum) for which the employer would contribute, but permitting the employee to pick a particular plan within that tier. The SHOP would also aggregate bills presented by the insurers whose plans were chosen by employees, providing employers with a single bill. Another function of the exchange was to offer access to the small employer tax credit, which after January 1, 2014 is only available to employers whose employees enroll in a qualified health plan offered by the employer through an exchange. This tax credit covers up to 50 percent of an employer's premium contributions as of 2014 (35 percent for nonprofits).

D. Final Employer Mandate Rules Give Extra Time to Small and Large Businesses. The Treasury Department and the Internal Revenue Service issued final regulations on February 10, 2014 (T.D. 9655) implementing the employer mandate under the Affordable Care Act. The provisions will take effect in 2015 following a delay last year. Businesses that employ between 50 and 99 full-time workers have until 2016 to comply with the employer mandate. Those that claim the exemption for 2015 will need to certify under penalty of perjury that they did not reduce their workforce to fewer than 100 employees in order to qualify. Large employers with 100 or more full-time employees were also given additional time. The proposed regulations had originally required that they offer coverage to 95 percent of their full-time employees starting in 2015. That requirement has now been reduced to 70 percent in 2015 and 95 percent beginning in 2016. However, there is no delay in the individual mandate that requires most individuals to purchase health insurance coverage. The Treasury and the IRS also said that future regulations would simplify the reporting requirements for businesses.

E. "Pay-or-Play" & Contingent Workers. On February 10, 2014, the IRS issued final regulations on the Affordable Care Act's (ACA) employer shared responsibility requirements—the so-called "pay-or-play" mandate. In the regulations, the IRS provides new and additional guidance on a wide range of issues relating to the implementation of the pay-or-play rules. Among them, the IRS has restated its position and introduced some new rules relating to the engagement by employers of "contingent workers," including temporary employees, individuals hired through temporary staffing firms and independent contractors ("1099 employees"). Not surprisingly, in its proposed regulations released about a year ago, the IRS had flagged contingent workers as presenting challenging issues for compliance with the pay-or-play requirements. Key provisions of the final regulations' rules for contingent workers are summarized below.

1. Definition of Employee. In the final regulations the IRS reaffirms its position that it will use a common law definition of employee to determine employer-employee status. Generally, an individual is the common law employee of an entity if that entity has the right to control the individual's performance of services. The final regulations continue to exclude leased employees, sole proprietors, partners in a partnership, 2-percent S corporation shareholders, and certain direct sellers and real estate agents from the definition of employee.

2. Common Law Employees of the Client Employer. For purposes of the pay-or-play mandate, when the client is the common law employer, an offer of coverage made by the temporary staffing firm "on behalf of" the client employer will be considered to be an offer of coverage by the client employer. In order for an offer of coverage to be "on behalf of" the client employer, the client employer must pay a higher fee to the temporary staffing firm for those employees who enroll in the temporary staffing firm's plan. In other words, if the contract provides for a flat fee per employee placement irrespective of whether the employee enrolls in the staffing company's coverage, the employer will not be considered to have made an offer of coverage. This could lead to exposure under the pay-or-play mandate's $2,000 per full-time employee "no coverage offered" penalty if more than 5% of its full-time employees (30% in 2015) are employed through the staffing agency.

3. Contingent Worker Misclassification Issues.

a. Employers are not required to offer coverage to independent contractors; however, because the final regulations use a common law definition of employee, an IRS examination finding that common law employees have been misclassified as independent contractors could result in significant penalty exposure to the employer. Employers that engage a significant number of "1099 employees" run a tremendous risk of incurring the pay-or-play mandate's $2,000 per full-time employee "no coverage offered" penalty, even when they offer coverage to all of the employees they categorize as full-time. If the number of 1099 employees who are reclassified as common law employees exceeds 5% of the employer's full-time workforce (30% in 2015), the "no coverage offered" penalty may be tripped.

Another important issue for employers that hire independent contractors is whether they could rely on the IRS so-called "Section 530" relief for identifying common law employees. In short, this relief is based on Section 530 of the Internal Revenue Code of 1978 and provides that no penalties or interest will be incurred as the result of worker misclassification if the employer (i) consistently treated the workers in question as independent contractors, (ii) complied with the Form 1099 tax reporting requirements for the independent contractors and (iii) had a reasonable basis for treating the workers as independent contractors.

b. The ACA regulations specifically reject the availability of Section 530 relief for purposes of the pay-or-play requirements. Despite the requirement for a reasonable basis as a condition for Section 530 relief, the IRS based its decision on the concern that allowing Section 530 relief would incentivize worker misclassification. Given the lack of available relief, employers should carefully review their contractual arrangements with service providers to ensure that they have been properly classified as independent contractors as opposed to common law employees under the more traditional common law tests.

4. Short-Term Employees. The final regulations confirm the IRS's position that short-term employees (other than seasonal employees) who are reasonably expected to work full-time (30 hours or more per week) at date of hire must

generally be offered coverage within 90 days. There is no blanket exemption for short-term employees—if employment extends beyond the end of the third full calendar month of employment, the employer must offer coverage regardless of the projected termination date (the offer of coverage will generally be within 90 days from date of hire due to the ACA's waiting period rules).

5. Employees of Temporary Staffing Firms. There are special rules for determining whether a variable hour employee is a full-time employee. Variable hour employees are employees with no set schedule or seasonal employees (generally those working 6 months or less on a seasonal basis). Under these rules, the employer (staffing company) can use a determination period of from 3 to 6 to 12 months to determine an individual's full-time status for a following so-called "stability period" of 6 or 12 months. Because of the nature of the business—where employees may work for several client employers during a certain period of time—commenters observed that it would be difficult to determine when a staffing company employee was a variable hour employee. Some commenters asked that a presumption—either for or against variable hour status—be developed. Noting the varying nature of the industry, the regulators rejected the idea of a presumption. Instead, the final regulations provide criteria that a staffing company may consider to determine whether a new employee is "variable hour." This assessment is done at the time of hire based on the staffing company's reasonable expectations. Considerations may include whether other similar employees of the staffing company: retain the right to reject assignments; have periods during which no assignments are available; are offered assignments of differing lengths; and are typically offered assignments that do not extend more than thirteen weeks. No one factor is dispositive.

6. Other Considerations. These are just a few of the significant issues employers need to consider as they identify their worker classification arrangements in light of the ACA rules. Of course, employers also need to consider their contractual agreements with any temporary staffing agencies and all of the other possible legal requirements that could apply in this context (such as ERISA section 510 liability for intentional interference with attainment of benefits and the ACA whistleblower protections).

F. New Affordable Care Act Reporting Requirements. New annual reporting obligations under the Affordable Care Act go into effect for 2015. Although the new reporting won't actually begin until early 2016, employers will need to look at (and if necessary, modify) their payroll systems in 2014 to ensure that they will be capturing the required information throughout 2015.

1. Minimum Essential Coverage. Under new Tax Code Section 6055, any employer that offers employees a self-insured medical plan (other than a limited list of excepted benefits) will have to file an annual information return with the IRS and provide annual information statements to individuals.

2. Employer-Sponsored Coverage. Under new Tax Code Section 6056, an employer who averages at least 50 full-time equivalent employees under the

Affordable Care Act's employer responsibility requirements must report to the IRS and to its employees whether the employer offers its full-time employees (and the employees' dependents) the opportunity to enroll in minimum essential coverage. For these purposes, full-time employee means someone who averages 30 or more hours of work per week. If a company averages at least 50 full-time equivalent employees during 2014, this reporting requirement applies during 2015, even if the company qualifies for a transitional rule under the employer responsibility rules. Also, the reporting requirement applies to employers and not insurers, regardless of whether the health plan coverage is insured or self-insured.

G. Final 90-Day Health Plan Waiting Period Rules Issued. On February 24, 2014, the Internal Revenue Service (the "IRS"), Department of Labor and Department of Health and Human Services jointly issued the final regulations implementing the 90-day waiting period limitation under the Affordable Care Act (the "ACA") and related proposed regulations, clarifying the extent to which an employer may impose an orientation period that is consistent with the 90-day waiting period limitation. Applicable for plan years beginning on or after January 1, 2015, the final regulations apply to both grandfathered and non-grandfathered plans and generally adopt the provisions of the proposed regulations. While a plan need not include a waiting period, to the extent that it does, the waiting period may not exceed 90 days from the date an individual meets the plan's eligibility criteria. However, a plan may impose substantive eligibility conditions prior to starting any waiting period, including:

1. An employee's attainment of an eligible job classification (for example, full-time status);

2. An employee's attainment of a job-related license;

3. Satisfying a reasonable and bona fide employment-based orientation period; or

4. An employee meeting a cumulative hours of service requirement that does not exceed 1,200 hours for the year.

H. Final Regulations on Employer Shared Responsibility Requirements.

1. Beginning in 2015, applicable large employers (i.e., employers that employ on average at least 50 full-time employees on business days during the preceding calendar year) may be subject to one of two "shared responsibility" assessable payments under section 4980H of the Internal Revenue Code:

a. An employer that fails to offer minimum essential coverage (MEC) to its full-time employees and their dependents may be subject to a nondeductible "play or pay" assessable payment if at least one full-time employee enrolls in marketplace coverage and receives a premium tax credit or cost-sharing reduction. The "play or pay" assessment is one-twelfth of $2,000 for each calendar month the employer fails to offer MEC times the number of employer's full-time

employees, disregarding the first 30 full-time employees. The $2,000 assessment is indexed in 2015 and future years.

b. An employer that offers MEC to its full-time employees and their dependents may be subject to a nondeductible "play and pay" assessable payment for each full-time employee who enrolls in marketplace coverage and receives a premium tax credit or cost-sharing reduction because the employer coverage fails to provide "minimum value" or is "unaffordable." The "play and pay" assessment is one-twelfth of $3,000 for each calendar month in which a full-time employee receives a marketplace subsidy. The $3,000 assessment is indexed in 2015 and future years.

2. On January 2, 2013, the IRS published proposed regulations on the employer shared responsibility requirements under the ACA. On July 2, 2013, the Department of the Treasury announced that the employer obligation to comply with the shared responsibility requirement would be deferred for one year to 2015 because the process for reporting the information necessary to enforce the requirement had not yet been finalized. During the last two months, the IRS has issued final regulations on both the employer's shared responsibility obligations and on how employers will report the information that the agency needs to enforce the shared responsibility requirements in 2015.

I. Simple Cafeteria Plans.

1. Background. Historically, many small businesses were hesitant to establish cafeteria plans for their employees. A key factor in accounting for this hesitancy is that small employers have found it difficult to justify providing a cafeteria plan to employees if it requires diminishing benefits enjoyed by owner-employees in order to satisfy the applicable nondiscrimination requirements. The nondiscrimination requirements are found in Code Section 125(b) and consist of (i) an eligibility test, (ii) a contributions and benefits test, and (iii) a key employee concentration test. Due to their smaller size, small employers can easily run afoul of the traditional cafeteria plan nondiscrimination rules. If these nondiscrimination rules are violated, the value of the taxable benefits that the employee could have selected are included in the employee's income.

2. Simple Cafeteria Plan. First effective for years beginning after 2010, the ACA allows eligible small employers to establish a "simple cafeteria plan." The main advantage of the simple cafeteria plan over the traditional option is that it removes the obstacle of nondiscrimination requirements favoring highly compensated and key employees which disqualify many small businesses from participating in traditional cafeteria plans. Instead, under a simple cafeteria plan, the applicable nondiscrimination requirements of a classic cafeteria plan are treated as satisfied, as long as specified contribution, eligibility, and participation rules are met.

3. Eligible Small Employers. An employer eligible to establish a simple cafeteria plan is any employer that, during either of the two preceding years, employed an average of 100 or fewer employees on business days. For purposes of

this rule, a year may only be taken into account if the employer was in existence throughout the year. If an employer was not in existence throughout the preceding year, the employer may nonetheless be considered as an eligible employer if it reasonably expects to average 100 or fewer employees on business days during the current year. If an employer has 100 or fewer employees for any year and establishes a simple cafeteria plan for that year, then it can be treated as meeting the requirement for any subsequent year even if the employer employs more than 100 employees in the subsequent year. However, this exception does not apply if the employer employs an average of 200 or more employees during the subsequent year. This provision allows small but growing employers to continue to offer simple cafeteria plan benefits to employees without the concern of having to meet the discrimination requirements by having to switch to a classic cafeteria plan. Without this exception, the establishment of simple cafeteria plans could create a disincentive to increased hiring. For purposes of determining the number of employees, the "controlled group" rules under Code Section 52, applying the rules of Code Section 1563, (except that a "more than 50 percent" threshold is substituted for "at least 80 percent" in Code Section 1563(a)(1), and Code Sections 1563(a)(4) and (e)(3)(C) are disregarded) and Code Section 414 (relating to controlled and affiliated service groups) apply for purposes of determining an eligible employer.

4. Contribution Requirements. A simple cafeteria plan must meet rigid contribution requirements on the part of the employer. The contribution requirements are met if the employer is required by the plan, regardless of whether a qualified employee makes any salary reduction contribution, to make a contribution to provide qualified benefits on behalf of each qualified employee, in an amount equal to: (i) a uniform percentage (not less than two percent) of the employee's compensation for the year, or (ii) an amount not less than the lesser of: (a) six percent of the employee's compensation for the plan year or (b) twice the amount of the salary reduction contributions of each qualified employee. If the employer bases the satisfaction of the contribution requirements on the second option, it will not be treated as met if the rate of contributions with respect to any salary reduction contribution of a highly compensated or key employee is greater than that with respect to any other employee. Beyond this prohibition, the established contribution requirements are not to be treated as prohibiting an employer from making contributions to provide qualified benefits under the plan in addition to the required contributions. For purposes of the contribution requirements, a salary reduction contribution is any amount contributed to the plan at the election of the employee and not includable in the employee's gross income under the cafeteria plan provisions. The terms "highly compensated employee" and "key employee" retain their definitions under the classic cafeteria plan provisions. A "qualified employee" is any employee who is not a highly compensated or key employee.

5. Eligibility, Participation Requirements. A simple cafeteria plan must also satisfy minimum eligibility and participation requirements. The requirements are met if all employees who had at least 1,000 hours of service for the preceding plan year are eligible to participate and if each employee eligible to participate may elect any benefit under the plan, subject to terms and conditions applicable to all participants. An employer may elect to exclude from the plan, regardless of the satisfaction of the 1,000

hour requirement, employees who have not attained the age of 21 before the close of the plan year, employees who have less than one year of service with the employer as of any day during the plan year, employees who are covered under a collective bargaining agreement if there is evidence that the benefits covered under the plan were the subject of good faith bargaining between employee representatives and the employer, or employees who are nonresident aliens working outside the United States whose income did not come from a U.S. source. References to employers with regard to simple cafeteria plans include references to predecessors of such employers. This means that, among other considerations, for purposes of determining the qualification of a business that has recently changed ownership, the fact that the previous owner had 100 or fewer employees in a preceding year can be used to determine eligibility of the current ownership to establish a simple cafeteria plan. Also, any person treated as a single employer for purposes of the Work Opportunity Credit or for purposes of deferred compensation rules under Code Sections 414(n) or (o) are to be treated as one person for purposes of simple cafeteria plans.

J. Plan Administrator Must Give Providers ERISA Appeal Process. *Penn. Chiropractic Ass'n v. Blue Cross Blue Shield Ass'n.,* No. 09 C 5619 (N.D. Ill. Mar. 28, 2014), is a case that essentially arose out of a computer glitch, which caused BCBSA member Independence Blue Cross to pay capitated payments to chiropractors who were not approved to get them. Overpayments resulted. IBC's policy consisted of sending "demand letters" and informing providers that if they failed to make arrangements to pay back the funds within 30 days, offsets would begin forthwith. The U.S. District Court for the Northern District of Illinois decided that the insurer's efforts to recoup overpayments (that arose due to payer, not provider, error) had violated ERISA's claims and appeal requirements. The court then ordered the insurer to follow those requirements as a remedy. The payment offsets fell in the definition of an ERISA adverse benefit determination, which required a process for the providers to challenge the recoupment.

K. Closely Held Businesses Excepted From ACA Contraceptive Mandate. The Supreme Court, in a 5-4 decision, held that closely held businesses may be excepted from the contraceptive coverage mandate of the Affordable Care Act, finding that the Health and Human Services regulations imposing the mandate violate the Religious Freedom Restoration Act (RFRA). Justice Samuel A. Alito Jr., writing for the court, emphasized that the decision concerns only the contraceptive mandate and "should not be understood to hold that all insurance-coverage mandates, e.g., for vaccinations or blood transfusions, must necessarily fall if they conflict with an employer's religious beliefs." Alito added that the decision does not provide "a shield for employers who might cloak illegal discrimination as a religious practice." The government sought review of a Tenth Circuit decision that reversed a district court's denial of injunctive relief to two companies, Hobby Lobby, a craft store chain, and Mardel, a Christian bookstore chain. The companies challenged the regulations that require them to provide contraceptive coverage under the ACA. They further claimed that their refusal to comply with the mandate would result in substantial penalties under Sections 4980D and 4980H. The Tenth Circuit held that the companies were entitled to bring claims under the RFRA, that they had established a likelihood of success, and that

they had established that they would suffer irreparable harm. The government argued that a for-profit corporation could not bring an RFRA challenge based on its owners' religious objections. The Hobby Lobby case was considered in conjunction with a family-owned woodworking business, Conestoga Wood Specialties Corp., that sought review of a Third Circuit decision that rejected its religious challenges to the contraceptive coverage mandate. *Burwell et al. v. Hobby Lobby Stores Inc. et al.*, S. Ct. Dkt. No. 13-354 (2014); No. 13-354.

