TWENTY-FIFTH
ANNUAL TAX SYMPOSIUM

November 12, 2016
SHERATON DETROIT NOVI
NOVI, MICHIGAN

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

maddin hauser
Maddin Hauser Roth & Heller PC
attorneys and counselors

28400 Northwestern Highway Second Floor Southfield, MI 48034-1839 (248) 354-4030 fax (248) 354-1422 www.maddinhauser.com

November 12, 2016

Dear Tax Symposium Participant:

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

This year's program marks a significant milestone for Maddin Hauser. For 25 years we've been honored to present our Tax Symposium to the accounting community. Not only has it given us the opportunity to meet you, but also help you better serve your clients.

Like 1992 (our first Tax Symposium), the tax community faces the uncertainty of an election and what the new administration and Congress will bring to our tax system. We, of course, cannot anticipate what will come, so our program today will address the law, planning opportunities and concerns of what we know. Interestingly, as we review the topics and presentations from 1992, there are some striking similarities. Estate planning, retirement planning, controversy with the Internal Revenue Service and speculation over what the new administration will implement were all featured at that time.

Finally, we are also proud of what our firm has accomplished during these past 25 years. Not only have we grown to become a "full service law firm," but our attorneys and the firm as a whole have been recognized by our clients and the legal community of being the "best of the best."

We certainly don't know what the next 25 years will bring, but we're hopeful that for Maddin Hauser and you, it will be as successful and fulfilling as the past 25 years. As always, we appreciate your attendance at the program and welcome your comments and suggestions.

Very truly yours,

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

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

**** Seminar Qualifies for 4 CPE Credits ****

THE (DREADED) PROPOSED CODE SECTION 2704 REGULATIONS

By: Geoffrey N. Taylor

I. INTRODUCTION

A. In August 2016, the United States Department of Treasury issued proposed regulations designed to reduce significantly or eliminate valuation discounts for federal estate, gift, and generation-skipping transfer tax purposes currently available for gifts of interests in family-controlled entities.

B The proposed regulations accomplish this by treating the lapse of voting or liquidation rights as a separate, additional gift and by ignoring for valuation purposes nearly all restrictions contained in governing agreements and applicable law.

C. The IRS understandably hates these discounts, viewing them simply as artificial depressors of transfer tax value and tools for the wealthy to avoid paying their fair share. Nevertheless, the IRS has been fairly unsuccessful in court challenges to valuation discounts.

D. While there have certainly been instances of abusive taxpayer practices, economic reality supports discounting the value of noncontrolling interests compared to the value of controlling interests.

II. BACKGROUND

A. Gift and estate tax savings through valuation discounts.

1. Valuation standard. Internal Revenue Code ("IRC") Section 2512 provides that value for federal gift tax purposes of a gift made in property is the value of the gift on the date of the gift. Treasury Regulation ("Regulation") Section 25.2512-1 provides that the value of a gift is the price at which the gifted property

would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts. In the case of a gift of a membership interest in a family limited liability company ("LLC"), the relevant value is the value of the interest itself, not the proportional value of the underlying assets of the LLC.

2. Lack of marketability. Family LLC interests are not publicly traded and are not otherwise generally marketable. This is particularly true where, as in the case of most family LLC arrangements, the operating agreement for the LLC contains significant restrictions on a member's ability to transfer the member's membership interest. For example, except for transfers to "permitted assigns" (e.g., family members and the member's revocable living trust), operating agreements often prohibit a member from transferring or assigning the member's membership interest either entirely or without first offering it to the other members. Additionally, transferees of a membership interest often are entitled only to a proportionate share of LLC distributions and may not otherwise exercise the rights of a member without being formally admitted as a member by the other members or the LLC's manager. Members often also may not withdraw from the LLC without the consent of all other members or the LLC's manager. A hypothetical buyer would certainly take these restrictions into account when determining the price at which he will offer to purchase a membership interest; that buyer will pay less for an asset that cannot be easily converted to cash.

3. Lack of management/minority interest. A member of an LLC generally cannot control the LLC's operations, dissolve the

LLC, or otherwise compel operating or liquidating distributions. A hypothetical buyer will pay less for a membership interest that does not carry with it any ability to control the LLC's operations unilaterally.