L. Court Challenge to Premium Tax Credits. On September 4, 2014, the United States Court of Appeals for the District of Columbia granted a request by the government for a rehearing en banc (by the full court) in *Halbig v. Burwell.* A divided three judge panel in the Halbig case had held on July 22, 2014 that an Internal Revenue Service rule allowing federally facilitated exchanges to grant premium tax credits was invalid. The D.C. Circuit's decision to hear the case en banc vacated the panel's judgement. On the same day as the Halbig panel decision, a three-judge panel of the Fourth Circuit Court of Appeals in Richmond, Virginia, had unanimously upheld the rule. The conflicting decisions resulted in dueling petitions for review. The plaintiffs in the King case petitioned the Supreme Court for certiorari, asking the Court to reverse the Fourth Circuit decision and hold the IRS rule invalid. The government, on the other hand, petitioned the D.C. Circuit for a rehearing en banc. Rehearings en banc by the Court of Appeals are only available for questions of "exceptional importance" and are rarely granted. In recent years the D.C. Circuit has granted only one or two a year. But Halbig is clearly exceptionally important. A holding that federal exchanges could not grant premium tax credits would deny nearly five million Americans in 34 states (or possibly 36, depending on how one counts Idaho and New Mexico) affordable health insurance and possibly lead to the collapse of the individual health insurance markets in those states. Indeed, the significance of the issue was admitted by the plaintiffs, whose response to the request for en banc review begins, "There is no doubt that this case is of great national importance." The plaintiffs argued, however, that the case was so important—and so urgent—that it needed to be decided now by the Supreme Court, an argument repeated in their petition for certiorari to the Supreme Court. But the plaintiffs' primary argument to the Supreme Court was that a Supreme Court decision was necessary to resolve the conflicting decisions of the D.C. and Fourth Circuit on this important issue (although they also argued that additional delay would increase the resulting upheaval if the Supreme Court does ultimately rule that premium tax credits are not available on federal exchanges). The Supreme Court rules provide that petitions for certiorari can only be granted for "compelling reasons," and give as a prime example conflicting decisions among the circuits. The Supreme Court on September 2 gave the government an additional 30 days to respond to the plaintiff's petition for certiorari. The government's primary argument will no doubt be that, since the D.C Circuit has now vacated the Halbig panel's judgement, there is no longer a circuit split and the Supreme Court should stay its hand until one develops. Normally, the Supreme Court usually does wait until the lower courts have had their say before weighing in, even on important issues. It would be very unusual (although not entirely unprecedented) for the Supreme Court to decide to review a case where an appellate court has upheld a federal rule and there is no division among the circuits. It is also likely that the en banc review will not result in a circuit split, as en banc reviews reverse

panel decisions about 2/3 of the time. There is little reason for a court to grant en banc review if a majority of the judges who must vote to grant review already agree with the panel decision. Much is being made of the fact that the active judges of the D.C. Circuit who will decide this case (joined by the two senior judges who sat on the panel, Judges Edwards and Randolph) have predominantly been appointed by Democratic presidents, including four Obama appointees. But one of the two district court judges (Judge Spencer) who originally upheld the IRS rule was a Republican appointee, and Judge Gregory, who wrote the decision for the Fourth Circuit upholding the rule, was nominated by President Bush (albeit after a recess appointment by President Clinton). Judge Silberman, a Reagan appointee, wrote the D.C. Circuit opinion upholding the Affordable Care Act individual mandate. The plaintiffs, on the other hand, are clearly hoping that the four Republican-appointed Supreme Court justices who would have rejected the entire ACA in in the National Federation of Independent Business case will vote to take the King/Halbig case. It only takes four votes to grant a petition for certiorari (although a fifth vote would of course be needed for a majority on the merits). A decision to take the case away from the D.C. Circuit at this point, however, would be quite extraordinary and could be attacked as politicized. It is far more likely that the Supreme Court will allow the lower courts to do their job. Of course, two other cases presenting this issue are working their way through the district courts in Oklahoma and Indiana and eventually the Tenth and Seventh Circuits. The Supreme Court may, therefore, get another crack at this issue if a circuit split develops in the future. The D.C. Circuit order set a briefing schedule for the case and set oral argument for December 17, 2014. A decision is not likely before early 2015.

M. IRS Clarifies Employer Mandate's Look-Back Method. In Notice 2014-49, the IRS has proposed an approach to applying the look-back measurement method to determine if an employee is a full-time employee for purposes of the Code Sec. 4980H employer health insurance mandate, also known as the shared responsibility payment. These rules supplement the final regulations that were published on February 12, 2014. Taxpayers may rely on the IRS proposal until further guidance is issued, and in any case through the end of the 2016 calendar year. The proposal is not intended to prohibit or discourage employers from adopting eligibility provisions that make some employees eligible for coverage before they would be considered a full-time employee under this approach. The employer mandate imposes a penalty on an applicable large employer (ALE) that fails to provide its full-time employee with minimum essential health coverage, if any of those employees is certified to receive a premium tax credit or a cost-sharing reduction. An ALE is generally an employer that employed at least 50 full-time employees, including full-time equivalent employees, on business days during the preceding calendar year. The look-back method is one of the two methods an employer may use to identify full-time employees. The employer sets the starting date and length of two separate measurement periods: the standard measurement period, which is used for ongoing employees; and the initial measurement period, which is used for new variable hour, seasonal, or part-time employees. An ALE member also selects a stability period that immediately follows and is associated with a standard measurement period or an initial measurement period. An ALE member may also use an administrative period of up to 90 days between a measurement period and its associated stability period, or between a new employee's date and the beginning of the

initial measurement period. Each ALE member may use different measurement methods or measurement periods that differ in duration or that start on a different date for certain specified categories of employees, such as groups of collectively bargained employees covered by separate collective bargaining agreements, salaried and hourly employees, and employees in different states. Under the look-back measurement method, an employee generally is treated as a full-time employee for any month within a stability period if the employee averaged 30 or more hours of service per week during the applicable measurement period preceding the stability period. The IRS proposal applies to the look-back measurement method in two situations, and includes examples of their application:

1. Employee transfers. When the measurement period applicable to a particular employee changes because the employee transfers from one position to another within the same ALE or ALE member and the positions do not use the same measurement period, the employer includes hours of service earned in the first position either by counting the hours of service under the counting method applied to the employee in the first position, or recalculating the hours of service in the first position under the counting method applied to the employee in the second position. The employer must treat all similarly situated employees consistently. If the employee is in a stability period applicable to the first position as of the date of transfer, the employee's status as a full-time or non-full-time employee for the first position remains in effect until the end of that stability period. Otherwise, the employee's status as a full-time or non-full-time employee is determined solely under the look-back measurement method applicable to the second position as of the date of transfer, including all hours of service in the first position. In all other respects, the rules generally applicable to the look-back measurement method continue to apply. The status of a new employee who is expected to be a full-time employee continues to be determined on the bases of hours of service in each calendar month.

2. Employer changes in measurement periods or methods. An employer may change the measurement period or method (from or to the monthly measurement method, or in the duration or start date) for one or more categories of employees. If the employer changes the measurement method, the Reg. §54.4980H-3(f)(2) transition rules for employees who are changed between the monthly and look-back measurement methods must apply to all employees impacted by the change for a transition period after the effective date of the change. The status of each affected employee as of the date of the change is determined as if, on the date of the change, each of those employees had transferred from a position to which the original measurement method applied, to a position to which the revised measurement method applied. Similarly, if an employer changes the duration or start date of the measurement period under the look-back measurement method for a category of employees, the status of each employee in that category as a full-time employee after the date of the change is determined as if on the date of the change each employee in the category had transferred from a position to which the original measurement method applied, to a position to which the revised measurement method applied.

V. ESTATE PLANNING

A. Estate, Gift, and GST Tax Exemptions For 2014.

1. The unified estate and gift tax exemption amount is $5,340,000 (up from $5,250,000 in 2013)

2. The exemption from GST tax is $5,340,000 (up from $5,250,000 in 2013)

3. The gift tax annual exclusion remains at $14,000

4. The annual exclusion for gifts made to noncitizen spouses is $145,000 (up from $143,000 in 2013)

B. Tax Court Sends Message on Valuation. *Estate of Helen P. Richmond*, T.C. Memo. 2014-26, involved the valuation of an interest in a family-owned personal holding company for estate tax purposes. Helen Richmond died in 2005, owning a 23.44 percent interest in Pearson Holding Company (PHC), a subchapter C corporation, formed in 1928 to provide income to the descendants of Frederick Pearson. As of the date of death, PHC held a $52 million portfolio consisting mostly of large-cap, high-yield stocks. PHC's investment philosophy included preserving capital and maximizing dividend income for the family shareholders. This case is significant for three reasons: (i) it rejects an income-based approach for valuing an entity holding mainly publicly traded securities reasoning that the net asset value approach was more appropriate for a non-operating company that held publicly traded stock; (ii) it reaffirms the Tax Court's commitment to using a present value approach in calculating the discount for the built-in capital gains (BICG) tax liability of a C corporation; and (iii) it imposes an accuracy-related valuation penalty on an estate that used a non-specialized accountant to value a decedent's stock interest.

C. Limited Time Portability Election Procedure. Rev. Proc. 2014-18 provides that any time on or before December 31, 2014, some taxpayers may file Form 706, and those returns will be deemed to be timely filed for purposes of the portability election. This is true even if the usual deadline for filing the estate tax return -- typically nine months after the decedent's date of death, with a possible six-month extension -- may have passed. The estates eligible for relief under Rev. Proc. 2014-18 are those in which (i) the decedent had a surviving spouse; (ii) the decedent died in 2011, 2012, or 2013; (iii) the decedent was a citizen or resident of the United States as of the date of the decedent's death; (iv) the decedent's executor was not required to file an estate tax return under Section 6018 (because the value of the gross estate plus the decedent's adjusted taxable gifts was less than the applicable exemption amount); and (v) the decedent's executor previously did not timely file an estate tax return.

D. Failure to Segregate Trust Asset Caused Estate Inclusion. A husband and wife created two revocable trusts for estate planning purposes, naming the husband as trustee of both trusts. Upon the death of the first spouse (the wife), the assets of her revocable trust were to be divided into two marital trusts and a family trust.

Upon his wife's death, the husband elected under IRC Sec. 2056(b)(7) to treat the assets, valued at $2.1 million, as qualified terminal interest property. However, he never segregated the assets of his wife's revocable trust into the three separate trusts. Before the husband's death 10 years later, he had withdrawn amounts from his wife's trust for charitable donations, as well as for personal use. Because the family trust never held any of the trust assets from the wife's trust, the Tax Court held that the entire value of her trust should be included in the husband's estate. *Estate of Elwood H. Olsen*, TC Memo 2014-58 (Tax Ct.).

E. Estate Deferral Disallowed. An executor of an estate wanted to make a Section 6166 election to pay the estate tax in installments. Rather than making the election on a timely filed return [as required by Reg. 20.6166-1(b)], the executor included a letter with Form 4768 (the application to extend the time to file the return) indicating the intent to make the election. Upon filing the estate tax return (filed nearly 2 ½ years late), the executor included all of the required information to make the election. However, because the letter included with the extension request failed to meet the requirements of the election, and the tax return was not timely filed, the Tax Court disallowed the election. *Estate of Wallace R. Woodbury*, TC Memo 2014-66 (Tax Ct.).

F. Final Regulations on Estate and Trust Costs Subject to 2 Percent Floor. The IRS has issued final regulations (T.D. 9664) providing guidance on which costs incurred by estates or non-grantor trusts are subject to the 2 percent floor for miscellaneous itemized deductions under section 67(a). Effective May 9, 2014, the final regulations adopt, with minor changes, proposed regulations (REG-128224-06) issued in 2011. The regulations as originally proposed in 2007 provided that a cost is fully deductible to the extent that it is unique to an estate or trust and that if a cost is not unique, it is subject to the 2 percent floor. The Supreme Court in 2008 issued its decision in *Michael J. Knight v. Commissioner*, holding that costs paid to an investment adviser by a non-grantor trust or estate generally are subject to the 2 percent floor for miscellaneous itemized deductions under Section 67(a). In light of that decision, the IRS issued and extended interim guidance (Notice 2008-32, Notice 2008-116, Notice 2010-32, Notice 2011-37) on bundled fiduciary fees and later withdrew the 2007 proposed regulations and reissued them in 2011 to allow the public to comment on the impact of the *Knight* decision. Under the final regulations, a cost is subject to the 2 percent floor to the extent that it is included in the definition of miscellaneous itemized deductions under Section 67(b), is incurred by an estate or non-grantor trust, and would commonly or customarily be incurred by a hypothetical individual holding the same property. In response to a comment on the proposed regulations, the final regulations remove a provision under which costs that do not depend on the identity of the payer are costs that are incurred commonly or customarily by individuals. The final regulations do not adopt a suggestion to create a rebuttable presumption that ownership costs are not subject to the 2 percent floor, because the IRS and Treasury believe that ownership costs are costs that commonly or customarily would be incurred by a hypothetical individual holding the same property and, accordingly, should be subject to the 2 percent floor. However, the final regulations clarify several examples used to illustrate ownership costs. To resolve ambiguities in the proposed regulations, the final regulations provide an exclusive list of tax return preparation costs that are not subject

to the 2 percent floor. Any other tax return preparation cost that is included in the definition of miscellaneous itemized deduction under section 67(b) is subject to the 2 percent floor. The final regulations do not adopt a recommendation that the cost of preparing all gift tax returns should be exempt from the application of the 2 percent floor. However, in response to other comments, the final regulations expressly provide that some appraisal fees incurred by an estate or non-grantor trust are not subject to the 2 percent floor. The final regulations provide that a bundled fee (for both costs that are subject to the 2 percent floor and costs that are not) must be allocated between those two categories of costs. However, the final regulations provide an exception to the allocation requirement for a bundled fee that is not computed on an hourly basis. Despite objections from commentators to the requirement that a fiduciary commission be unbundled, the IRS and Treasury believe that retaining the unbundling requirement in the final regulations is appropriate because it provides equitable tax treatment to similarly situated taxpayers.

G. Transfer from One Trust to Another Trust (Decanting). By analogy to decanting a bottle of wine or spirits, decanting a trust involves a metaphorical pouring of trust assets from one trust into another. Estate planning advisers have spent considerable time elevating decanting from a potential strategy for clients seeking to fix a broken trust to a routine solution for trusts that have grown problematic due to changed circumstances. The most popular uses of decanting appear to be postponing or eliminating withdrawal rights; modifying or inserting powers of appointment; altering successor trustee provisions; creating a special needs trust; resolving drafting ambiguities; and changing trust situs to avoid state income taxes. Unfortunately, after initially seeking and receiving comments on decanting from national legal and tax groups (see Notice 2011-101), the IRS omitted decanting from its 2013–2014 Priority Guidance Plan, thus indicating that it would not issue a revenue ruling on the tax aspects of decanting this year. Advisers are left to sift through private letter rulings and regulations on trust mergers, modifications, and severances to gauge the likely tax impacts of decanting. From an income tax standpoint, Section 661 allows a trust in calculating its taxable income to deduct the value of distributions made to beneficiaries. The beneficiaries then pick up the income on their individual returns under Section 662. Given the notion that a decantment is essentially an exercise of the trustee's distributive authority, where Trust *A* distributes less than all of its assets to Trust *B*, it seems appropriate to treat the distribution under the principles of Sections 661 and 662. However, where Trust *A* distributes all of its assets to Trust *B*, it is preferable to treat the second trust as an entirely new trust. This requires filing a final return for Trust *A* and obtaining a new tax identification number for Trust *B*. This has several advantages. Upon the filing of the final returns, the IRS and state revenue department are on notice regarding the decantment and the termination of Trust *A*. In this respect, silence would be golden, and the passing of three years would be evidence that the decantment was a nonevent for income tax purposes. This closure is vital for beneficiaries as well as fiduciaries. The remaining issues surrounding the income tax consequences of decantment of all of a trust's assets fall into three categories: (i) whether the termination of Trust *A* and distribution of appreciated assets from Trust *A* to Trust *B* cause gain to be recognized on the value of appreciated assets under Sections. 643 and 1001; (ii) whether other tax attributes, such as net operating loss carryovers, are transferred with

the trust assets upon a decantment; and (iii) whether migrating trusts can avoid state income taxes by changing the situs of a trust. From a gift tax standpoint, as a general proposition under Internal Revenue Code Chapter 12, the decanting of a trust by a nonbeneficiary trustee exercising his or her discretion is not a gift. The exception to this rule centers on the release of a general power of appointment that is currently exercisable by the beneficiary. This exception is in Sec. 2514(b). To the extent a decantment involves a straightforward release of a presently exercisable power of appointment, the trustee should file a Form 709 and make a late allocation of GSTT exemption.

H. Beneficiary's Appointment of Trust Property From Grandfathered Trust Didn't Constitute Constructive Addition for GST Tax Purposes. In PLR 201418005 (May 2, 2014), the IRS ruled on a trust beneficiary's exercise of a limited power of appointment (POA) in favor of a new trust for the benefit of herself and her son. The existing trust was a pre-1985 trust grandfathered for generation-skipping transfer (GST) tax purposes. The grantors established the trust for their granddaughter, who was entitled to all the income during her life and eligible to receive additional distributions of principal for certain purposes. She had an inter vivos and testamentary power of attorney (to appoint the trust property to other trusts (or free of trust) to or for the grantors' then-living descendants who, at the time the power is exercised, aren't current beneficiaries of the trust. On her death, in default of the exercise of the POA, the trust property would be distributed to the granddaughter's then-living descendants, or if none, to the grantors' then-living grandchildren in equal shares. The granddaughter proposed to appoint the trust property to a trust that had identical provisions for her during her life. On her death, instead of the trust property going outright to her then-living descendants, the new trust provided for a trust for her son. The trustees could accumulate income or pay out income and principal to her son in their discretion. Her son was also granted a limited POA to appoint trust property to his descendants, spouse, life partner, a charity or any descendant of the granddaughter. The rule against perpetuities (RAP) period for the new trust remained the same as the original trust. It's interesting to note that the granddaughter's exercise of her limited POA appeared to be (at least in part) exercised in favor of herself, as she was the lifetime beneficiary of the new trust. However, the IRS didn't discuss this point. The IRS appears to assume the exercise of the POA was valid and held that it didn't constitute a constructive addition to either trust. Under Treasury Regulations Section 26.2601-1(b)(1)(v)(B), the exercise of a limited POA won't be an addition to a trust if the POA was created in a trust that was irrevocable on Sept. 25, 1985, and the exercise of the power doesn't postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period beyond a life in being at the time of the original trust plus 21 years. Here, because the POA was created in a trust that predated the GST tax, and the RAP period wasn't extended, the exercise didn't constitute a constructive addition. This ruling shows that appointing trust property from a grandfathered trust to a new trust with different terms (even when such appointment allows property to be retained in trust longer than it would have originally) may not be a constructive addition, as long as the perpetuities period with respect to the GST-exempt property remains the same. Similarly, the IRS noted that the potential granddaughter's son's exercise of his POA in the second trust

also wouldn't result in a constructive addition because the RAP period wouldn't be extended beyond that of the original trust. Therefore, it appears that the second trust must have been grandfathered as well (because under the regulations, the POA must have been created in a trust that predated the GST tax for its exercise not to be considered a constructive addition).