B. Problems.

1. Scrutiny. As noted above, the IRS detests the use of valuation discounts for gifts of interests in family entities and has repeatedly challenged these valuation discounts to attempt to curb what it considers a windfall to taxpayers. Forms 706 and 709 have a box where the taxpayer must indicate whether a discount was taken in valuing any asset reported on the return. The IRS has used many bases for challenging the discounts.

   a. Gift on formation equal to the excess of the value of the assets transferred to the LLC over the discounted value of the LLC membership interests.

   b. Indirect gift of the assets transferred to the LLC rather than a gift of an interest in the LLC.

   c. Inclusion in donor's estate due to:

      i. Donor's retained economic interest;

      ii. Donor's retained ability to control economic interests; or

      iii. Implied agreement that the donor would retain an economic interest or the ability to control economic interests.

   d. Failure to follow formalities such that the existence of the entity is disregarded.

2. Organizational costs. Creating a family LLC is not inexpensive. An appraisal will be needed to be obtained to determine the value of a membership interest (i.e., to determine the appropriate discount from the underlying value of the assets owned by the LLC that is proportional to the membership interest). Appraisals can cost several thousand dollars even where the only assets held by the LLC are liquid (e.g., marketable securities). An estate planning attorney and an accountant should be engaged to assist with ensuring that the entity conforms to state law requirements and proper tax planning is in place.

3. Operating costs. Costs are not limited to creating the family LLC structure. A new or updated appraisal may be needed for gifts of interests after the year of the initial gift or upon the owner's death. Federal and state income tax returns for the LLC must be filed. Additional costs will be incurred to pay expenses of retaining an attorney and/or an accountant if there is an audit.

III. <u>FOREGROUND – PROPOSED REGULATIONS</u>

A. Application.

1. The regulations only apply to gifts to family members.

2. The regulations only apply when the family controls the entity.

3. Family includes the donor's spouse, the donor's and the donor's spouse's ancestors and descendants, the donor's siblings, and spouses of the foregoing.

4. Control means:

   i. For a corporation:

      a. At least 50% of the stock by vote; or

      b. At least 50% of the stock by value.

   ii. For a partnership:

      a. At least 50% of the capital interests;

      b. At least 50% of the profits interests; or

      c. The holding of any general partner interest.

   iii. For an LLC:

      a. Holding at least 50% of capital interests;

      b. Holding at least 50% of profits interests; or

      c. Holding any equity interest with the ability to cause liquidation of the entity "in whole or in part."

5. The proposed regulations are generally effective 30 days after the date they are finalized.

B. Lapse of voting or liquidation right - New three year recapture rule.

1. Code Section 2704(a) generally provides that if an individual holds a voting or liquidation right and there is a lapse of that right, the lapse will be treated as an additional, taxable transfer by the individual by gift, or a transfer which is includible in the gross estate, whichever is applicable. The amount of the transfer is the fair market value of all interests held by the

individual immediately before the lapse (determined as if the voting and liquidation rights were nonlapsing) over the fair market value of such interests after the lapse.

2. The Treasury Regulations provide an exception to treating the lapse as an additional, taxable transfer. The exception can be illustrated by an example:

   i. Donor owns a 51% interest in ABC LLC and gives a 2% interest to Donor's daughter. By going from a 51% interest to a 49% interest, Donor has lost voting and liquidation control over ABC as a result of the gift. However, the control (or lack thereof) inherent in each of the two ownership blocks, the 2% given and the 49% retained, remains unchanged. Therefore, the lapse of control is not treated as an additional, taxable transfer and each ownership block can be valued on a discounted basis.

3. A new recapture rule would apply to certain gifts made <u>before</u> the effective date of the proposed regulations. The recapture rule can be illustrated by an example:

   i. Donor owns a 51% interest in ABC LLC, gives a 2% interest to Donor's daughter, and dies within three years after the gift and after the effective date of the regulations. Donor is deemed to have made an additional, taxable transfer on Donor's date of death.

   ii. The amount of the deemed transfer equals the excess of the value of the 51% interest over the combined discounted value of the 49% and 2% interests.

iii. This "phantom" asset raises issues about whether a marital or charitable deduction could be taken with respect to it and raises concerns about having sufficient liquidity to pay estate tax thereon.

C. Expansion of "applicable restrictions" - State law exception effectively eliminated.

1. Code Section 2704(b) generally provides that an "applicable restriction" is disregarded in valuing a donor's transferred interest.

i. An applicable restriction is a restriction that limits the ability of the entity to liquidate but which, after the transfer, may be removed by the donor or the donor's family.

ii. An applicable restriction does <u>not</u> include a restriction in the governing documents that is no more restrictive than that imposed by state law (most states' LLC statutes contain default provisions that apply absent a contrary provision in a governing agreement).

iii. This state law exception provided states with an incentive to attract or retain family businesses by enacting restrictive laws that would support valuation discounts. A typical example was prohibiting a member from withdrawing from the LLC and liquidating his membership interest without the unanimous consent of the other members.

2. The proposed regulations greatly broaden the definition of an applicable restriction by taking only mandatory state law rules into account. In other words, default state laws, which are only permissive, are no longer relevant for valuation purposes.

3. The proposed regulations also eliminate any discount based on the recipient's status as a mere assignee or economic interest owner and not a full owner and participant in the entity (i.e., a lack of control discount).

4. Finally, the proposed regulations render virtually unworkable the technique of avoiding the control requirement of Code Section 2704(b) by having a nonfamily member as an owner (often a charity). An interest owned by a nonfamily member is ignored for purposes of determining control if <u>any</u> of the following applies:

   i. The interest has been held for less than three years;

   ii. The interest is less than a 10% interest;

   iii. The aggregate interests of all nonfamily members is less than 20% of all interests; or

   iv the nonfamily member does not have the put right described below.

D. New "disregarded restrictions."

   1. Saving the best for last, the proposed regulations ignore a newly-created category of "disregarded restrictions" when valuing interests.

2. A restriction is generally a "disregarded restriction" for valuation purposes if it does one or more of the following:

    i. Limits the recipient's ability to compel liquidation of the interest;

    ii. Limits the liquidation amount to something less than a proportional "minimum value" of the interest (essentially the net fair market value of the interest);

    iii. Defers payment on liquidation more than six months; or

    iv. Permits noncash liquidation payments.

3. This imputed "put" right would effectively eliminate discounts (including marketability discounts) and would apply even though the imputed right does not actually exist and never will exist.

4. In other words, the interest will be valued as though the recipient has these highly desirable rights when in reality he does not.

IV. NOW WHAT?

A public hearing is scheduled for December 1, 2016, after which the proposed regulations may be revised or published as final. If finalized in their current form, the regulations would effectively prohibit taxpayers from claiming discounts in connection with outright gifts during life and upon death and would also affect other planning strategies such as GRATs and sales to grantor trusts.

While the process of analyzing, commenting on, finalizing, interpreting, and enforcing the new regulations is in its infancy, one of the many issues raised is almost certain to include whether the Treasury Department has crossed the line between enforcing and creating law by effectively overturning decades of seemingly settled, albeit evolving, case law. Many commentators believe the Department of Treasury exceeded its authority in issuing these proposed regulations.

Regardless of potential challenges, taxpayers who may be affected need to act and act soon. These taxpayers own interests in family-owned businesses and may be subject to federal transfer taxes, which, based on current law, includes individuals with estates near or exceeding $5,450,000 and couples with a combined estate near or exceeding $10,900,000. Of course, the outcome of the November elections may impact, potentially significantly, planning in this area.

HISTORIC TAX CREDITS: EVERYTHING YOU WANTED TO KNOW ABOUT HISTORIC TAX CREDITS, BUT WERE AFRAID TO ASK

By: Gary A. Kravitz

I. HISTORY

A. Started in 1978.

B. Intended to encourage rehabilitation of buildings with historic significance.

C. Intended to stimulate outside investment in historic buildings with tax credit carrot.

D. Realization that most rehab projects were more expensive than new construction and were not profitable on a pretax basis.

E. Section 47 of the Internal Revenue Code of 1986, as amended.

II. AMOUNT OF TAX CREDIT

A. Not a tax deduction, but an actual credit, lowering the amount of tax owed, dollar for dollar.

B. A 10% or 20% credit is available when the building is placed in service and depends upon whether the building is listed on the National Register of Historic Places or contributes to the historic district in which it is located.

C. The 10% credit.

1. Available to buildings placed in service prior to 1936.

2. Can't be listed in the National Register of Historic Places. If it is listed, 20% credit is applicable.

3. Can't be located within a Registered Historic district unless the National Park Service has certified that the building <u>does not</u> contribute to the significance of the district.