I. Appeals Court Reverses Art Valuation Decision. In *Estate of James A. Elkins Jr. v. Commissioner*, No. 13-60472 (5th Cir. 2014), the Fifth Circuit reversed the Tax Court's decision to uniformly apply a 10 percent fractional ownership discount to each work of art in the decedent's collection, holding instead that the estate's much higher discount rate was correct. The Tax Court lacked "any record evidence whatsoever" on which to base its ordered discount, and its application of the willing buyer/willing seller test was flawed, the appeals court said.

J. Shares Conveyed in Merger Constitute Deemed Gift. In *William Cavallaro et ux. v. Commissioner*, T.C. Memo. 2014-189, Nos. 3300-11, 3354-11, The Tax Court held a couple liable for a gift tax liability, finding that the merger of the couples' company with their sons' company for less than full and adequate consideration was a deemed gift, and that the couple was not liable for failure to file and accuracy-related penalties because they reasonably relied on professional advice.

VI. MERGERS & ACQUISITIONS

A. Newly Proposed Asset Reorganization E&P Regulations. Newly proposed regulations, which address which corporation gets a target corporation's earnings and profits when an asset reorganization is followed by a drop, could completely change a rule existing since 1960 that says the E&P and all other tax attributes stay at the acquiring corporation unless all the target's assets are dropped. The proposed regulations (REG-131239-13), released May 6, 2014, provide that not only the E&P, but also all other attributes (like net operating losses and tax credits), stay up at the direct acquiring corporation even if the assets are transferred later to a controlled subsidiary. Treasury declined to take an approach that would give the E&P to whichever corporation ended up with substantially all of the assets or give the E&P to the issuing corporation. According to the preamble to the regulations, Treasury chose the new approach because it wanted to eliminate the electivity that was possible under the original proposal in the proposed Section 312 regulations (REG-141268-11) issued in April 2012. It also said the new proposal doesn't present the same administratively burdensome determination of whether "all" the acquired assets have been subsequently transferred.

B. Sale of Personal Goodwill Upheld. *Bross Trucking Inc. v. Commissioner*, T.C. Memo. 2014-107, involved a company that was liquidating and distributing its assets to its sole shareholder. It was facing a shutdown as a result of a safety investigation by the regulatory agencies. No employment or non-compete agreement existed between the company and its sole shareholder. The sole shareholder's sons had started a new company with its own licenses, regulatory authorizations, supplies and customers. It had also hired about half of Bross' former

employees. The IRS determined that the company had made a taxable distribution of the intangible asset of goodwill to its shareholder, who then made a taxable gift of the appreciated intangibles to his sons. This resulted in an income tax deficiency to the company of $883,800 and a gift tax deficiency to the shareholder of $1.02 million. The issue before the Tax Court was whether the company had any goodwill to distribute or whether any goodwill that existed was owned by the shareholder. The Tax Court found that if the company had any goodwill it had lost most of it by the time of the transaction.

The court looked at the revenue and cash flow streams, and concluded that they resulted from the shareholder's personal efforts and relationships that developed the customer base. It further found that due to the absence of any employment or non-compete agreement the shareholder was free to use his personal goodwill in competition with the company. The court found the case to be analogous to *Martin Ice Cream Co. v. Commissioner*, 110 T.C. 189 (1998).

VII. REAL ESTATE

A. Completed Contract Method and Home Construction Contracts.

1. Background. Section 460(f)(1) defines a long-term contract as "any contract for the manufacture, building, installation, or construction of property if such contact is not completed within the taxable year in which such contract is entered into." The statute does not define completion, which is to be determined on a contract-by-contract basis, but the regulations provide that a contract is completed when it first meets one of two tests. These tests are commonly known as:

a. The "use and 95% completion test." Under this first test, the contract is completed upon use of the subject matter of the contract by the customer for its intended purpose (other than for testing) and at least 95% of the total allocable contract costs attributable to the subject matter have been incurred by the taxpayer. Treas. Reg. 1.460-1(c)(3)(i)(A).

b. The "final completion and acceptance test." Under this second test, the contract is completed upon final completion and acceptance of the subject matter of the contract. To determine whether final completion and acceptance of the subject matter of a contract have occurred, a taxpayer must consider "all relevant facts and circumstances."

A further wrinkle to determining when a taxpayer completes a contract is the role of "secondary items." Taxpayers are to apply the tests above to determine when a contract is completed, "without regard to whether one or more secondary items have been used or finally completed and accepted." Thus, in applying the 95% completion test, taxpayers "must separate the portion of the gross contract price and the allocable contract costs attributable to the incomplete secondary item(s) from the completed contract." If under either test, a taxpayer's contract is completed within the same year that it is entered into, the contract is not a long-term contract, and the income related to the contracts must be recognized on the earlier of the dates it is earned, due or received

as dictated by the general revenue recognition principles of Section 451. If the contract does qualify as a long-term contract, however, because neither the "use and 95% completion test" nor "final completion and acceptance test" are met in the same year that the contract is entered into, then the taxpayer must generally use the percentage of completion method to recognize revenue, unless the contract is otherwise exempted from Section 460. One such exemption is provided for certain "home construction contracts."

2. Home Construction Contracts. Exempted by Section 460(e)(1)(A) from the definition of a long-term contract is a "home construction contract." A taxpayer may account for income from home construction contracts under the completed contract method. A "home construction contract" is defined as any construction contract if 80% of the estimated total contract costs are reasonably expected to be attributable to building, construction, reconstruction, or rehabilitation of, or the installation of any integral component to, or improvements of, real property with respect to (i) dwelling units contained in buildings containing 4 or fewer dwelling units, and (ii) Improvements to real property directly related to such dwelling units and located on the site of such dwelling units. Depending on the meaning of the word "site," taxpayers can have trouble meeting this 80% requirement. This occurs because a significant portion of the contract costs may be attributable to items not "located on the site of such dwelling units," such as development infrastructure. The regulations, however, instruct a taxpayer to "include in the cost of the dwelling units his or her allocable share of the cost that the taxpayer reasonably expects to incur for any common improvements (e.g., sewers, roads, clubhouses) that benefit the dwelling units and that the taxpayer is contractually obligated, or required by law, to construct within the tract or tracts of land that contain the dwelling units." Treas. Reg. 1.460-3(b)(2)(iii)). Thus, at least for the purpose of determining whether the contract qualifies as a home construction contract, the taxpayer includes for the 80% test costs attributable to common improvements.

3. Tax Court. In *Shea Homes Inc. v. Commissioner*, 142 T.C. No. 3 (2014) , decided on February 12, 2014, the Tax Court sided with the taxpayers in upholding their interpretation of the completed contract method in which the subject matter of their contracts consists of the home as well as the larger development, including amenities and other common improvements. The IRS had contended that the subject matter of the contracts consists only of the houses and the lots on which the houses are built. Without being able to include the cost of common improvements in the total costs for purposes of either of these two tests, Shea's construction contracts would fail to qualify as long-term contracts, and Shea would be required to include the home sales in income upon closing under Section 451. Noting that the regulations for determining whether a contract qualifies as a home construction contract under Section 460(e) provide that the taxpayer includes, for the 80 percent test, costs attributable to common improvements in the manner dictated by the regulations, the court found that the regulations accompanying Section 460 explicitly acknowledge that the subject matter of a home construction contract extends beyond the construction of a home. Treas. Reg. 1.460-3(b)(2)(iii)). The court stated that, at the minimum, the 95 percent completion test considers costs beyond just those associated with the house, the lot, and improvements to the lot. It found that, for the purpose of the 95 percent completion test in the

completed contract method, the petitioners correctly tested the total allocable costs associated with the development against the costs incurred to date.

B. Trust Material Participation Decision Will Affect Nil Tax. The U.S. Tax Court held on March 27, 2014, that a trust holding rental real estate properties qualifies for the Section 469(c)(7) passive activity exception, because services performed by the trustees are considered personal services performed by the trust and the trust materially participated in the real estate business activities. *Frank Aragona Trust et al. v. Commissioner*, 142 T.C. No. 9, No. 15392-11 (2014). The decision will be important to the application of the 3.8 percent net investment income tax under Section 1411, which doesn't apply to taxpayers who materially participate in a trade or business.

C. Second Circuit Affirms Denial of Deduction for Easement Donation. The Second Circuit, in *Huda T. Scheidelman v. Commissioner*, No. 13-2650, affirmed a Tax Court decision that an individual was not entitled to a charitable contribution deduction for the donation of a facade conservation easement because it did not reduce the value of her property, holding that the Tax Court applied the correct legal standard and substantial evidence existed to support its findings.

D. Qualifying Taxpayer Status Unaffected by Real Estate Election. In a legal memorandum, the IRS concluded that whether a taxpayer is a qualifying taxpayer under Section 469(c)(7)(B) is governed by the rules for determining a taxpayer's real property trades or businesses and is not affected by an election to treat all interests as a single rental real estate activity. The individual taxpayer owned two interests in real estate as well as a real property development trade or business. The taxpayer provided no personal services in other businesses and did not make an election under Treas. Reg. Section 1.469-9(g) to treat all interests in rental real estate as a single rental real estate activity. Section 469(c)(7) provides that if a taxpayer is a qualifying taxpayer for a year, Section 469(c)(2), which generally states that the term "passive activity" includes any rental activity, would not apply to any of the taxpayer's real estate activity. In that case, the qualifying taxpayer's rental real estate activity would not be a passive activity if the taxpayer materially participated in the rental real estate activity. The IRS said the first step was determining whether the taxpayer is a qualifying taxpayer under Section 469(c)(7)(B). All of the taxpayer's real property activities were combined for this determination. Under Treas. Reg. Section 1.469-5T(a)(1), because the taxpayer spent more than 500 qualifying hours on the combined real property trade or business, the taxpayer materially participated in it. Therefore, time spent on the combined activities counted toward meeting the qualifications of Section 469(c)(7)(B). Next, the IRS determined that the taxpayer was a qualifying taxpayer under Treas. Reg. Section 1.469-9(b)(6) because the taxpayer owned an interest in rental real estate; more than half of the personal services the taxpayer performed in trades or businesses were performed in real property trades or businesses in which the taxpayer materially participated; and the taxpayer performed more than 750 hours of services during the year in those trades or businesses. Finally, having determined that the taxpayer was a qualifying taxpayer, the IRS addressed whether the taxpayer materially participated in each of the real estate activities. Because the taxpayer had not made an election under Treas. Reg. Section 1.469-9(g), the two properties were each treated as separate real

estate activities, and the taxpayer's participation in the real property development trade or business was disregarded in determining material participation in both rental properties. Thus, the IRS concluded that each activity must meet one of the seven tests for material participation set forth in Treas. Reg. Section 1.469-5T(a). ILM 201427016.

FEDERAL INCOME TAX ISSUES ARISING DURING THE LIFE OF A PARTNERSHIP (OR LLC)

By: Alexander G. Domenicucci, Esq.

I. PARTNERSHIP[1] FORMATION.

A. Receipt of a Partnership Interest for Services. If an individual receives an interest in a partnership in exchange for services, the tax consequences to the recipient depends on the type of interest he receives.

1. Capital Interest.

a. A capital interest is a partnership interest that, on the date of the receipt of the interest, would give the holder a share of the proceeds of liquidation if the assets of the partnership were hypothetically sold at fair market value and the proceeds of the sale distributed by the partnership to its partners in complete liquidation. Rev. Proc. 93-27.

b. The receipt of a capital interest is taxable to the recipient.

2. Profits Interest.

a. A profits interest is a partnership interest other than a capital interest. Rev. Proc. 93-27. In other words, a profits interest is a partnership interest that, on the date of the receipt of the interest, would not give the holder a share of the proceeds of liquidation if the assets of the partnership were hypothetically sold at fair market value and the proceeds of the sale

[1] Any reference to "partnership" in this outline includes an LLC or other entity that is classified as a partnership for federal income tax purposes.

distributed by the partnership to its partners in complete liquidation.

b. The receipt of a profits interest is nontaxable to the recipient unless:

i. the profits interest relates to a substantially certain and predictable stream of income from partnership assets (such as income from a high-quality debt security or a high-quality net lease);

ii. the recipient disposes of the interest within two years of receipt; or

iii. the profits interest is a limited partnership interest in a "publicly traded partnership" (within the meaning of Section 7704(b)[2]).

3. <u>Restricted (Unvested) Capital Interest</u>.

a. A capital interest is restricted (or unvested) if the interest is nontransferable or subject to a substantial risk of forfeiture. An interest is subject to a substantial risk of forfeiture if the recipient's right to full enjoyment of the capital interest is conditioned upon the future performance of substantial services by the recipient.

i. In general, a recipient of a restricted capital interest is not taxed on the receipt of the interest until the restriction lapses.

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[2] Unless the context indicates otherwise, any reference to "Section" in this outline means a section of the Internal Revenue Code of 1986, as amended.

ii. A recipient of a capital interest may accelerate the date upon which the interest is taxed by filing a Section 83(b) election no later than 30 days after the receipt of the interest. The Section 83(b) election allows the recipient to treat the receipt of the interest as an immediate taxable event notwithstanding the fact that the interest has not yet vested.

b. If a Section 83(b) election is made, the recipient recognizes, as ordinary income, an amount equal to the fair market value of the capital interest (less the amount, if any, that the recipient paid for the interest). Any subsequent appreciation in the interest is generally taxed at capital gains rates upon the disposition of the interest.

c. If a Section 83(b) election is not made, the recipient does not recognize any income until the capital interest vests and, at such time, the recipient recognizes ordinary income to the extent of the then fair market value of the portion of the capital interest that has vested (less the amount, if any, that the recipient paid for the interest).

4. <u>Restricted (Unvested) Profits Interest</u>.

a. The recipient of a restricted (unvested) profits interest is treated as receiving the interest (and, thus, treated as a partner) on the date of issuance of the interest if:

i. both the partnership and the recipient treat the recipient as a partner from the date the interest is issued;

ii. the recipient takes into account the distributive share of partnership income, gain, loss, deduction, and

credit with respect to the interest in determining his tax liability for the entire period during which the recipient holds the interest,

iii. neither the partnership nor the other partners take a compensation deduction in connection with the issuance of the interest, and

iv. the other requirements applicable to profits interests discussed above are satisfied.

b. A Section 83(b) election is not required for a restricted (unvested) profits interest (although taxpayers might consider making a protective Section 83(b) election in case the interest is sold within two years).

B. Contribution of Appreciated Property. Special tax accounting is required in situations involving the contribution of appreciated property to a partnership.

1. Items of income, gain, loss, and deduction with respect to property contributed to a partnership must be shared among the partners to take into account any difference between the fair market value of the property at the time of the contribution and the basis in the property. Section 704(c)(1)(A).

2. If a partnership receives a contribution of appreciated property, it has a property with a "built-in gain" in the amount by which the property's fair market value exceeds its basis.

a. The initial book value of the property to the partnership is the property's fair market value.

b. The basis of the property to the partnership is generally equal to the basis that the contributing partner had in the property.

3. If the property contributed to the partnership is depreciable, the excess of depreciation deductions as calculated for book purposes over the same deductions as calculated for tax purposes reduces the built-in gain over time. When the partnership sells the property, the remaining built-in gain is allocated to the contributing partner. Any gain on the sale of the property in excess of the built-in gain is allocated among the partners as provided in the partnership agreement.

4. The difference between the property's book value and its basis is reconciled by adopting one of three alternative methods:

   a. <u>Traditional Method</u>. In general, the traditional method requires the partnership to make appropriate allocations to the contributing partner of income, gain, loss, or deduction with respect to the property in order to avoid the shifting of the built-in gain to the other partners. Under the so-called "ceiling rule," the amount of income, gain, loss, or deduction that can be allocated to the partners for a taxable year with respect to the property cannot exceed the total amount of these partnership items that the partnership has realized during the taxable year with respect to the property.

   b. <u>Traditional Method with Curative Allocations</u>. Under this method, the partnership makes "curative" allocations of *actual items* of income, gain, loss, or deduction from other property of the partnership that differ from the corresponding book item in the amount necessary to offset the effect of the ceiling rule for the taxable year.

c. Remedial Method. Under the remedial method, the partnership reconciles (or cures) the difference between the property's book value and its basis by creating *notional items* of loss or deduction for tax purposes and allocating those items to the noncontributing partners and creating offsetting *notional items* of gain or income for tax purposes in the same amounts and allocating the offsetting items to the contributing partner.

C. "Disguised Sales" of Property to the Partnership. Under the so-called "disguised sale" rules, the contribution of property to a partnership in exchange for an interest in the partnership may be treated in whole or in part as a taxable sale from the partner to the partnership.

1. Distribution of Cash to Contributing Partner. Under the disguised sale rules, a partner's contribution of property to a partnership and a distribution of cash by the partnership to the partner are treated as a taxable sale if the substance of the transaction is a sale from the partner to the partnership.

a. The determination of whether the transaction is treated as a taxable sale is based on all of the facts and circumstances.

b. If a partner contributes property to a partnership and receives a distribution of cash from the partnership within two years of the contribution, the transaction is presumed to be a taxable sale of the property to the partnership unless the facts and circumstances indicate otherwise.

c. There are certain safe harbors for:

i. Guaranteed payments;

ii. Preferred returns;

iii. Operating cash flow distributions;

iv. Reimbursements of preformation expenditures; and

v. Debt-financed distributions.

2. Contribution of Encumbered Property. The disguised sale rules also address situations in which a partnership assumes or takes property subject to a debt of the partner.

a. In general, if the debt is considered a "qualified liability," the partnership is considered not to have paid consideration to the partner in a disguised sale. A debt is considered a qualified liability if:

i. it was incurred by the partner more than two years prior to the earlier of the date the partner agrees in writing to contribute the property or the date the partner contributes the property to the partnership, and has encumbered the property throughout the two-year period;

ii. it was incurred by the partner during the two-year period described above but was not incurred in anticipation of the contribution of the property to the partnership, and has encumbered the property since it was incurred;

iii. it is allocable under the rules of Section 1.163-8T of the Treasury Regulations to capital expenditures with respect to the property; or

iv. it was incurred in the ordinary course of the trade or business in which the property contributed to the partnership was used or held but only if all the assets

related to that trade or business (other than assets that are not material to a continuation of the trade or business) are contributed.

b. Conversely, if a partnership assumes or takes property subject to a debt of the partner other than a qualified liability, the partnership is treated as transferring consideration to the partner in a disguised sale to the extent that the amount of the debt exceeds the partner's share of the debt immediately after the partnership assumes or takes subject to the debt.