4. Cannot be used for residential purposes.

5. Internal and External Wall Retention Requirements:

    a. 50% of the existing external walls are retained in place as external walls.

    b. 75% of the existing external walls are retained in place as internal or external walls.

    c. 75% of the existing internal structural framework is retained in place.

6. No formal review process.

D. Tax credit is generally available when rehabbed property is placed in service.

E. Unused portion of the credit can be carried back one (1) year and carried forward twenty (20) years.

F. Owner must hold building for five (5) years after rehab is complete or forfeit tax credit. For buildings sold by an owner within five (5) year period, a proportionate amount must be returned to IRS.

G. Must be a building. Dams, bridges and ships do not qualify.

III. <u>FACTORS TO DETERMINE ELIGIBILITY ON 20% TAX CREDIT</u>

A. The building must be listed in the National Register of Historic Places or be certified as contributing to the significance of a "registered historic district".

1. Assuming that George Washington did not once use your bathroom on his way to Valley Forge, what does this mean?

2. Request to National Park Service – Part 1 of the Historic Preservation Certification Application to have the building in question certified as a historic structure.

3. Part 1 will also allow National Park Service to determine if a building within a historic district contributes to the historic nature of the district.

4. Secretary of the Interior's "Standards for Evaluating Significance within Registered Historic Districts will be applied to determine if a particular building will contribute to a historical district.

5. Just because your property is located in a historic district does not mean the property automatically qualifies. For Example: a tri-level built in the 1960s amongst brownstones built in the 1890s would not qualify.

B. Substantial Rehabilitation Test.

   1. Cost of project must exceed the greater of: $5,000 or the building's adjusted basis.

      a. Objective: To avoid taxpayers from joining several small routine repairs into a tax credit project.

      b. Adjusted Basis: A minus B minus C plus D is the calculation for adjusted basis.

         i. A is the purchase price of the property, building and land.

ii. B is the cost of the land at the time of the purchase.

iii. C is the depreciation taken for an income-producing property.

iv. D is the cost of any capital improvements made since the purchase.

2. Test must be met within two years, or five years if it is a project completed in multiple phases. For multiple phased project to qualify, it must:

a. Have a set of plans and specifications that clearly outlines all phases of construction.

b. Plans must be completed prior to rehab commencement.

c. Reasonable expectation that all phases will be completed.

C. Rehabilitation must comply with Secretary of the Interior's standard for Rehabilitation.

1. National Park Service must approve proposed rehabilitation. Applicant must complete Part 2 of the Historic Preservation Certification Application – Description of Rehabilitation to have this determination reviewed.

2. Ten Principles that the National Park Service will consider (taken directly from the National Park Service website).

a. A property shall be used for its historic purpose or be placed in a new use that requires minimal change to the defining characteristics of the building and its site and environment.

b. The historic character of a property shall be retained and preserved. The removal of historic materials or alteration of features and spaces that characterize a property shall be avoided.

c. Each property shall be recognized as a physical record of its time, place, and use. Changes that create a false sense of historical development, such as adding conjectural features or architectural elements from other buildings, shall not be undertaken.

d. Most properties change over time; those changes that have acquired historic significance in their own right shall be retained and preserved.

e. Distinctive features, finishes, and construction techniques or examples of craftsmanship that characterize a property shall be preserved.

f. Deteriorated historic features shall be repaired rather than replaced. Where the severity of deterioration requires replacement of a distinctive feature, the new feature shall match the old in design, color, texture, and other visual qualities and, where possible, materials. Replacement of missing features shall be substantiated by documentary, physical, or pictorial evidence.

g. Chemical or physical treatments, such as sandblasting, that cause damage to historic materials shall not be used. The surface cleaning of structures, if appropriate, shall be undertaken using the gentlest means possible.

h. Significant archeological resources affected by a project shall be protected and preserved. If such resources must be disturbed, mitigation measures shall be undertaken.

i. New additions, exterior alterations, or related new construction shall not destroy historic materials that characterize the property. The new work shall be differentiated from the old and shall be compatible with the massing, size, scale, and architectural features to protect the historic integrity of the property and its environment.

j. New additions and adjacent or related new construction shall be undertaken in such a manner that if removed in the future, the essential form and integrity of the historic property and its environment would be unimpaired.

3. Applicants are strongly encouraged to submit Part 2 prior to performing rehabilitation work.

D. Income producing.

1. Property must be used for an income producing purpose for at least five years. Commercial, industrial or agricultural enterprises or rental housing.