II. PARTNERSHIP OPERATIONS.

A. Reduction in Partner's Share of Partnership Debt. A reduction in a partner's share of partnership debt can cause the partner to recognize gain in respect of his partnership interest.

1. A partner is deemed to receive a distribution of cash equal to the reduction in his share of partnership debt. If the deemed distribution exceeds the basis in his partnership interest, the partner recognizes gain.

2. If there is an increase in the partner's share of another partnership debt, the increase is generally netted against the decrease in the partner's share of the other debt. If a partner anticipates a decrease in his share of a partnership debt that would result in the recognition of gain, the partner might (with the cooperation of the partnership and other partners) arrange the partnership's affairs such that the partner receives an increased share of another partnership debt.

3. A reduction in a partner's share of partnership debt might occur, for example, if:

a. the partnership repays the debt,

b. the creditor discharges the debt,

c. the creditor forecloses the property securing the debt or the partnership transfers the property to the creditor by deed in lieu,

d. an additional partner is admitted to the partnership, or

e. the status of the debt changes from nonrecourse to recourse or vice-versa.

B. Distributions of Marketable Securities. While distributions of property by a partnership are generally nontaxable, a partner recognizes gain on the receipt of "marketable securities" if the fair market value of the securities exceeds the basis in his partnership interest.

1. Marketable securities include:

a. Financial instruments that are actively traded, including stocks and other equity interests, evidences of indebtedness, options, forward or futures contracts, notional principal contracts, and derivatives;

b. Interests in a common trust fund or regulated investment company (RIC);

c. Financial instruments that are readily convertible into money or marketable securities;

d. Financial instruments the values of which are determined substantially by reference to marketable securities;

e. Actively traded interests in precious metals;

f. An interest in an entity if 90% or more (by value) of the entity's assets consist (directly or indirectly) of marketable securities and money at the time of distribution; and

g. An interest in an entity whose assets consist of less than 90% but 20% or more of marketable securities and money, to the extent the value of entity is attributable to marketable securities and money.

2. The general rule of gain recognition does not apply to:

a. A distribution of marketable securities that had been contributed to the partnership by the distributee-partner.

b. A distribution of marketable securities if (i) they were acquired by the partnership in a nonrecognition transaction in which less than 20% of the value of the property exchanged by the partnership consisted of marketable securities and money, and (ii) the marketable securities are distributed within 5 years of the date of the nonrecognition transaction or, if later, the date on which the securities became actively traded.

c. A distribution of a marketable security if (i) they were not marketable on the date acquired by the partnership and the entity to which the security relates did not have any outstanding marketable securities on that date, (ii) the security was held by the partnership for at least 6 months before it became marketable, and (iii) the security was distributed within 5 years of the date upon which it became marketable.

d. A distribution of a marketable security acquired in a nonrecognition transaction in exchange for another security

to the extent the distribution of the other security immediately prior to the exchange would have been eligible for any of the three exceptions described above.

e. A distribution of marketable securities from an investment partnership to an eligible partner.

   i. An investment partnership is a partnership that has never been engaged in a trade or business and substantially all of whose assets consist of money, stock in a corporation, notes, bonds, debentures, or other evidences of indebtedness, interest rate, currency, or equity notional principal contracts, foreign currencies, and interests in or derivative financial instruments in any such assets or in any traded commodity.

   ii. An eligible partner is any partner who, before the date of the distribution, did not contribute any property to the partnership other than financial instruments described above, except that a partner cannot be an eligible partner if he was a transferor or transferee in a nonrecognition transaction involving a transfer of a partnership interest which respect to which the transferor was not an eligible partner.

   iii. A partnership is not treated as being engaged in a trade or business by reason of any activity undertaken as an investor, trader, or dealer.

   iv. A look-through rule applies to tiered partnerships under which a partnership is treated as holding a proportionate share of assets of any lower-tier

partnership and as conducting any trade or business of any lower-tier partnership.

C. Disproportionate Distributions.

1. A disproportionate distribution is recast as a taxable exchange to the extent the distribution changes the partners' proportionate shares of the partnership's "hot assets," which includes unrealized receivables and substantially appreciated inventory.

2. If a partner receives more than his share of hot assets, the partner recognizes capital gain equal to the excess share of the appreciation in capital gain assets that remain in the partnership. The distribution is recast as a distribution of the partner's share of all the partnership's assets to the partner, followed by an exchange of capital gain assets to the partnership for the excess share of hot assets actually received by the partner.

3. The portion of the ordinary income assets received in the deemed exchange has a basis to the distributee partner equal to their fair market value. The remaining ordinary income assets and capital gain assets have a carryover basis from the partnership.

4. "Unrealized receivables" include:

   a. Any rights (contractual or otherwise) to payment for (i) goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset or (ii) services rendered or to be rendered;

   b. Depreciation recapture;

   c. Excess depreciation under Section 1250;

d. Mining exploration expenses recapture;

e. Franchises, trademarks, and trade names;

f. Oil, gas, or geothermal property;

g. Excess farm loss recapture;

h. Market discount bonds and short-term obligations; and

i. Stock in a DISC or certain foreign corporations.

5. "Substantially appreciated inventory" is inventory of the partnership whose aggregate fair market value exceeds 120% of its aggregate basis.

D. Distributions of Previously Contributed Property to Other Partners or of Other Property to Contributing Partner.

1. A partner who contributed appreciated property to a partnership recognizes the built-in gain in the property if the partnership distributes the property to another partner within 7 years of the contribution.

2. A partner who contributed appreciated property to a partnership recognizes the built-in gain in the property if the partnership distributes other property to the contributing partner within 7 years of the contribution.

3. In general, the partner recognizes an amount of gain equal to the gain that would have been allocated to him if the contributed property had been sold by the partnership for its fair market value at the time of the distribution. Exceptions to the general rule apply in certain circumstances.

E. Revaluation of Partnership Capital Accounts.

1. A partner's capital account tracks the investment of the partner in the partnership. The balance in the capital account represents the partner's share of net equity in the partnership's assets. A partner's share in the net equity of the partnership's assets is distributable to the partner when the partner's interest is redeemed by the partnership or the partnership liquidates.

2. Capital accounts are initially maintained at the historical cost of the partnership's assets. In other words, they do not reflect any subsequent appreciation or depreciation in the partnership's assets.

3. The partners' capital accounts may be revalued to equal the fair market value of the net equity in the partnership's assets in connection with any of the following events:

   a. a contribution of a non-de minimis amount of cash or other property to the partnership by a new or existing partner as consideration for a partnership interest;

   b. a distribution of a non-de minimis amount of cash or other property by the partnership to a retiring or continuing partner as consideration for a partnership interest;

   c. the issuance of a non-de minimis partnership interest as consideration for the provision of services to or for the benefit of the partnership by a new or existing partner; and

   d. the liquidation of the partnership.

4. The difference between the existing balance in the partners' capital accounts and the amount to which their capital accounts would be increased or decreased, as applicable, creates a so-called "reverse-Section 704(c) gain/loss layer" that must be reconciled by

using the (i) "traditional method," (ii) "the traditional method with curative allocations," or (iii) the "remedial method." See Section I.B.4 above.

F. Section 754 Election.

1. A Section 754 election allows an adjustment to be made to a partner's share of the basis of the partnership's assets (or so-called "inside basis") so that it equals the partner's basis in his partnership interest (or so-called "outside basis").

2. A Section 754 election applies where there is a transfer of a partnership interest by sale or exchange or upon the death of a partner.

3. Once a Section 754 election is made, the election applies to all transfers and can be revoked only with the IRS' consent.

4. If a Section 754 election has not been made with respect to the partnership, no adjustment is made to the inside basis of the partnership assets unless a mandatory adjustment is required.

   a. A Section 754 election is mandatory if the partnership has a "substantial built-in loss" immediately after the transfer of the partnership interest.

   b. A partnership has a substantial built-in loss if the aggregate adjusted basis in its property exceeds the aggregate fair market value of the property by more than $250,000.

5. The basis adjustment resulting from a Section 754 election is allocated among the partnership's assets under the rules of Section 755. The basis adjustment applies solely to the transferee and has no effect on the partnership's income or loss. The adjustment does not affect the transferee's capital account.

G. Technical Termination of the Partnership.

1. A partnership terminates for federal income tax purposes if there is a sale or exchange of 50% or more of the total interest in partnership capital and profits within a 12-month period.

   a. The partnership is deemed to contribute all of its assets subject to all of its liabilities to a "new" partnership in exchange for the interests in the new partnership, and then is deemed to distribute the interests in the new partnership in complete liquidation.

   b. A technical termination causes the recovery period for the partnership's depreciable property to restart.

   c. A technical termination causes any partnership elections to terminate, including any Section 754 election.

2. The issuance of a partnership interest to a person in exchange for property, money, or services is generally not treated as a sale or exchange for purposes of determining whether there has been a technical termination.

3. The redemption of a partner's interest is generally not treated as a sale or exchange for these purposes.

III. LIQUIDATION OF PARTNERSHIP OR PARTNERSHIP INTEREST.

A. Liquidation of a Partner's Interest in the Partnership.

1. The redemption of a partner's interest by the partnership may have different tax consequences than a purchase of the interest by the other partners.

a. The redeemed partner has ordinary income to the extent of the partner's share of any gain attributable to hot assets of the partnership. See Section II.C above. The remainder of the gain is treated as capital gain.

b. Ordinary income from hot assets is recognized in the first year but limited to the amount of cash received plus the share of partnership debt of which the partner is relieved.

c. The redeemed partner is not subject to 25% depreciation recapture with respect to the partnership's unrecaptured Section 1250 gain.

d. After considering the impact of hot assets, the redeemed partner is permitted to recover his entire basis before recognizing any additional capital gain. The redeemed partner cannot recognize a capital loss until the final payment has been made by the partnership to the partner.

e. Installment payments are not subject to the original issue discount rules and, thus, can have no interest or below-market interest.

f. The redeemed partner is relieved of his share of partnership debt unless he continues to bear the economic risk of loss with respect to recourse debt of the partnership as installment payments are made to the redeemed partner.

g. The redeemed partner remains a "partner" for federal income tax purposes until the final payment by the partnership. While he does not receive allocations of income or loss after the date of the redemption, the partner receives a blank Form K-1.

h. A portion of the installment payments can be structured as a guaranteed payment that is deductible to the partnership or as a distributive share of income to the redeemed partner reducing the income allocable to the other partners.

2. The purchase of a partner's partnership interest by the other partners has the following tax consequences:

   a. The selling partner has ordinary income to the extent of the partner's share of any gain attributable to hot assets. The remainder of the gain is treated as capital gain.

   b. Inventory, regardless of whether it is substantially appreciated, is considered a hot asset.

   c. Ordinary income from hot assets is recognized in the first year even if the partnership interest is sold on the installment method.

   d. The selling partner must pay 25% depreciation recapture on his share of the partnership's unrecaptured Section 1250 gain.

   e. The selling partner generally reports the gain on the sale of his partnership interest on the installment method (except for the portion of the gain representing the partner's share of hot assets). Therefore, a portion of the partner's basis in his interest is allocated under the installment sale rules to each payment received by the partner.

   f. Any deferred payments must provide for adequate interest or interest is imputed with respect to the sale.

g. The partner is relieved of his share of partnership debt in the year of sale regardless of whether payments are made in installments.

h. The selling partner ceases to be a "partner" for federal income tax purposes on the date of sale, even if payment are made in future years.

i. The sale of the partner's interest in the partnership is treated as a transfer for purposes of determining whether there is a technical termination of the partnership.

B. Liquidation of the Partnership.

a. If the business and/or all of the assets of the partnership are sold and the proceeds of the sale are distributed to the partners in liquidation of the partnership, first the gain from the sale of the business and/or assets is allocated among the partners increasing the basis in their partnership interests, and to the extent the liquidating distribution exceeds the basis in their partnership interests (as increased), the partners then recognize gain in respect of their partnership interests.

i. A partner's relief from his share of partnership debt assumed or taken subject to by the buyer in the sale of the business and/or assets is treated as a deemed distribution and increases the overall amount of the partner's liquidating distribution.

ii. The gain from the sale of the business and/or assets may be capital gain and/or ordinary income depending on the nature of the assets sold by the partnership.

1. If the partnership has property that was previously contributed by a partner, gain is first allocated to the partner who contributed the property.

2. If there is so-called "partnership minimum gain" at the time of the sale, gain and/or ordinary income is also charged back to the partners to the extent of their shares of partnership minimum gain.

   a. In general, partnership minimum gain is the amount by which the debt of the partnership exceeds the book value of the partnership assets that encumber the debt.

   b. A deficit in a partner's capital account balance usually represents the partner's share of partnership minimum gain.

b. It is possible for a partner to receive an allocation of ordinary income from the sale of the business and/or assets and a capital loss on the liquidating distribution from the partnership.

USE AND SALES TAX ISSUES
AND
MICHIGAN OFFER-IN-COMPROMISE PROGRAM

By: Richard F. Roth, Esq.

I. MICHIGAN SALES AND USE TAX

A. Background

1. The Michigan Use Tax Act (MCL § 205.91, *et seq.*) and the Michigan General Sales Tax Act (MCL § 205.51, *et seq.*) are complementary and supplementary acts.

2. The Michigan Use Tax Act

a. The Michigan Use Tax Act provides for a 6% tax on the use, storage and consumption of "tangible personal property" in the State of Michigan. MCL § 205.93(1).

b. Certain services are also taxed under the Act, *see* MCL §§ 205.93a, 205.93b (***e.g.***, telecommunications services, rooms or lodging furnished by hotels/motels, certain laundering services, etc.).

c. A number of exemptions apply to use tax requirements, including, for example and without limitation:

i. Property purchased for resale, MCL § 205.94(1)(c)(*i*);

ii. Property sold within Michigan "on which a tax is paid under the general sales tax act...if the tax was due and paid on the retail sale to a consumer," MCL § 205.94(1)(a);

iii. A transaction (or a portion thereof) in which the transferor and the transferee are closely related (***i.e.***, spouse, parent, child, stepparent, stepchild, sibling, stepsibling, grandparent, grandchild, legal guardian, legal ward), MCL § 205.93(3)(a); *see also* MCL § 205.94bb (vehicle transfers between closely related in-laws, and discussed below);

iv. A transaction or portion thereof, "if the transfer is a gift to a beneficiary in the administration of an estate," MCL § 205.93(3)(b); and

v. If a vehicle, manufactured home, aircraft, watercraft, snowmobile, or off-road recreation vehicle has once been subject to sales tax in Michigan, and is then transferred in connection with the initial organization, reorganization, liquidation, or dissolution of a business (incorporated or unincorporated), and the beneficial ownership of the personalty has not changed, MCL § 205.93(3)(c); among others.

3. <u>The Michigan General Sales Tax Act</u>

a. The Michigan General Sales Tax Act creates an annual six (6%) percent tax from "persons engaged in the business of making sales at retail." The Act requires retailers to obtain a sales tax license. MCL § 205.52(1).

b. Certain sales are exempt from sales tax, including, for example and without limitation:

i. The sale of prescription and over-the-counter drugs, MCL § 205.54g(1)(a);

ii. The sale of food or food ingredients, except prepared foods that are intended to be immediately consumed, MCL § 205.54g(1)(a);

iii. Deposits on returnable beverage containers, MCL § 205.54g(1)(b);

iv. The sale of food or other tangibles purchased with food stamps, MCL § 205.54g(1)(c);

v. Property purchased at retail for resale, such as promotional merchandise, MCL § 205; and

vi. Sales of tangible personal property not for resale to exempt organizations (501(c)(3) or (4)), with certain exceptions, MCL § 205.54q; among others.

c. Under the General Sales Tax Act, retailers are allowed to reimburse themselves for sales tax by passing the tax on to the consumer and adding the tax amount to the sale price. MCL § 205.73.

B. *Andrie Inc. v. Dep't of Treasury*, No. 145557, 2014 WL2853776 (Mich. June 23, 2014)

1. Facts of the Case:

a. Plaintiff, Andrie, Inc., is a Michigan corporation, whose business is in marine construction and transportation. The company purchases fuel and other supplies for its business, some purchases which come from Michigan sellers.

b. The Department of Treasury conducted a use tax audit on Andrie. On many of Andrie's receipts, sales tax was not itemized separately from the purchase price of the goods.

c. During the audit Andrie, either by itself or through the retailer, could not prove that sales tax had been paid on the sales, thereby exempting the sales from use tax. Therefore, the department found that Andrie had understated its use tax obligation by $398,755.

d. The Department conceded that it did not know whether or not the retailers actually collected and remitted sales tax to the Department for the transactions in question.

e. Andrie paid in protest, and brought suit for a refund.

2. Court's Ruling: The Michigan Supreme Court upheld the use tax obligation on the grounds that Andrie failed to establish that sales tax was paid on the transactions at issue at the time of sale, or thereafter.

   a. "We hold that when the retail seller does not admit that sales tax was collected or paid on a particular sale of tangible personal property, the user of that property must show that it paid sales tax on the purchase of that property before the user can claim an exemption from the use tax."

3. Court's Reasoning:

   a. "Absent an exception, tangible personal property sold and used in Michigan is subject to *both* use and sales tax."

   b. Under MCL § 205.94(1)(a), property sold in Michigan on which transaction a tax is paid under the general sales tax

act is exempt from use tax, if the tax was due and paid on the retail sale to a consumer.

c. Taxpayers have the burden of proving entitlement to a use tax exemption.

d. There is no presumption that a taxpayer has paid sales tax at the point of sale.

e. Andrie failed to prove that it had paid sales tax on the transactions at issue, in large part, due to the fact, that sales tax was not itemized on its purchase receipts.