2. Owner-occupied homes do not qualify – possible exclusion for personal residences that are used for business purposes.

3. This requirement applies to both the 10% and the 20% credit with important caveat that 10% credit cannot be used for rental housing. No residential at all for 10% credit.

IV. QUALIFIED EXPENSES

A. Walls, partitions, floors, ceilings, paneling, tile, windows and doors, HVAC, plumbing, stairs, sprinkler systems, fire escapes.

B. NOT QUALIFIED: acquisition costs, appliances, decks (if not part of original building), demolition costs, enlargement costs which expand the total volume of the building, work done to facilities related to a building such as a parking lot or sidewalk or landscaping.

C. Generally, structural improvements to a component of a building will qualify for the rehabilitation tax credit.

D. Some soft costs can also be included such as construction management fees, developer fees, architect fees and engineering fees, if such costs are added to the basis of the property.

E. Detailed plans must be submitted to the NPS so that NPS can determine if rehab is consistent with historic character of building – if seeking 20% credit (Part of Part 2 of application). Not necessary for 10% credit.

V. TIMING

A. Sometimes credit can be obtained after the work is completed and the building placed into service.

   1. If the building is individually listed on the National Register this is acceptable.

   2. If the building is simply located in a registered historical district, the Taxpayer must submit Part 1 of the Historic Preservation Certification Application prior to the building being placed into service.

B. Placed in service means that the work in question has been completed which would allow for occupancy of the entire building or some identifiable portion of the building. Tres. Reg. 1.46-3(d).

VI. TAX LIMITATIONS

The ability to qualify for historic tax credits may be adversely affected by these other applicable limitations:

A. At risk rules.

B. Passive activity limitations.

1. Omnibus Budget Reconciliation Act of 1993 extended availability of Historic Tax Credits.

2. An individual taxpayer is eligible if more than one-half of the taxpayer's business services for the taxable year, amounting to more than 750 hours of services are performed in real property trade or business in which the taxpayer materially participates.

C. Alternative minimum tax.

1. If investor is subject to AMT, the investor cannot use historic tax credits.

VII. PARTNERSHIPS WITH INVESTORS

A. Frequently, the property owner does not have sufficient income tax liability to benefit from the tax credit, so they bring on a partner who will benefit.

B. A market for tax credits opened up and the concept of "buying" tax credits come into play.

C. Prior to Historic Boardwalk Case.

1. Investors would require fixed return in addition to residual cash flow.

2. Investors received a guaranty from developer that tax credit would work as well as promised returns.

3. Investors would negotiate a put price fixed at some percentage of their capital contribution.

4. Developers would often receive competing bids for tax credits.

5. Investors would often invest capital at completion or after completion of the project.

6. Internal Revenue Service became increasingly concerned over practice of selling tax credits and lack of risk taken on by tax credit investors.

7. Investor partners were trying to structure deals so that the investor partners could benefit from the tax credits, but had very little downside. No risk deals.

VIII. HISTORIC BOARDWALK CASE

A. Historic Boardwalk Hall, LLC v. Comm'r, 694 F. 3d 425 (CA-3 2012), cert. denied 133 S. Ct. 2734 (2013).

B. New Jersey Sports and Exposition Authority ("NJSEA") undertook restoration of Boardwalk Hall to turn it into a convention center. A critical element of the case was that the State of New Jersey had already fully funded the project before any tax credit investors were sought.

C. NJSEA sought investors because, as a governmental entity, the NJSEA could not take advantage of the 20% tax credit.

D. NJSEA that undertook the restoration of Boardwalk Hall, provided guaranties and indemnities to the investor (Pitney Bowes) so that Pitney Bowes would be guaranteed a certain return on its involvement in the transaction and would be protected from downside risk in case of environmental issues, failure of the tax credit plan, and/or construction delays, etc.

E. Some specific elements that the Court of Appeals found troubling.

1. Offering memorandum described transaction as an "interest only loan" and a "sale of historic tax credits".

2. Capital contributions were tied directly to the amount of historic credits allocated to Pitney Bowes.

3. Pitney Bowes made installment payments of capital contributions only if the project generated historic tax credits equal to its contribution. This made Pitney Bowes' downside risk nearly non-existent according to the Court of Appeals.