C. Other Use/Sales Tax Updates

1. Public Acts 108 and 109 of 2014 (MCL § 205.68, 205.104a): amend the General Sales Tax Act and the Use Tax Act, respectively, to permit the Department of Treasury to assess tax due under either Act via an "indirect audit procedure".

a. In the event a taxpayer fails to maintain "sufficient records" or the records provided by the taxpayer are inaccurate or incomplete, the Department may either: (i) choose to assess the amount of tax due based on information available to it, or (ii) assess the amount of tax due based on an indirect audit procedure.

b. "Sufficient records" means "records that meet the department's need to determine the tax due" under the Act(s). MCL §§ 205.68(8)(b); 205.104a(7)(b)

c. An "indirect audit procedure" means "an audit method that involves the determination of tax liabilities through an analysis of a taxpayer's business activities using information from a range of sources beyond the taxpayer's declaration

and formal books and records." MCL §§ 205.68(8)(a); 205.104a(7)(a).

d. The indirect audit procedure must be conducted in accordance with the Michigan statutes regulating the Department of Treasury, Revenue Division (MCL §§ 205.1-205.31), as well as Department standards. MCL §§ 205.68(4); 205.104a(4).

e. The indirect audit procedure must include all of the following:

   i. A review of the taxpayer's books and records;

   ii. An evaluation of the credibility of the evidence and the auditor's conclusion, prior to any determination of tax liability;

   iii. Any method used by the Department to reconstruct "income, deductions or expenses" that is reasonable under the circumstances, including the use of third-party records; and

   iv. An investigation of all reasonable evidence provided by the taxpayer to refute the computation of tax liability. MCL §§ 205.68(4)(a)-(d); 205.104a(4)(a)-(d).

f. The Department cannot base a determination of tax deficiency on an indirect audit procedure if the taxpayer has filed all required returns and maintained sufficient records, *unless* the Department has a documented reason to believe that records filed or maintained are incomplete or inaccurate, or that additional taxes are owed. MCL §§ 205.68(5); 205.104a(5).

2. Public Act 458 of 2012 and Public Act 585 of 2012 (MCL §§ 205.56; 205.96): amends the General Sales Tax Act and the Use Tax Act, respectively, to increase the accelerated sales and use tax filing requirements of taxpayers with $720,000 or more of tax liability in the immediately preceding year (less permitted tax credits). Taxpayers who meet the threshold must remit monthly to the Department of Treasury 75% of the taxpayer's liability from the same month in the preceding year. Prior to January 1, 2014, it was only 50%.

3. Public Act 248 of 2014 (MCL § 205.94bb): exempts transfers of vehicles, manufactured homes, aircrafts, watercrafts, snowmobiles, and ORVs from use tax if the transfer is between closely related in-laws (***i.e.***, father- or mother-in-law; brother- or sister-in-law; son- or daughter-in-law; or grandparent-in-law).

4. Public Act 161 of 2014 (MCL § 205.93f): reinstates use tax on medical services provided to Medicaid beneficiaries by Medicaid managed care organizations that have contracted with the State of Michigan, beginning April 1, 2014. Public Act 161 was enacted in conjunction with Public Act 162 of 2014, which amended the Health Insurance Claims Assessment Act to reduce health insurance claims assessment (HICA) rates.

II. MICHIGAN OFFER-IN-COMPROMISE PROGRAM

A. Public Act Number 240 of 2014 (MCL § 205.23a) was enacted on June 21, 2014, upon approval of the Governor. The Act created an Offer-In-Compromise Program ("Program") for the State of Michigan, allowing the State Treasurer to compromise all or a portion of a tax liability, including related interest and penalties. *See* MCL § 205.23a.

B. **The Program becomes effective January 1, 2015.** MCL § 205.23a(1).

C. The grounds under which the State Treasurer <u>may</u> compromise a tax liability (and related interest and penalties) are:

1. If doubt exists as to liability if the Department of Treasury concludes, based on evidence provided by the taxpayer, that the taxpayer would have prevailed in a contested case if the taxpayer's appeal rights had not expired, MCL § 205.23a(1)(a);

2. If doubt exists as to collectability if the taxpayer establishes <u>both</u> of the following: (*i*) the amount offered in payment is the most that can be expected to be paid or collected from the taxpayer's present assets or income. [and] (*ii*) the taxpayer does not have reasonable prospects of acquiring increased income or assets that would enable the taxpayer to satisfy a greater amount of the liability than the amount offered, within a reasonable amount of time, MCL § 205.23a(1)(b); or

3. A federal tax compromise under I.R.C. § 7122 was granted for the same tax year(s). In the event a federal tax compromise was granted, the State Treasurer may compromise the outstanding balance of the liability for each year by applying the same percentage as the federal liability compromised to the total liability, MCL § 205.23a(1)(c).

D. A taxpayer who submits an offer of compromise relating to a tax, interest or penalty must submit the greater of $100.00, or 20% of the offer; the remitted amount is applied to the outstanding balance of the taxpayer's tax liability and is not refunded in the event the offer of compromise is reduced or rejected altogether. MCL § 205.23a(8).

E. A compromise is subject to continued review, and the Treasury Department may revoke any compromise and may re-establish all compromised liabilities (without regard to any statute of limitations), if:

1. The Treasurer reasonably determines that the person receiving the compromise concealed from the department any property belonging to the taxpayer or, with the intent to mislead, withheld, destroyed, mutilated, or falsified any book, document, or record or made any false statement, relating to the estate or financial condition of the taxpayer...to induce the compromise, MCL § 205.23a(3)(a); or

2. The taxpayer fails to comply with any term or condition related to the offer or to file subsequent tax returns and pay subsequent final tax liabilities within 20 days after the department issues a notice and demand indicating that continued failure to file and/or pay may result in a revocation of the compromise. MCL § 205.23a(3)(b).

F. The Department of Treasury is not allowed to levy against property to collect liabilities while an offer in compromise is pending, unless the state treasurer determines that the taxpayer's offer in compromise was intended for the purpose of delaying collection, or the Department has issued a jeopardy assessment. MCL § 205.23a(7).

G. Administrative Requirements of the Program:

1. Records and Reports: The Department of Treasury must keep written reports of all compromises, and must publish the written reports on the Department's website containing a statement of:

   a. The amount of tax assessed;

   b. The amount of interest or assessable penalty imposed by law on the person against whom the tax is assessed;

   c. The terms of the compromise and the amount actually paid in accordance with the terms of the compromise; and

   d. The grounds for the compromise. MCL § 205.23a(2).

2. Public Review. The Department of Treasury is required to disclose return information to the general public, for the purpose of, and to the extent necessary to permit inspection of any accepted offer. MCL § 205.23a(5).

3. Regulations: Within 180 days from the enactment of 2014 P.A. 240, the Department of Treasury is required to:

   a. Establish guidelines for the Program, modeled after the federal program, including guidelines for those persons determining whether an offer is appropriate; and

   b. Establish procedures for independent administrative review of rejected offers-in-compromise. The taxpayer shall make a written request within 30 days after the rejection is issued by the Department to initiate a review. Other than the independent administrative review under the Program, rejections are final and not subject to further challenge or appeal. MCL § 205.23a(4).

THE ONE MAN BAND

By: Stuart M. Bordman

I. FACT PATTERN

Bill is the sole shareholder, director and officer of a manufacturing business with plants in Michigan and four other states. Bill is 60 years old. He has three adult children, none of whom is interested in coming into the business. Sales are approximately $90 million per year and the business is highly profitable. Bill, through related entities, owns the real estate used by the company. Leases are in place between the related entities and the company. Bill has had difficulty developing and maintaining a management team. Bill has difficulty in delegating. The company has some debt but no debt or other obligation is personally guaranteed by Bill.

II. PREPARE THE BUSINESS FOR SALE

A. Document related party transactions:

1. Leases.

2. Loans.

B. Corporate matters:

1. Transfer stock to the shareholder's revocable living trust if he has such a trust.

2. Update the Minute Book:

   a. Elect officers and directors.

   b. Approve significant actions.

3. Update bylaws, if necessary.

III. DETERMINE GOALS OF SHAREHOLDER, I.E., WHAT HAPPENS TO THE BUSINESS IF HE DIES?

A. Continue the business indefinitely.

B. Continue the business until a purchaser can be found.

C. Liquidate and dissolve.

IV. POTENTIAL PURCHASERS

A. Strategic buyer; i.e., competitor which integrates the acquired business into its business.

B. Financial investor.

1. Looks for return on investment.

2. Needs competent management to remain in place.

C. Existing Management.

1. Alternatives.

a. Purchase is negotiated by shareholder and triggered upon death or disability of the shareholder.

b. Negotiated after the death of the shareholder.

2. Payment:

a. Cash.

b. Seller financing.

D. ESOP.

V. <u>DISPOSITION OF STOCK UPON DEATH</u>

A. Revocable living trust becomes irrevocable upon death.

B. Transfer to a separate trust.

C. Designation of Trustees to control stock of business.

VI. <u>LETTER OF INSTRUCTION TO TRUSTEES (SEE ATTACHED)</u>.

[TO BE PLACED ON THE LETTERHEAD OF BILL'S MANUFACTURING, INC.]

_______________, 2014

TO: The Trustees of the Bill's Special Trust
- Owner of the stock of
Bill's Manufacturing, Inc. ("BMI")

Gentlemen:

As a preliminary matter let me thank you for serving as trustees. As set forth in detail below, it is my request that you continue the business of BMI without any unnecessary changes until the business is sold.

The purpose of this letter is to give you suggestions to achieve my goal:

1. The Bylaws of BMI should be amended to provide for a three-member board of directors. You should elect directors as soon as possible. You can elect yourselves directors or you can elect other individuals who are experienced in the industry or have other experience in management and financial matters.

2. While BMI can run for some period of time without a president, you should elect a president who will provide management direction and lead the company until it is sold. You may, of course, by contract and by amendment to the bylaws, limit the power of the president of the company to the extent that you deem necessary.

3. Reasonable efforts should be made to retain management employees until the business is sold. A business with management in place will make BMI more attractive to certain prospective purchasers. It is likely that the management employees will learn that BMI will be sold. A frank discussion with key employees in this regard may be appropriate. An agreement to pay each employee an amount equal to, for example, one year's salary if he remains until the sale is consummated may be advisable.

4. Except to the extent necessary there should be no changes in the operation of the business. Compensation and fringe benefits should not be disturbed. Arrangements with vendors, customers and others should remain in place. From the perspective of employees, vendors and customers it should be "business as usual".

5. Loan agreements should be reviewed to make certain that my death does not give the lender the power to demand immediate payment. If any loan agreement contains such a provision the lender should be assured that BMI will continue its business without interruption and that the loan is secure.

6. If there are no subordination agreements in place amounts that BMI owes to my estate or trust should be repaid as cash becomes available. After such loans are repaid there should be dividends paid as cash becomes available.

7. You should be compensated for your services and, accordingly, I would suggest each of you receive ___ % of the sales proceeds for your duties in serving as trustees and/or directors. In the event that there is a director who is not a trustee, you should compensate that director.

8. You should retain an investment bank to value BMI. Once a value has been established you can either contact potential purchasers on your own or retain the investment bank to do so. Potential purchasers include the following competitors or vendors:

   A.

   B.

   C.

   D.

9. While unlikely, one or more of my children may express interest in purchasing BMI. That child or those children should also be considered as potential purchasers. However, to protect my wife and to treat all of my children fairly an offer from any of my children must be as favorable as an offer from an outsider unless my wife and all of my other children agree otherwise.

10. The goal is to maximize the purchase price and eliminate or limit any credit risk. Accordingly, if possible, the sale should be for cash except for any amount held in escrow to support BMI's warranties and representations in connection with the sale of the business.

11. The real estate used by BMI is leased from ______________________________ ____. If the purchaser of the business is a creditworthy entity long-term leases should be entered into between the purchaser and those entities so that my family will have a continuing source of income. If the purchaser will not agree to long term leases short term leases should be negotiated so that rental income will continue until a purchaser or a new tenant can be located for the real estate owned by the related entities.

Again, thank you for serving as trustees and assisting my family.

Very truly yours,

Bill

LET'S TALK CIRCULAR 230 – TWO ETHICAL DILEMMAS

By: Charles M. Lax

I. CIRCULAR 230

A. Who Does It Cover

1. Certified Public Accountants, Attorneys, Enrolled Agents and Enrolled Retirement Plan Agents.

2. Section 10.8(c) of Circular 230 also provides that any individual who for compensation prepares or assists in the preparation of all or a substantial portion of a document pertaining to tax liability which is submitted to the IRS.

B. Format for Circular 230

1. Subpart A – Rules governing authority to practice.

2. Subpart B - Duties and restrictions relating to practice before the IRS.

3. Subpart C – Sanctions for violations.

4. Subpart D – Rules for disciplinary proceedings.

C. Outline of Subpart B

1. Section 10.20 – Information to be Furnished to the IRS.

a. A practitioner must promptly submit information to the IRS unless it is privileged [Section 10.20(a)(1)].

b. If a third party possesses requested information, the practitioner must provide any "identity" information they have [Section 10.20(a)(2)].

c. A practitioner cannot interfere with the IRS in obtaining information unless it is privileged [Section 10.20(b)].

2. Section 10.21 - Knowledge of Error or Omission

   a. A practitioner must promptly advise their client of: (i) an error or omission or non-compliance; and (ii) the consequences of such items [Section 10.21].

3. Section 10.22 - Diligence to Determine Accuracy

   a. A practitioner must exercise due diligence in (i) preparing IRS returns and documents, (ii) determining the correctness of representations made to the IRS and (iii) determining the correctness of representations made to their client [Section 10.22(a)].

   b. A practitioner may generally rely upon the work product of others, if reasonable care is used in evaluating the work product and the other person [Section 10.22(b)].

4. Section 10.23 - Prompt Disposition of Pending Matters

   A practitioner may not unreasonably delay the disposition of a matter before the IRS [Section 10.23].

5. Section 10.27 - Fee

   A practitioner may not charge an unconscionable fee in connection with a matter before the IRS [Section 10.27].

6. Section 10.28 - Return of a Client's Records

   a. Generally, a practitioner must promptly return client records upon request even if there is a fee dispute [Section 10.28(a)].

b. “Records” include items that: (i) pre-existed the practitioner's retention; or (ii) were prepared by the client or a third party [Section 10.28(b)].

c. Records do not include practitioner prepared documents, which are withheld pending the payment of fees with respect to that document [Section 10.28(b)].

7. Section 10.29 - Conflicting Interests

a. A practitioner may not represent a client if: (i) the representation of one client is adverse to the interest of or responsibility to another client; or (ii) the representation of a client would be limited due to the personal interests of the practitioner [Section 10.29(a)].

b. Even if a conflict exists, representation is permitted if: (i) the practitioner reasonably believes that they can provide competent and diligent representation; and (ii) the client waives the conflict and gives informed written consent [Section 10.29(b)].

8. Section 10.34 - Preparation Standards

a. A practitioner may not sign a return or advise a client to take a position that: (i) lacks a reasonable basis; (ii) willfully attempts to understate the tax; or (iii) intentionally disregards the rules and regulations [Section 10.34(a)].

b. A practitioner may not advise or allow a client to submit a document or paper to the IRS that is: (i) frivolous; or (ii) intentionally disregards the rules and regulations [Section 10.34(b)].

c. A practitioner may generally rely on information furnished by the client without verification; however, they cannot ignore what is actually known [Section 10.34(d)].

d. A practitioner must make reasonable inquiries if information appears to be: (i) incorrect; (ii) incomplete; or (iii) inconsistent with another fact [Section 10.34(d)].

9. Section 10.35 - Competence

a. A practitioner must possess the requisite competence to practice before the IRS [Section 10.35].

b. Competence requires knowledge, skill, thoroughness and preparation necessary for the matter [Section 10.35].

10. Section 10.36 - Procedures to Ensure Compliance

a. A practitioner with the principal responsibility for overseeing the firm's practice of preparing returns or documents for submission to the IRS, must ensure that Circular 230 compliance procedures are in place for all members [Section 10.36(b)].

b. If the practitioner with the principal responsibility knows or should know a firm member has engaged in a pattern of practice that is in violation of Circular 230 and fails to take prompt action to correct the non-compliance, they may be subject to disciplinary action [Section 10.36(b)].

II. CASE STUDIES

A. **Can You Give a Friend a Hand**

You are a CPA and receive a referral from a friend who owns a small bookkeeping service in April 2014. The friend typically refers two or three new clients to you each year. In this case, the referral is to a client that has grown and now needs to provide its bank with tax returns prepared by

a certified public accounting firm. The friend reasons that if you handle the tax return preparation, he will likely be able to retain the balance of the bookkeeping work.

You are given the client's records and prior returns and in the course of a review for the December 31, 2013 year you find:

> Legal fees "for extensive estate planning" were incurred during 2011, 2012 and 2013 and deducted as business expenses on the 2011 and 2012 returns.
>
> "Extensive improvements" were made during the years 2011, 2012 and 2013 to the building which the client occupied, including a new roof and a "small addition", which were deducted on the 2011 and 2012 returns under a category "Repairs and Maintenance" and a new air conditioning system which was installed during 2013.

To make certain that you are not "missing anything" you call your friend, report these two problems and suggest that the client should be apprised of the errors for 2011 and 2012. The friend tells you that he prefers this not be disclosed because it would be very embarrassing to him. What is your responsibility?

1. Section 10.21 of Circular 230 requires you to advise the client of the non-compliance and the tax consequences.

2. Section 10.29(a) of Circular 230 provides that a conflict exists if your representation is materially limited by a "personal interest".

What would be your responsibility if the friend assures you that he will discuss the issues himself with the client and later reports: (i) he had the discussion with the client, (ii) he met the "Circular 230" obligation by advising the client of the problems, (iii) the client told him to tell you to ignore the issue for filing its return for 2013 and that the client "will bear

any responsibility and (iv) will not amend prior years returns for 2011 and 2012?

1. Your Circular 230 obligation under Section 10.21, probably has not been met by having a third party advise the client of the non-compliance.

2. Section 10.34(a) prohibits you from taking a position on a return that intentionally disregards the rules and obligations.

B. **The Case of the Unsigned Operating Agreement**

You are retained by a new client, who is the manager of a limited liability company to perform tax and accounting services. The limited liability company is the owner of an apartment complex and has two unrelated investors in addition to the manager. When the "deal" was initially structured in 2012 the investors were provided with pro forma projections that included special allocations of losses that made the investment particularly attractive. The prior accountant filed the 2012 and 2013 returns reflecting the special allocation of losses. You request a complete set of documents from the client, including the Operating Agreement, which delineates the special allocation. After a diligent search, the client provides them to you, but is unable to locate a signed copy of the Operating Agreement. What is your responsibility?

Section 10.21 of Circular 230 requires you to advise the client of the non-compliance and the tax consequences.

What if the client provides the Operating Agreement dated December 17, 2012, but discloses to you that while their attorney had timely prepared the Operating Agreement, they just got around to signing it?

What if the client first makes the disclosure to you of when it was dated during the course of an IRS audit, while the IRS agent is waiting for you to produce the Operating Agreement?

1. Section 10.20(a)(1) of Circular 230 requires you to promptly submit requested documents to the IRS unless privileged.

2. Section 10.34(b)(2) prohibits you from submitting a document which intentionally disregards the rules and regulations.

TO BE OR NOT TO BE (A TRUSTEE), THAT IS THE QUESTION

By: Robert D. Kaplow, Esq.