4. NJSEA provided a completion guaranty, a tax benefits guaranty, operating deficit guaranty, and environmental guaranty to limit Pitney Bowes' risk related to the transaction. The Court of Appeals identified the tax benefits guaranty as another argument that Pitney Bowes had no downside risk in the transaction.

5. Put and call options were put into place requiring NJSEA to purchase Pitney Bowes' interest in the LLC, plus Pitney Bowes preferred return which put and call options were backed up by a

guaranteed investment contract to insure that NJSEA would always have the funds to buy out Pitney Bowes.

6. The rehabilitation was completed in October 2001, and Pitney Bowes had only contributed 38% of its capital contribution at that point.

7. The Court of Appeals noted that the economic projections for the project forecasted no residual cash flow available for distribution after all of the debt payments were made. This meant that Pitney Bowes had no reasonable upside expectations from the Partnership.

F. Court held that the Pitney Bowes downside risk or upside potential was so limited that Pitney Bowes could not really be considered a "partner" in the LLC that owned the property.

G. Court concluded that Pitney Bowes had no meaningful upside risk due to the prioritization of distributions and the LLC's heavy debt service (no residual cash flows were projected). Since the investor was not a "partner", the investor could not benefit from the allocation of historic tax credits.

H. Subsequent to the decision, confusion reigned due to court's lack of guidance and Supreme Court's decision not to grant cert.

Were all guaranties invalid?

1. Could investors defer their capital contributions? If so, by how much?

2. How much risk had to be assumed in order for investor to be considered a partner?

IX. REVENUE PROCEDURE 2014-12

A. Issued on December 30, 2013.

1. Applies to projects "placed in service" after December 30, 2013. So if a project closed prior that date, but wasn't placed into service until after December 20, 2013, it is still eligible.

2. All or nothing.

   a. If you comply with requirements, you have safe harbor.

   b. If just one requirement is missed, no safe harbor.

   c. However, project may still be viable even if safe harbor requirements are not met.

B. Investment Requirement

1. Developer must have at least 1 percent interest in partnership – meaning that the developer would have a 1 percent interest in the income and losses of the partnership. This must be maintained during 5 year recapture period.

2. Investor must maintain 5% interest of its highest allocation percentage over the life of the deal. Since Investor will likely have 99% allocation of the bottom-line profits during 5 year recapture period so that it gets almost all of the tax credits, the Investor's resulting interest in gain, loss, etc. would have to be at least 4.95% at all times.

   a. Investor's equity interest in partnership (LLC) must be a "bona fide equity investment" with a value that is contingent upon the investor's percentage interest in the partnership's net income, gain and loss. Bottom line:

Investor must have skin in the game and enjoy the possibility of loss.

3. Reasonably anticipated value commensurate with Investor's overall percentage interest in the partnership.

    a. Value does not have to tie into capital contribution.

    b. Value cannot be fixed.

    c. IRS recognizes that investor's capital contribution will be tied to expected tax credit return; however, investors' other economic benefits must match its percentage interest in the partnership.

    d. No minimum cash or return required.

4. Bona fide equity investment.

5. Limitation on moving cash out of partnership – Any arrangements that move cash out of the partnership must not be "unreasonable" as compared with an arrangement not involving Historical Tax Credits. You cannot artificially reduce value of investor' interest by charging various fees.

6. "Flip" transaction is permitted. Investor's interest starts at 99% and "flips" to 4.95% after tax credit recapture period (5 years) has expired.

C. Timing Requirements.

1. Investor must contribute 20% of expected total contribution prior to the date building is placed in service – amount must remain in partnership for the duration of investor's ownership in

partnership. Must be an actual investment – notes and loans do not count.

2. At least 75 percent of investor's total expected capital contributions must be fixed in amount before the date the building is placed in service. Capital contribution cannot be borrowed from parties in transaction.

   a. At least 75% of investor's expected capital contributions must be fixed in amount by the time the project is placed in service.

   b. However, amount in excess of 20% (mentioned above) can be contingent on reaching standard tax credit requirements, like Part 3 approval.

D. Limitations on Guaranties.

Only unfunded guaranties are allowed – (i.e. no funds or collateral is set aside to "back up" the guaranty or if the guarantor agrees to a minimum net worth requirement).

1. Guaranties related to the tax credits – permissible – guaranty that covers a loss of credits due to the developer failing to do some act so that the partnership does not qualify. (i.e. failing to complete construction or failing to satisfy the NPS standards).