I. WHY YOU SHOULD BE A TRUSTEE

a. Shows that client has confidence in you

b. It's an honor

c. Can get good fees as trustee

d. Can lose client if you decline to serve as trustee

II. WHY YOU SHOULDN'T BE A TRUSTEE

a. Takes time away from more challenging work

b. It's not an honor – it's aggravation

c. You don't like the beneficiaries

d. Liability, liability, liability

III. TRUSTEE DUTIES – FIDUCIARY OBLIGATION

a. Based on trust terms, Michigan statutes and common law

b. Michigan Trust Code – effective April 1, 2010

MCL 700.7801

The trustee shall administer the trust in good faith, expeditiously, in accordance with its terms and purposes, for the benefit of the trust beneficiaries, and in accordance with [the Michigan Trust Code.]

c. Duty to Administer the Trust

d. Duty of Care and Performance

e. Duty of Loyalty

Administer the trust in the best interests of the beneficiaries and in an impartial manner

f. Duty to Keep Records and Furnish Accounts

Generally, beneficiaries are entitled to receive an annual accounting of trust activity

g. Duty to take control of trust property

Take reasonable steps to protect and preserve trust property

h. Duty to enforce claims on behalf of the trust and defend claims against the trust

i. Duty to pay expenses and taxes of the trust

j. Duty to keep trust property separate from trustee's property

k. Duty to make trust property productive

   i. Unless trust specifically provides otherwise

   ii. Prudent investor rule

l. Duty to follow trust terms regarding distributions to beneficiaries

   i. Required distributions

   ii. Permissive distributions

   iii. Health, education, maintenance and support (HEMS)

m. Duty to furnish information

Under Michigan law, a beneficiary has the right to a copy of the terms of the trust that describe or affect the beneficiary's interest and to relevant information about the trust property. The beneficiaries need to be notified of this right.

n. Duty to exercise reasonable care and skill as the trustee

i. Exercise care and skill that a person of ordinary prudence would use in dealing with his own property – prudent man (woman) rule

ii. As an accountant, you will be required to use your professional skills when serving as trustee

IV. TRUSTEE POWERS

a. Make sure the trust has broad powers to enable you to exercise your judgment and duties without much restriction

b. The Michigan Trust Code includes a substantial number of powers of the trustee. See the attached Exhibit A.

c. Caution – you can be liable for exceeding your powers in the administration of the trust

d. Michigan has adopted the Uniform Principal and Income Act (MCL 555.501, et. seq.), and the Uniform Prudent Investor Act (MCL 700.1501, et. seq.)

i. These statutes give some protection to the trustee

ii. Trustee can invest the portfolio as a whole, provided that the investment portfolio is "prudent"

iii. No categorical disallowance of an investment, if it fits into the overall prudent investment strategy

V. TRUSTEE LIABILITY

a. Anyone can bring a lawsuit – don't give anyone a reason to do so

b. Breach of fiduciary duty

To the beneficiaries – such as self-dealing, favoring one beneficiary over another, failure to follow trust terms

c. Bad administration

i. Such as assisting the Nigerian prince to get money out of Nigeria

ii. Failure to make proper tax elections

iii. Excess compensation as trustee

iv. Failure to dispose of an asset timely

d. Environmental issues

Make sure that you investigate any property that may have environmental issues before accepting that property into the trust

VI. HOW TO PROTECT AGAINST LIABILITY

a. Get good trustee liability insurance policy and personal umbrella policy

b. Have strong language in trust indemnifying the trustee and holding the trustee harmless from liability

c. Have a good relationship with the beneficiaries and communicate with them frequently -- probably have more risk with the next generation than the current generation that knows you

d. Be transparent

e. Check with your attorney at Maddin Hauser when you have any questions

f. Avoid trusts where the beneficiaries are litigious or hate each other (or their parent)

g. Avoid trusts where beneficiaries are "trust babies" waiting for distributions

h. Avoid trusts which require substantial active management of businesses unless you can devote sufficient time to the business

i. Review the trust terms before agreeing to be trustee – make sure that you are comfortable with the obligations set forth in the trust

j. If the grantor is alive, have the grantor provide a side letter as to how he/she would like the trust administered

k. DON'T AGREE TO BE THE TRUSTEE!

VII. IRREVOCABLE LIFE INSURANCE TRUST (ILIT)

a. Must take an active role as trustee before the insured dies

b. Is the insurance policy still good or should it be replaced with a better, cheaper policy

c. Send out Crummey letters

d. Risk from beneficiaries that they sue for breach of fiduciary duties for failure to examine the life insurance policy periodically

EXHIBIT A

Statutory Trustee Powers

ESTATES AND PROTECTED INDIVIDUALS CODE (EXCERPT)
Act 386 of 1998

700.7816 General powers of trustee.

Sec. 7816.

(1) A trustee, without authorization by the court, may exercise all of the following:

(a) Powers conferred by the terms of the trust.

(b) Except as limited by the terms of the trust, all of the following:

(i) All powers over the trust property that an unmarried competent owner has over individually owned property.

(ii) Any other powers appropriate to achieve the proper investment, management, and distribution of the trust property.

(iii) Any other powers conferred by this article.

(2) The exercise of a power is subject to the fiduciary duties prescribed by this article.

History: Add. 2009, Act 46, Eff. Apr. 1, 2010
Popular Name: EPIC

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ESTATES AND PROTECTED INDIVIDUALS CODE (EXCERPT)
Act 386 of 1998

700.7817 Specific powers of trustee.

Sec. 7817.

Without limiting the authority conferred by section 7816, a trustee has all of the following powers:

(a) To take possession, custody, or control of property transferred to the trust and accept or reject additions to the trust.

(b) To retain property that the trustee receives, including property in which the trustee is personally interested, in accordance with the Michigan prudent investor rule.

(c) To receive property from a fiduciary or another source that is acceptable to the trustee.

(d) To perform, compromise, or refuse to perform a contract of the settlor that is an obligation of the trust, as the trustee may determine under the circumstances. In performing an enforceable contract by the settlor to convey or lease land, if the contract for a conveyance requires the giving of a warranty, the deed or other instrument of conveyance to be given by the trustee shall contain the warranty required. The warranty is binding on the trust as though made by the settlor, but does not bind the trustee except in the trustee's fiduciary capacity. The trustee, among other possible courses of action, may do either of the following:

(i) Execute and deliver a deed of conveyance for cash payment of money remaining due or the purchaser's note for the money remaining due secured by a mortgage on the land.

(ii) Deliver a deed in escrow with directions that the proceeds, when paid in accordance with the escrow agreement, be paid to the trustee, as designated in the escrow agreement.

(e) To satisfy a settlor's written charitable pledge irrespective of whether the pledge constitutes a binding obligation of the settlor or was properly presented as a claim, if in the trustee's judgment the settlor would have wanted the pledge completed under the circumstances.

(f) To deposit trust property in a financial institution, including a financial institution operated by or affiliated with the trustee and to invest and reinvest trust property as would a prudent investor acting in accordance with the Michigan prudent investor rule and to deposit securities with a depositary or other financial institution.

(g) To acquire property, including property in this or another state or country, in any manner for cash or on credit, at public or private sale; and to manage, develop, improve, exchange, partition, or change the character of trust property.

(h) To make an ordinary or extraordinary repair or alteration in a building or another structure, to demolish an improvement, or to raze an existing or erect a new party wall or building.

(i) To subdivide, develop, or dedicate land to public use; to make or obtain the vacation of a plat or adjust a boundary; to adjust a difference in valuation on exchange or partition by giving or receiving consideration; or to dedicate an easement to public use without consideration.

(j) To enter for any purpose into a lease as lessor or lessee, with or without an option to purchase or renew, for a period within or extending beyond the duration of the trust.

(k) To enter into a lease or arrangement for exploration and removal of minerals or another natural resource or to enter into a pooling or unitization agreement for a period within or extending beyond the duration of the trust.

(l) To abandon or decline to administer property if, in the trustee's opinion, the property is valueless, or is so encumbered or in such a condition that it is of no benefit to the trust.

(m) To vote a stock or other security in person, by general or limited proxy, or in another manner provided by law, or enter into or continue a voting trust agreement.

(n) To pay a call, assessment, or other amount chargeable or accruing against or on account of a security, and sell or exercise stock subscription or conversion rights.

(o) To hold property in the name of a nominee or in another form without disclosure of the interest of the trust. However, the trustee is liable for an act of the nominee in connection with the property so held.

(p) To insure the trust property against damage, loss, or liability and to insure the trustee, the trustee's agents, and the trust beneficiaries against liability arising from the administration of the trust.

(q) To borrow property, with or without security, for any purpose from the trustee or others and to mortgage or pledge trust property for a period within or extending beyond the duration of the trust.

(r) To effect a fair and reasonable compromise with a debtor or obligor, or extend, renew, or in any manner modify the terms of an obligation owing to the trust. If the trustee holds a mortgage, pledge, or another lien on property of another person, the trustee may, instead of foreclosure, accept a conveyance or transfer of encumbered property from the property's owner in satisfaction of the indebtedness secured by a lien.

(s) To pay a tax, an assessment, the trustee's compensation, or another expense incident to the administration of the trust.

(t) To sell or exercise a subscription or conversion right or to consent, directly or through a committee or another agent, to the reorganization, consolidation, merger, dissolution, or liquidation of a business enterprise.

(u) To allocate an item of income or expense to either trust income or principal, as permitted or provided by law.

(v) To employ, and pay reasonable compensation for services performed by, a person, including an auditor, investment advisor, accountant, appraiser, broker, custodian, rental agent, realtor, or agent, even if the person is associated with the trustee, for the purpose of advising or assisting the trustee in the performance of an administrative duty; to act without independent investigation upon such a person's recommendation; and, instead of acting personally, to employ 1 or more agents to perform an act of administration, whether or not discretionary.

(w) To employ an attorney to perform necessary legal services or to advise or assist the trustee in the performance of the trustee's administrative duties, even if the attorney is associated with the trustee, and to act without independent investigation upon the attorney's recommendation. An attorney employed under this subdivision shall receive reasonable compensation for his or her employment.

(x) To prosecute, defend, arbitrate, settle, release, compromise, or agree to indemnify an action, claim, or proceeding in any jurisdiction or under an alternative dispute resolution procedure. The trustee may act under this subdivision for the trustee's protection in the performance of the trustee's duties.

(y) To sell, exchange, partition, or otherwise dispose of, or grant an option with respect to, trust property for any purpose upon any terms or conditions for a period within or extending beyond the duration of the trust.

(z) To continue or participate in a business or enterprise in any manner, in any form, and for any length of time.

(aa) To change the form, in any manner, of a business or enterprise in which the settlor was engaged at the time of death.

(bb) To provide for exoneration of the trustee from personal liability in a contract entered into on behalf of the trust.

(cc) To respond to environmental concerns and hazards affecting trust property as provided in section 7818.

(dd) To collect, pay, contest, settle, release, agree to indemnify against, compromise, or abandon a claim of or against the trust, including a claim against the trust by the trustee.

(ee) To respond to a tax matter as provided in section 7819.

(ff) To make a payment of money, or other property instead of money, to or for a minor or incapacitated trust beneficiary as provided in section 7820.

(gg) To make a distribution or division of trust property in cash or in kind, or both; to allot a different kind or disproportionate portion of, or an undivided interest in, trust property among beneficiaries and determine the value of allotted trust property; or to distribute an unclaimed share in the same manner as described in section 3916.

(hh) To transfer the property of a trust to another jurisdiction and appoint, compensate, or remove a successor trustee, individual or corporate, for trust property in another jurisdiction, with any trust powers set out in this part that the trustee delegates to the successor trustee.

(ii) To execute and deliver an instrument that accomplishes or facilitates the exercise of a power vested in the trustee.

(jj) To select a mode of payment under any employee benefit or retirement plan, annuity, or life insurance payable to the trustee, exercise rights thereunder, including exercise of the right to indemnification for expenses and against liabilities, and take appropriate action to collect the proceeds.

(kk) To make loans out of trust property, including loans to a trust beneficiary on terms and conditions the trustee considers to be fair and reasonable under the circumstances. The trustee has a lien on future distributions for repayment of loans made under this subdivision.

(ll) To pledge trust property to guarantee loans made by others to the trust beneficiary.

(mm) To resolve a dispute concerning the interpretation of the trust or its administration by mediation, arbitration, or other procedure for alternative dispute resolution.

(nn) On termination of the trust, to exercise the powers appropriate to wind up the administration of the trust and distribute the trust property to the persons entitled to it.

History: Add. 2009, Act 46, Eff. Apr. 1, 2010 ;-- Am. 2010, Act 325, Eff. Apr. 1, 2010
Compiler's Notes: Enacting section 1 of Act 325 of 2010 provides:"Enacting section 1. (1) Except as provided in subsection (2), this amendatory act takes effect April 1, 2010."(2) Section 3207 of the estates and protected individuals code, 1998 PA 386, MCL 700.3207, as amended by this amendatory act, takes effect on the date this amendatory act is enacted into law."
Popular Name: EPIC

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ESTATES AND PROTECTED INDIVIDUALS CODE (EXCERPT)
Act 386 of 1998

700.7818 Environmental concerns or hazards; powers of trustee.

Sec. 7818.

(1) In connection with an environmental concern or hazard, a trustee may do any of the following:

(a) Inspect property or the operation of a business activity on property, including property held in or operated by a sole proprietorship, partnership, corporation, or limited liability company or any other type of entity, for the purpose of determining compliance with environmental law affecting the property and to respond to an actual or threatened violation of an environmental law affecting property held or tendered to the trustee.

(b) Take action necessary to prevent, abate, or otherwise remedy an actual or threatened violation of an environmental law affecting property held by the trustee, either before or after a governmental body initiates an enforcement action.

(c) Refuse to accept property in trust if the trustee determines that the property to be transferred to the trust either is or may be contaminated by a hazardous substance or has been or is being used for an activity directly or indirectly involving a hazardous substance that could result in liability to the trust or otherwise impair the value of the trust property.

(d) Settle or compromise at any time a claim against the trust that a governmental body or private party may assert involving the alleged violation of an environmental law affecting property held in the trust.

(e) Disclaim a power granted by a document, statute, or rule of law that, in the sole discretion of the trustee, may cause the trustee to incur personal liability under an environmental law.

(f) Decline to serve or resign as a trustee if the trustee reasonably believes that there is or may be a conflict of interest between it in its fiduciary capacity and in its individual capacity because of a potential claim or liability that may be asserted against the trustee on the trust's behalf because of the type or condition of property held in trust.

(g) Appoint an independent special trustee to hold title to, and take a reasonably required action, as provided in this section, relating to environmental law in regard to, property tendered to the trust, until the time that the trustee determines that no substantial risk exists if the tendered property becomes part of the trust property or abandons the tendered property.

(h) Charge the cost of an inspection, review, abatement, response, cleanup, settlement of claim, or remedial action authorized by this section against the trust property.

(2) A trustee is not personally liable to a trust beneficiary or other party for a decrease in value of trust property by reason of the trustee's compliance with an environmental law, specifically including a reporting requirement under that law. The trustee's acceptance of property or failure to inspect property or a business operation does not create an inference that there is or may be liability under an environmental law with respect to the property or business operation. The authority granted by this section is solely to facilitate the administration and protection of trust property and is not to impose greater responsibility or liability on the trustee than imposed by law absent this section.

ESTATES AND PROTECTED INDIVIDUALS CODE (EXCERPT)
Act 386 of 1998

700.7819 Tax matters; powers of trustee.

Sec. 7819.

(1) A trustee may do any of the following in connection with a tax matter:

(a) Make, revise, or revoke an available allocation, consent, or election affecting a tax that is appropriate in order to carry out the settlor's estate planning objectives and to reduce the overall burden of taxation, both in the present and in the future. This authority includes, but is not limited to, all of the following:

(i) Electing to take expenses as estate tax or income tax deductions.

(ii) Electing to allocate the exemption from the tax on generation skipping transfers among transfers subject to estate or gift tax.

(iii) Electing to have all or a portion of a transfer for a spouse's benefit qualify for the marital deduction.

(iv) Electing the date of death or an alternate valuation date for federal estate tax purposes.

(b) Exclude or include property from the gross estate for federal estate tax purposes.

(c) Value property for federal estate tax purposes.

(d) Join with the surviving spouse or the surviving spouse's personal representative in the execution and filing of a joint income tax return and consenting to a gift tax return filed by the surviving spouse or the surviving spouse's personal representative.

(2) A trustee's decision on a matter described in subsection (1)(a) binds all beneficiaries.

(3) After making a decision described in subsection (1)(a), a trustee may make compensating adjustments between principal and income in the manner provided by the uniform principal and income act, 2004 PA 159, MCL 555.501 to 555.1005.

History: Add. 2009, Act 46, Eff. Apr. 1, 2010
Popular Name: EPIC

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ATTORNEY BIOGRAPHIES

LAVINIA S. BIASELL is a partner of the firm. Receiving her Bachelor of Arts degree with High Honors from Michigan State University in 2000, she earned 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. 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 title insurance coverage and commercial and real estate litigation. She served on the Board of Women's Bar Association as WLAM Representative, Vice-President and President-Elect. Ms. Biasell is currently the Co-Chair of the Bench Bar Culinary Challenge Committee, which organizes an annual charity event that raises money for local charities. She is also on the Board of Directors of Life Remodeled which is a nonprofit organization that remodels homes, schools and neighborhoods in need. Ms. Biasell has been selected as a 2012-2014 **Michigan *Super Lawyers*® Rising Star** and she also serves on the State Bar District I Character and Fitness Committee.

IAN S. BOLTON is a shareholder and member of the firm's Creditor's Rights, Insolvency and Bankruptcy, and Complex and General Litigation Practice Groups. He practices in the areas of bankruptcy and insolvency, business law, landlord-tenant law, property tax appeals and commercial and real estate litigation. He earned his Juris Doctor with high honors from Wayne State University Law School, where he served as a senior notes and comment editor of the Wayne Law Review and as a junior member of the Wayne State University Moot Court. Mr. Bolton is licensed to practice law in Michigan, Illinois and Texas, and his professional affiliations include the Building Owners & Managers Association, Programs Committee; American Bankruptcy Institute, Young Lawyers Section; the State Bar of Michigan, Young Lawyers Section; and the American Bar Association. He joined the firm as an associate in 2010.

STUART M. BORDMAN is a shareholder, certified public accountant and Chairman Emeritus of the firm's Franchise and Distribution Practice Group. He concentrates his practice in the areas of franchise, corporate and tax law and has been engaged in franchise work for more than 40 years. One of his clients is a franchisor with more than 500 franchisees. Mr. Bordman began working with this franchisor in the early 1980s when the system was a startup and has continued that relationship as it has matured into an industry leader. He has counseled franchisors with respect to all issues related to franchise agreements, franchise disclosure documents, registration, contract negotiations and disputes with franchisees. Mr. Bordman has also counseled franchisees in disputes with franchisors and served as a sole arbitrator in a franchisee-franchsior dispute, as well as an expert witness. He is a lecturer before the Michigan Association of Certified Public Accountants and contributor to Laches, the Oakland County Bar Association publication. Mr. Bordman has written on use tax, corporate finance under the Michigan Business Corporation Act and single business tax. He is a

graduate of the Northwestern University School of Law. Additionally, Mr. Bordman has been continuously selected by his peers for inclusion in the annual edition of **Best Lawyers in America®** since 2013 in the area of franchise law.

BRANDON K. BUCK is a shareholder of the firm and focuses his practice on litigating complex real estate, financial services and title matters. Mr. Buck has obtained favorable results for his clients in district, circuit and federal courts across Michigan.

In addition to the foregoing, Mr. Buck frequently represents clients in contested matters in bankruptcy, including preference actions, relief from stay, claims objections and adversary proceedings.

Mr. Buck also litigates franchise disputes involving terminations, non-competes, intellectual property rights, vicarious liability and claims arising under Michigan's Franchise Investment Law.

Recently, Mr. Buck has spent time counseling clients on regulatory finance and mortgage compliance matters which led him to assist in the development of the **Lending Litigation ToolKit (L2TK™)**- a product designed to reduce institutional costs in the mortgage industry in the handling of portfolio level litigation. Additionally, Mr. Buck participated in the largest default servicing audit in U.S. history as directed by the United States Office of the Comptroller of the Currency and Federal Reserve Board (the Independent Foreclosure Review) which focused on the examination and analysis of the foreclosure and default servicing practices of the nation's largest mortgage servicing companies.

Mr. Buck was featured in the February, 2014 issue of **Michigan Banker** magazine and was also profiled in the **Macomb County Legal News** and **Oakland County Legal News** for his franchise law experience.

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 was admitted to practice by the State Bar of Michigan in 2005. Ms. Bunch concentrates her practice in the areas of real estate and finance.

ALEXANDER G. DOMENICUCCI is a shareholder of the firm who specializes in the area of federal and state taxation. He counsels businesses and individuals on a complete range of transactional, planning, and controversy matters.

Mr. Domenicucci has extensive expertise in the taxation of business entities, including "C" corporations, "S" corporations, partnerships, limited liability companies, real estate investment trusts, tax-exempt organizations, and disregarded entities. He advises clients on complex business transactions, including mergers and acquisitions, cross-border transactions, real estate syndications, and tax credit transactions.

In addition to counseling clients on transactional matters, Mr. Domenicucci assists public companies, closely-held businesses, entrepreneurs, and individuals with general tax planning. He advises clients on how to organize their business affairs so as to minimize taxes and reduce potential tax exposure. Mr. Domenicucci also advises clients on the reporting of tax return positions and serves as a resource on highly technical matters and issues.

Mr. Domenicucci also handles audit and controversy matters. He represents clients before federal and state tax authorities during the administrative process.

Mr. Domenicucci has served as a Member of the Michigan Tax Council, the governing body of the Taxation Section of the State Bar of Michigan, since 2011. He currently serves as Secretary of the Michigan Tax Council. Mr. Domenicucci previously served as the Chairperson of the Federal Income Tax Committee of the Taxation Section.

Mr. Domenicucci is a graduate of Wayne State University Law School, where he served as Editor-in-Chief of *The Wayne Law Review.*

MARTIN S. FRENKEL is an experienced business litigator, shareholder, executive committee member and Co-Chair of the **Consumer Finance Regulatory Compliance and Real Property Litigation Practice 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 risk management, litigation, and regulatory compliance matters with particular focus on matters involving mortgage, banking, construction, real estate development, landlord/tenant, and title-related issues. He is admitted to practice in Michigan, as well as the federal courts for the Eastern and Western Districts of Michigan, the United States Court of Appeals for the Third and Sixth Circuits, and has been admitted pro hac vice in numerous courts around the country.

Mr. Frenkel led the firm, as one of a small, select group of law firms in the United States, in its participation in the largest default servicing audit in U.S. history as directed by the United States Office of the Comptroller of the Currency and Federal Reserve Board. He possesses a unique combination of expertise and skills in having participated in high-level mortgage regulatory compliance matters, as well as having litigated hundreds of loan level mortgage litigation disputes. This unparalleled perspective allows him to serve his financial services clients efficiently, cost effectively, and with minimized risk while navigating the spectrum of mortgage origination and servicing processes.

Mr. Frenkel has published numerous articles, including: 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. He has also spoken nationally on mortgage industry issues including methods for controlling institutional spending on outside legal counsel and assisted the firm in developing its **Lending Litigation ToolKit (L2TK™)** - a product designed to reduce

institutional costs in the mortgage industry in the handling of portfolio level litigation. Mr. Frenkel is also a creator of the firm's **ASPECT™ System** - a product designed to assist in the efficient testing of client compliance with federal mortgage regulatory requirements.

Most recently, Mr. Frenkel was featured in the February, 2014 issue of **Michigan Banker** magazine, as well as in an article published in Crain's Detroit Business focusing on mortgage litigation trends. Additionally, he was previously 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.

JOHN P. GONWAY is a shareholder, Co-Chair of the Real Estate Practice Group and a member of the firm's executive committee. Mr. Gonway specializes in secured lending, real estate, mergers and acquisitions and commercial transactions. He received his Juris Doctor, cum laude, from the Wayne State University School of Law. 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 County Bar Association. Mr. Gonway's experience includes the acquisition, financing, construction, development and leasing of all types of commercial real estate (with particular expertise in multi-family housing), as well as the representation of clients in all aspects of corporate law, commercial law, mergers and acquisitions and commercial transactions, including complex franchise acquisitions and private equity syndications.

MICHELLE C. HARRELL is an experienced litigator, shareholder and Chair of the firm's Complex and General Litigation Practice Group. Ms. Harrell concentrates her practice in the areas of complex commercial litigation, real estate matters (land use/zoning, easements, landlord/tenant), shareholder disputes, receiverships, franchise and distribution law, hospitality law, family law (divorce and probate), trust disputes (trustees and beneficiaries), class actions defense and Alternative Dispute Resolutions (ADR). She was also named a DBusiness Top Lawyer for 2010 in the areas of Real Estate and Litigation.

Ms. Harrell 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, she participated in moot court competitions and received three American Jurisprudence Awards. Ms. Harrell 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 authored the article "Caveat Receiver: Practical Tips for Appointing or Serving as a Receiver" for the *Michigan Bar Journal.* Her receivership expertise was the focus of the *Michigan Lawyer's Weekly* article, "Putting the Stress in Distressed" while several of her litigation matters were featured in the *Crain's Detroit Business* story "A&P Stops Paying Rent on Farmer Jack's Spaces: 24 Lawsuits Filed." As of January 1, 2014, Ms. Harrell was appointed by the Mayor of Grosse Pointe Woods to the city's Planning Commission for a three-year term. On October 3, 2014, she was also appointed to the Board of Directors of Living Arts. Living Arts is a non-profit organization that exists to strengthen the urban neighborhoods of Southwest Detroit by cultivating an environment that sparks the imagination and fosters ingenuity through the arts and community development initiatives. She is also an active member of the Hydrocephalus Association, Michigan Chapter.

DAVID E. HART is a shareholder, a member of the firm's Executive Management Committee, and Co-Chair of the Consumer Finance/Regulatory Compliance and Real Property Litigation Group. Earning his Bachelor Degree in Philosophy and Political Science from the University of Michigan in 1988, he received his Juris Doctor Degree, cum laude, from the Detroit College of Law (now known as Michigan State University 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 was a member of the Board of the MSU/DCL College of Law Alumni Association from 1999 until 2006, serving as the president of the Alumni Association in 2005 and 2006. Active in community and charitable organizations, Mr. Hart served on the Board of Trustees of The Valley School and is currently a Board Member and the Vice President of his synagogue. He concentrates his practice in the areas of title insurance, business disputes, mortgage and real estate litigation, construction disputes, and creditor's rights law, including bankruptcy. Licensed to practice law in Michigan and Ohio, Mr. Hart is a member of the Oakland County and Federal Bar Associations, and The Michigan Land Title Association. He is a frequent lecturer on title insurance and real estate law topics and has been continuously selected for inclusion in the Michigan edition of ***Super Lawyers***® from 2007-2014. Mr. Hart is also a firm representative to the national Mortgage Bankers Association.

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.

Mr. Hauser and his team at Maddin Hauser have handled numerous multi state multi property acquisition/ disposition and financing transactions. His clients include both local and national real estate investors and developers. He has extensive experience in the manufactured home industry, both in investing and advising clients.

Mr. Hauser has also handled acquisitions, dispositions and mergers of all types of businesses including chains of supermarkets, drug stores and newspapers.

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.

Additionally, Mr. Hauser has been continuously selected by his peers for inclusion in the annual edition of ***Best Lawyers in America***® since 1999 in the area of real estate law and the Michigan edition of ***Super Lawyers***® from 2007-2014, as well as ***Chambers USA***. He is a past President of the United Jewish Foundation of Metropolitan Detroit, and has served as a National Vice Chairman and member of the Executive Committee of United Jewish Communities.

HARVEY R. HELLER is a shareholder, Managing Director and Chairman of the firm's Defense and Insurance Coverage Practice Group. Harvey is the creator of our Result Focused Case Management System®. 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, the International Association of Defense Counsel, as well as the Claims & Litigation Management Alliance. He has authored articles on the subject of professional liability and has been a featured speaker at professional liability seminars.

Mr. Heller has been continuously selected by his peers for inclusion in the Michigan edition of ***Super Lawyers***® from 2006-2014 and ***Best Lawyers in America***® since 2003 in the areas of insurance law and legal malpractice law-defendants. He also has the added distinction of being recognized as the **2015 "Detroit Lawyer of the Year"** for insurance law. This is a prestigious honor bestowed upon those in high-profile legal specialties in large legal communities. Only a single lawyer, who has earned high ratings in peer review surveys, as well as a high level of respect among their peers in a particular specialty in each community, is honored with this special recognition.

JOHN E. JACOBS is a shareholder of the firm who specializes in real estate transactions, residential mortgage banking, and finance. Throughout his career, Mr. Jacobs has represented mortgage companies in the purchase, sale, origination and servicing of residential mortgage loans. Mr. Jacobs represents the Michigan Mortgage Lender's Association. He has negotiated and drafted several laws in the State of Michigan. 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 and has been the President of three non-profit organizations.

Additionally, Mr. Jacobs has been continuously selected by his peers for inclusion in the annual edition of **Best Lawyers in America**® since 2009 in the areas of corporate law and real estate law.

LINDSEY R. JOHNSON focuses her practice on mortgage and real estate litigation, commercial general liability and bankruptcy. She has handled both federal and state cases involving the FDCPA and TILA on behalf of lenders and servicers, quiet title claims involving commercial and personal property, condemnation claims, premises liability claims and construction cases involving liens, breach of contract, bond issues and account stated claims. Ms. Johnson serves as a case evaluator in Oakland County Circuit and District Court for both commercial and tort disputes. She earned her Juris Doctorate degree, *cum laude*, from Thomas M. Cooley Law School, where she served as a subcite editor of the Thomas M. Cooley Law Review and a teaching assistant for the scholarly writing course. Ms. Johnson also received the Eugene Krasicky Award for writing excellence. She is licensed to practice in Michigan as well as the federal courts for the Eastern and Western Districts of Michigan. Ms. Johnson's professional affiliations include the State Bar of Michigan, and Oakland County Bar Association – Real Estate and ADR Sections.

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. Mr. Kaplow 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). He is a frequent lecturer before professional groups pertaining to tax and corporate matters.

Additionally, Mr. Kaplow has been continuously selected by his peers for inclusion in the annual edition of ***Best Lawyers in America***® since 2013 in the areas of tax law and trusts and estates, as well as the Michigan edition of ***Super Lawyers***® 2006, 2010-2014. He is also listed in ***Who's Who in American Law*** and ***Who's Who of Emerging Leaders in America***. Mr. Kaplow is active in various charitable and Bar related activities.

KATHLEEN H. KLAUS is a shareholder and member of the firm's Defense and Insurance Coverage Practice Group since 2004. She specializes in complex professional liability defense (including lawyers, accountants and insurance agents), employment defense and appellate practice, with an emphasis on taking cases seamlessly from initial intake through trial and appeal. Ms. Klaus graduated from the University of Michigan Law School in 1992 and received a Bachelor of Arts degree, with honors, from the University of Iowa in 1987. She is licensed to practice in Michigan and Illinois and is admitted to the Third, Fifth, Sixth and Seventh United States Court of Appeals, the United States Tax Court and the United States Supreme Court. Ms. Klaus has been invited to speak at numerous trade and professional organizations on various topics, including the application of the federal RICO statute to insurance claims handling procedures.

Additionally, Ms. Klaus has been continuously selected by her peers for inclusion in the annual edition of ***Best Lawyers in America***® since 2013 in the area of legal malpractice law-defendants. She has also been recognized in the Michigan edition of

Super Lawyers® from 2013-2014, as well as *HOUR Detroit* magazine as one of Michigan's top female attorneys.

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, American Society of Pension Professionals & Actuaries and other professional groups. He presently serves as ASPPA's Vice Chairman for Regional Conferences and as an emeritus 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, 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, the Chairman of the State Bar of Michigan Employee Benefits Committee, Co-Chair at the IRS-ASPPA Great Lakes Benefits Conference for 2007 and 2008 and Co-Chair at the ASPPA Annual Conference for 2010 and 2011.

Additionally, Mr. Lax is a Fellow of the American College of Employee Benefits Counsel and has been continuously selected by his peers for inclusion in the annual edition of ***Best Lawyers in America***® since 2006 in the area of employee benefits (ERISA) law. He also has the added distinction of being recognized as the **2011 "Detroit Lawyer of the Year"** in employee benefits law. This is a prestigious honor bestowed upon those in high-profile legal specialties in large legal communities. Only a single lawyer, who has earned high ratings in peer review surveys, as well as a high level of respect among their peers in a particular specialty in each community, is honored with this special recognition.

Mr. Lax has also been recognized by ***Chambers USA*** and continuously selected for inclusion in the Michigan edition of ***Super Lawyers***® from 2006-2014 (one of the top 100 lawyers in the State of Michigan for 2008). Mr. Lax has extensive experience in representing clients in tax controversy matters before the Internal Revenue Service and Tax Court of the United States.

KAREN LIBERTINY LUDDEN concentrates her practice on commercial insurance and professional liability coverage and defense and specializes in negotiating global resolutions on complex cases. She is a member of the Firm's Defense Practice and Insurance Coverage Group. Ms. Ludden sits as a commercial case evaluator in Oakland County and a tort case evaluator in Wayne County and is available to sit as a facilitator. She is a member of the Claims & Litigation Management Alliance and sits on the Executive Board for the Michigan Chapter of the Federalist Society.

Ms. Ludden graduated magna cum laude from the University of Michigan with a Bachelor of Arts degree in 1990. She graduated from the University of Michigan Law School and published in its Journal of International Law in 1993. She is AV Preeminent

rated; the highest peer rating available from Martindale-Hubbell. 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 is a member of the American Bar Association, the Federal Bar Association, and the Oakland County 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. Ms. Ludden joined the Firm in 2012 with 20 years of experience in private practice.

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.

Mr. Maddin's 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.

Mr. Maddin is a Fellow of the American Bar Foundation and member of the Real Property Law Section Council of the State Bar of Michigan. For many years, he also served as Chairman of the Commercial Leasing and Management Committee of the Real Property Law Section of the State Bar of Michigan. He 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.

Additionally, Mr. Maddin has been continuously selected by his peers for inclusion in the annual edition of **Best Lawyers in America®** since 2003 in the area of real estate law. He has also been 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.

RICHARD J. MADDIN is a firm shareholder who has practiced law for more than 40 years. He is a graduate of Michigan State University and University of Detroit 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 also the areas of real estate construction, zoning, Alternative Dispute Resolution (ADR) practice, and he is a certified mediator. He is a member of the real estate, litigation, and ADR sections of the State Bar of Michigan and the Southfield and Oakland Bar Associations.

Additionally, Mr. Maddin has been continuously selected by his peers for inclusion in the annual edition of **Best Lawyers in America®** since 2008 in the areas of construction law, land use and zoning law, litigation-construction, litigation-land use and zoning, litigation-real estate, and real estate law. He also has the added distinction of being recognized as the **2013 "Detroit Lawyer of the Year"** in litigation-land use and zoning law. This is a prestigious honor bestowed upon those in high-profile legal specialties in large legal communities. Only a single lawyer, who has earned high ratings in peer review surveys, as well as a high level of respect among their peers in a particular specialty in each community, is honored with this special recognition.

KATE MATLEN is an associate of the firm and focuses her practice in the areas of corporate and employment, franchise, real estate and health care law. Ms. Matlen's experience includes: corporate formation and dissolution; internal corporate governance matters; franchise registration and regulatory compliance; commercial real estate transactions; workforce management; employment agreements and policies; and employment discrimination and termination disputes.

Ms. Matlen received her Bachelor of Science degree from the University of Michigan in 2007, and 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.* She is a member of the State Bar of Michigan and has been admitted to practice before the Federal District Court for the Eastern District of Michigan. Ms. Matlen is also a member of Wayne State University's chapter of the Order of the Coif.

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. She is a member of the State Bar of Michigan and the American Bar Association.

Additionally, Ms. Mayer has been selected by her peers for inclusion in the 2015 edition of **Best Lawyers in America®** in the area of professional malpractice law-defendants.

RICHARD M. MITCHELL is a shareholder of the firm. He earned his Juris Doctor Degree from Indiana University Law School in 1991, where he served on the Indiana University Law Review. He also studied law at the University of London, England. He earned his Bachelor of Arts Degree from the University of Michigan in 1988. Mr. Mitchell focuses his practice on complex insurance coverage disputes, commercial litigation, and intellectual property disputes, as well as professional liability defense, including insurance agents, real estate agents and financial professionals. He has authored publications and spoken in these areas. He is also a member and past president of the Greater Detroit Chapter 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 ten examinations relating to insurance and business

related topics. Mr. Mitchell also serves as a case evaluator in matters pending before the Oakland County Circuit Court.

BRIAN A. NETTLEINGHAM is a shareholder in the Firm's Complex and General Litigation, Banking, and Consumer Finance Regulatory Compliance and Real Property Practice Groups, where he serves a range of clients on issues that include mortgage lending practices, employment disputes, and intellectual property claims. He graduated from Notre Dame Law School in 1998, after which he clerked for Michigan Court of Appeals Judge Joel Hoekstra.

Mr. Nettleingham regularly consults with clients on issues related to the development, sale, and use of software and computer, network, and internet technology, including retention practices for electronically stored information and methods for electronic contracting. He also uses his background in law and technology to assist in a broad range of electronic discovery issues.

Mr. Nettleingham assisted the firm, as one of a small, select group of law firms in the United States, in its participation in the largest default servicing audit in U.S. history as directed by the United States Office of the Comptroller of the Currency and Federal Reserve Board. He was deeply involved in the Independent Foreclosure Review (IFR) for nearly two years which focused on the examination and analysis of the foreclosure and default servicing practices of the nation's largest mortgage servicing companies. Mr. Nettleingham also assisted in the development of loan testing and remediation strategies and evaluating loan level findings for appropriate remediation. Throughout the IFR, he was able to leverage his expertise with mortgage servicer software and systems to help successfully complete the review.

Mr. Nettleingham embodies a rare combination of expertise and skills in having participated in high-level mortgage regulatory compliance matters, as well as extensive litigaton experience in handling loan level mortgage litigation disputes. This unique perspective enables him to serve his financial services clients efficiently, cost effectively, and with minimized risk while navigating the range of mortgage origination and servicing processes.

Mr. Nettleingham also assisted the firm in developing its **Lending Litigation Toolkit (L2TK™)** - a product designed to reduce institutional costs in the mortgage industry in the handling of portfolio level litigation. In addition, he is a creator of the firm's innovative **ASPECT™ System** - a product designed to assist in the efficient testing of client compliance with federal mortgage regulatory requirements.

Mr. Nettleingham is a member of the ABA's Law & Technology Group, as well similar State Bar Groups, and The International Technology Law Association. He was featured in an article regarding complex litigation and interviewed regarding mortgage litigation in Michigan for Crain's Detroit. Mr. Nettleingham was named a 2012 Top dbusiness Lawyer for Metro Detroit in the area of Information Technology law. On October 3, 2014, he was also appointed to the Board of Directors of Living Arts. Living Arts is a non-profit organization that exists to strengthen the urban neighborhoods of Southwest Detroit by

cultivating an environment that sparks the imagination and fosters ingenuity through the arts and community development initiatives.

MARK E. PLAZA is a shareholder and member of the firm's Consumer Finance Regulatory Compliance and Real Property Litigation Practice Group. He received his Bachelor of Arts degree, with High Distinction, from The University of Michigan in 1999, and 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* in which he had published his law review note on Title III of the Americans with Disabilities Act. He was admitted to practice by the State Bar of Michigan in 2003. Mr. Plaza 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 appellate, real estate, and financial services litigation, as well as regulatory compliance matters. As a member of the firm's Consumer Finance Regulatory Compliance and Real Property Litigation Practice Group, he possesses a unique combination of skills involving high-level mortgage regulatory compliance matters and numerous loan level mortgage litigation disputes. Mr. Plaza participated in the largest government-mandated default servicing audit in U.S. history. He also has represented financial institutions and insurance carriers in cases involving mortgage priorities, mortgage loan modifications, title insurance, wrongful foreclosure, construction, and adverse possession.

A strong legal writer, Mr. Plaza takes a leading role in appellate matters. His appellate expertise extends to all civil appeals, including representing clients in cases filed with the Sixth Circuit Court of Appeals, Michigan Supreme Court, and Michigan Court of Appeals. Mr. Plaza also serves as a member of the Michigan Appellate Bench Bar Conference Foundation and the Michigan Supreme Court Historical Society. He has also been recognized as a 2014 **Michigan *Super Lawyers*® Rising Star.**

Mr. Plaza is actively involved with the State Bar of Michigan. Since 2012, Mr. Plaza has been a member of the Law Related Education and Public Outreach Committee, and he is part of the Law Day subcommittee that sponsors an annual Law Day contest to help encourage and improve the public's understanding of the judicial system. In the community, Mr. Plaza volunteers as a scoring judge at the annual high school mock trial tournament sponsored by the Michigan Center for Civic Education (MCCE). Additionally, as an avid baseball fan, he serves on the Board of the Miracle League of Plymouth, an organization that assists children with disabilities experience the joy of playing baseball.

JAMES M. REID, IV is a shareholder and member of the firm's Corporate/Employment and Franchise and Distribution Practice Groups. Mr. Reid works mainly with employers on a spectrum of employment issues including; counseling and advising human resource professionals and business owners. He develops and improves employment policies and contracts, handbooks, employment agreements, non-competes, non-disclosure agreements, and unconditional release and separation agreements. Mr. Reid often provides legal assistance to employers in litigation, arbitration and administrative

proceedings, including; the Equal Employment Opportunity Commission, Michigan Department of Civil Rights, state and federal Departments of Labor, and the Unemployment Insurance Agency. He also assists employers with federal and state wage and hour audits.

Mr. Reid presents at local and national webcasts, podcasts and conferences regarding best employee handbook practices, strategies for franchisees and other non-union companies to comply with the National Labor Relations Act and respond to union activity. He has also authored several articles regarding strategies to update employee handbooks and challenge unemployment benefit claims.

Mr. Reid joined the firm as a summer associate (clerk) in 2004. He received a Bachelor of Arts in Political Science-Prelaw, cum laude, from Michigan State University in 2002 and his Juris Doctor, cum laude, from Wayne State University Law School in 2005. While at law school, Mr. Reid was an associate editor of the *Wayne Law Review*. He is also a member of the Society of Human Resources Management, Oakland County Bar Association and State Bar of Michigan (Labor and Employment Law Section e-News Committee). Mr. Reid is admitted to practice before the federal and state courts of Michigan.

GARY M. REMER is an experienced franchise and business lawyer, shareholder and Co-Chair of the firm's Franchise and Distribution Practice Group. Mr. Remer graduated from Michigan State University with a Bachelor of Arts in Accounting in 1990 and summa cum laude from the Detroit College of Law at Michigan State University in 1997. He was formerly employed as a Revenue Agent with the Internal Revenue Service, Employee Plans Division, from 1992 through 1996 before joining Maddin Hauser in 1997.

Mr. Remer has extensive expertise and practical experience assisting franchisors and franchisees through all stages of their business development and helps clients successfully address the needs of their franchise businesses in an ever-changing marketplace. He also lectures extensively on franchising and tax related topics and is regularly featured as a subject matter expert in the media. Mr. Remer has appeared on *Channel 7 Action News, WWJ News Radio 950* and been quoted in major publications, such as; the *Detroit News* and *Detroit Free Press*. He has published numerous articles, including: "Top Five Considerations When Buying a Franchise", *Franchise Handbook*; "Cyber Pirates - Protecting Credit and Debit Card Information", *Franchising World*; and "Affordable Care Act Likely to Hinder More Than Help", *Nation's Restaurant News.*

Mr. Remer is a Certified Public Accountant and serves as Chair of the MACPA Franchise Task Force. He is a past Council Member of the State Bar of Michigan Tax Committee and past adjunct professor at Walsh College.

Mr. Remer was named in Chambers USA: America's Leading Lawyers for Business 2011, 2012 and 2013 as a Leader in his Field.

RICHARD F. ROTH is a shareholder in the firm. He attended the Wharton School at the University of Pennsylvania where he received a Bachelor of Science in Economics. He graduated from the University of Michigan Law School, cum laude, in 1972. Mr. Roth has a business, estate planning and real estate practice, with a concentration in acquisitions, financing, taxation and estate planning for professionals and wealthy individuals.

With regard to the real estate side of his practice, Mr. Roth has handled the acquisition, sale and financing of apartment complexes, shopping centers, and office buildings. He has also handled workouts for distressed properties. Mr. Roth's most recent publication, entitled Protect More of your Assets from the Estate Tax, appeared in the September 2011 issue of Medical Economics® and the April 2012 issue of Laches, the monthly publication of the Oakland County Bar Association. 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.

Additionally, Mr. Roth has been continuously selected by his peers for inclusion in the annual edition of **Best Lawyers in America**® since 2013 in the areas of real estate law and trusts and estates. He has also been named as a Best Lawyer since 2010 by **DBusiness** and has been named in **Michigan Super Lawyers®** since 2007.

STEVEN D. SALLEN began his career at Maddin Hauser in 1983, as a law clerk. Today, he is the President and Chief Executive Officer of the firm, and a member of its executive 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, and his clients include some of Michigan's most successful manufacturing firms, real estate developers, general contractors, commercial real estate brokers and environmental consulting firms. Mr. Sallen is also the chair of Maddin Hauser's environmental law practice group, and co-chair of the real estate 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.

Additionally, Mr. Sallen has been continuously selected by his peers for inclusion in the annual edition of **Best Lawyers in America®** since 2010 in the area of real estate law. For many consecutive years, Mr. Sallen has also been named a **Michigan Super Lawyer©** and a **Top Lawyer by DBusiness©**, all in the field of real estate law..

DAVID M. SAPERSTEIN is a shareholder of the firm. He joined the firm in July, 2001. He is admitted to practice law in Michigan, Ohio, and California. He concentrates his practice in the area of professional liability defense and appellate law, primarily defending attorneys, registered representatives and broker-dealers, insurance agents, accountants, and real estate agents. He has given numerous presentations regarding developments in FINRA arbitrations that were approved for CLE credit in New York, New Jersey, and Illinois.

Mr. Saperstein graduated from the University of Michigan Law School in 1993, and the 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. His 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 has served as an officer of B'nai Israel Synagogue of West Bloomfield, the Chair of the Race Judicata Committee of the Oakland County Bar Association, and other community organizations.

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. He is a frequent lecturer and has authored many articles, including:

- "The Beneficiary as Trustee: Designing the Henhouse Around the Fox," *Laches*, No. 567 (April, 2014)
- "Selling the Keys to the Kingdom Without Bank Financing," *Michigan Tax Lawyer*, Volume XXXV, Issue 3 (Fall, 2009)
- "Executive Compensation Trends for Emerging Growth Companies," *Laches*, No. 523 (November, 2009)

- "Fifty Years of Practice Reversed By New Rules on Post-Death Events," *Michigan Tax Lawyer*, Volume XXXV, Issue 2 (Summer, 2009)
- "Innovative Retirement Plan Designs for the Small-Business Employer," *Laches*, No. 450 (July, 2003)
- "Qualifying for the Annual GST Tax Exclusion," *Laches*, No. 387 (April, 1998)
- "New Revenue Ruling Encourages Gifts of Stock in the Family Business, But Beware!" *Michigan Bar Journal*, Volume 72, No. 10 (October, 1993)
- "Supreme Court Declares Qualified Plan Benefits to be Exempt from Bankruptcy," *Michigan Bar Journal*, Volume 71, No. 10 (October, 1992)

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.

SHERYL K. SILBERSTEIN is a shareholder and concentrates her practice primarily in commercial real estate law, including financing, acquisitions, sales and development of shopping centers, industrial and office buildings, zoning and land use, in addition to residential transactions. Prior to joining the firm in September, 2000, she had 14 years of experience in the real estate industry in the corporate sector. She is a graduate of the Detroit College of Law and the University of Michigan and is also a member of the State Bar of Michigan.

RONALD A. SOLLISH is a shareholder, executive committee member and Chairman of the firm's Corporate/Employment Practice Group. Mr. Sollish specializes in employment, real estate, partnership, finance, corporate and business law. He 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.

Mr. Sollish is licensed to practice law in both Michigan and Illinois and is also a member of the American Bar Association, State Bar of Michigan, Illinois Bar Association and Oakland County Bar Association. He graduated from the University of Detroit School of Law where he was the managing editor of the Law Review. Mr. Sollish received his undergraduate degree from the University of Michigan.

Additionally, Mr. Sollish has been continuously selected by his peers for inclusion in the annual edition of **Best Lawyers in America®** since 2013 in the area of employment law-individuals

DANIELLE M. SPEHAR is a shareholder and co-head of the firm's Real Estate Practice Group and is a member of the firm's recruiting committee. She concentrates her practice in the areas of commercial real estate transactions, corporate, and business law and has particular expertise in the acquisition, financing, and sale of multifamily housing developments, including HUD financing. She also has extensive experience in

commercial leasing and the acquisition, sale, and development of shopping centers, commercial, industrial, and office buildings. She earned a bachelor of science in business administration from Central Michigan University, where she graduated summa cum laude. She also earned a master's degree in Business Administration from Wayne State University, also graduating summa cum laude, and she earned her juris doctor in 1998 from the University of Detroit Mercy School of Law, where she graduated magna cum laude. She is a member of the Real Property Section and the Commercial Real Estate Development and Ownership Committee of the State Bar of Michigan as well as the American Bar Association..

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.

GEOFFREY N. TAYLOR is a shareholder who 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.

REBECCA TURNER is a shareholder and Co-Chair of the firm's Franchise and Distribution Practice Group. She concentrates her practice in the areas of franchise law, corporate law and real estate transactions.

Ms. Turner counsels start up, emerging and mature franchise systems on issues involving corporate organization, disclosure and registration, sales compliance, system operations, franchisee relationships, franchisee dispute resolution, vendor contracts, and other business and real estate issues impacting the franchise industry. She also counsels single and multi-unit franchisees on structuring their businesses to promote growth, maximize efficient use of resources and minimize risk.

Ms. Turner has a unique inside view of the franchising industry since her family owns and operates multiple franchise concepts and outlets. She is also designated by the International Franchise Association as a Certified Franchise Executive™.

Ms. Turner was selected by her peers as a 2013 and 2014 DBusiness Top Lawyer; named a 2008 - 2010 and 2012, 2014 **Michigan *Super Lawyers*® Rising Star**; recognized as one of five Up and Coming Lawyers by Michigan Lawyers Weekly in 2006; and one of 10 women showcased in an article entitled "Raising the Bar" published in the *Crain's Detroit Business issue Focus: Law.*

Ms. Turner is a member of the International Franchise Association, Women's Franchise Network of Southeast Michigan, American Bar Association, State Bar of Michigan, Oakland County Bar Association and Oakland County Bar Foundation (Fellow). She is also a Past President of the Women's Bar Association, the Oakland Region of the Women Lawyers Association of Michigan.

Currently, Ms. Turner serves on the Board of Directors for Holy Family Regional School in Rochester, Michigan. She is also active with the Crohn's & Colitis Foundation of America, Michigan Chapter both in its leadership and fundraising activities.

DANIEL WARSH is an associate and member of the firm's Complex and General Litigation Practice Group. He practices in the areas of corporate litigation, employment law, franchise law, and real estate. Mr. Warsh earned his Bachelor of Arts degree, summa cum laude, from the University of Pennsylvania in 2008, and received his Juris Doctor Degree from the University of Michigan Law School in 2011. While in law school, he received a Certificate of Merit in International Environmental Law and Policy and served as an Associate Editor of the Michigan Telecommunications and Technology Law Review. Mr. Warsh is a member of the State Bar of Michigan, and has also been admitted to practice before the Federal District Courts for the Eastern and Western Districts of Michigan.

STEWART C.W. WEINER is a shareholder and member of the firm's Complex and General Litigation Practice Group. Approaching 30 years of practice, Mr. Weiner advises businesses and high net worth families and individuals in business, family law and trust litigation matters, as well as construction, securities, shareholder and entity disputes and succession planning issues. Having practiced on both the transactional and litigation sides of the practice and having a Masters of Social Work degree, Mr. Weiner has a unique and pragmatic sense of how to achieve clients' goals and objectives. If necessary, and in the best interest of his clients, he will aggressively pursue taking a case to trial or pursuing alternative dispute resolution. Mr. Weiner has served as a mediator, arbitrator and litigant for many years, both privately and for FINRA (Financial Industry Regulatory Authority). He has a profound commitment to exemplary customer service. Mr. Weiner is a member of the American Bar Association (Construction Forum, Litigation and Family Law Sections), State Bar of Michigan (Litigation, Computer Law and Family Law Sections) and Oakland County Bar Association.

Mr. Weiner is very active in community and charitable endeavors and has served as the past President of Jewish Family Service, the past President of the Franklin Baseball League, and has served on the Board of Governors of the Jewish Federation of Metropolitan Detroit for many years.

THOMAS W. WERNER joined the firm in November, 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 Michigan, the Western District of Pennsylvania, and the Northern District of Indiana. Tom was named a 2011 Rising Star by Michigan Super Lawyers.

MARC S. WISE is a shareholder of the firm who received a 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 from Wayne State University. Mr. Wise practices principally in the area of employee benefits with a strong emphasis on health and welfare benefit plan matters. He 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 to health care plans, Mr. Wise counsels clients in the review, redesign and documentation of insured and self-insured programs to comply with the many changes caused by the Patient Protection and Affordable Care Act. As part of his practice, he represents clients before the Internal Revenue Service, the U.S. Department of Labor, and the Pension Benefit Guaranty Corporation. Mr. Wise was also named in Chambers USA: America's Leading Lawyers for Business 2013 as a Leader in his Field of Employee Benefits & Executive Compensation.

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. Additionally, Mr. Wolock has been continuously selected by his peers for inclusion in the annual edition of ***Best Lawyers in America®*** since 2008 in the areas of legal malpractice law-defendants and professional malpractice law-defendants. He has also been selected for inclusion in the Michigan edition of ***Super Lawyers®*** from 2007-2014.

Mr. Wolock has served on the Michigan State Court Administrative Office Dispute Resolution Rules Committee and is currently serving on the Michigan Michigan State Court Administrative Office Mediation Confidentiality and Standards of Conduct Committee. He also serves as a panelist on the State Bar of Michigan Attorney Discipline Board. In June 2009, Mr. Wolock was appointed by Michigan's Governor to serve as the **attorney member of the Michigan State Board of Accountancy** for a four year term. By statute, the nine member Board of Accountancy is required to have one attorney member.

Mr. Wolock has published the following articles on litigation related issues: "Michigan's Sales Representative Act Revisited," Michigan Bar Journal (Nov. 2000); "Mediation Confidentiality: Too Much of a Good Thing?," Laches, Oakland County Bar Association (Jan. 2008); "Legal Malpractice Update: The Legacy of Simko and Winiemko," Michigan Bar Journal (Feb. 2009)(Kathleen Klaus - co-author).

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