2. Guaranties related to the partnership operations – if there is a challenge to the structure of the transaction – this cannot be guaranteed – you can obtain insurance.

3. Standard guaranties – such as those covering completion of the work or environmental issues are still allowed.

4. Developer cannot guaranty the investor's ability to claim historic tax credits, or a repayment of the investor's capital contribution if the historic tax credits are not available.

5. No guaranty that investor will receive distributions or consideration in exchange for its interest.

6. Indemnity of the investor if IRS challenges claim of historic credits.

7. However insurance can be obtained to cover losses so long as insurance is provided by persons not involved in the transaction.

E. Put and Call Limitations.

1. Call right on behalf of the developer/owner is strictly prohibited.

2. Investor may have a put right so long as price does not exceed fair market value.

F. The IRS recognized two types of partnerships structures:

1. Developer Partnership. The partnership owns and rehabs the building and the ownership is divided between the owner and the investor. Few deals are structured this way.

2. Master Tenant Partnership. The structure is that a Master Tenant leases the building in question from the Developer Partnership. Developer partnership makes an election under Section 50(d) to pass the. historic tax credits to the master tenant.

    a. Master Tenant is then treated as having incurred the qualified rehabilitation expenses.

b. Master Tenant may then pass tax credits onto its partners/members - the investor being one of them.

   i. Most transactions follow master tenant structure.

   ii. Investor cannot hold an interest in the Developer partnership. Investor only holds interest in the master tenant partnership. However, Master Tenant partnership can have an interest in Developer partnership.

X. CONCLUSION

YOU CALL THAT ART? ISSUES REGARDING ART AND COLLECTIBLES

By: Robert D. Kaplow, Esq.

I. COLLECTIBLES

A. Typical collections -

1. Art
2. Jewelry
3. Coins
4. Stamps

B. More unusual -

1. Kaleidoscopes
2. Lunch boxes
3. Marbles
4. Match book covers
5. Photographs
6. Presidential memorabilia
7. Chess sets
8. Sports memorabilia

C. Anything can become a collection and you don't have to be ultra-rich to have a valuable collection.

D. Emotional attachment to the collection.

E. Who will want it?

II. <u>OWNERSHIP AND LEGAL ISSUES</u>

A. Provenance – what is the history of the physical possession of the item from the date of creation to the current ownership.

1. Perhaps more important for artwork, ancient objects – but really needed for any item.

2. Is that the original (Mona Lisa, stamp, lunchbox, etc.) or just a good copy?

3. A good provenance history would include:

a. owner's names and dates of ownership

b. how item was transferred to each subsequent owner – gift, sale, bequest, etc.

c. locations where the item was kept

B. Legal Title

1. Proof of purchase – bill of sale.

2. Verify seller's title when buying the item.

3. Stolen object? Purchaser may be a "bona fide purchaser" if no reason to suspect he was buying a stolen item.

4. Fraud – Is the object legitimate or a fraudulent copy/knockoff.

5. Obtain title insurance for more expensive purchases.

C. Inventory

1. Collector should keep a written (preferably computerized) inventory of her collection to include the following information:

   a. Date of purchase

   b. Seller

   c. Identifying number

   d. History of the object

   e. Maker or artist

   f. Title of object

   g. Date of creation of object

   h. Cost of item

   i. Picture of the object

2. Don't use abbreviations that won't be understood by third parties looking at the inventory list.

3. Keep extra copies of the inventory in a few locations and keep them updated.

III. <u>VALUATION OF COLLECTION</u>

A. Purpose of valuation.

1. Insurance protection

2. Sale to third party

3. Charitable donation

4. Gift

5. Estate tax

6. Divorce

7. Brag to friends

B. Insurance

1. Insurance company – based on retail replacement value, not liquidation value.

2. Protection for theft, loss or damage to the object.

3. Insurance company will generally rely on valuations from reputable sources – dealers, retail stores, etc., but may require specialized appraisals for high-end or unusual items.

4. Check reputation of the insurance company – do they dispute most claims? Do they pay promptly?

C. Appraisals for Internal Revenue Service

1. The Internal Revenue Code provides requirements for appraisals of certain assets in connection with contributions to charities, gifts or estate valuations.

2. IRS Publication 561, "Determining the Value of Donated Property", provides information for determining the value of donated property, including information regarding required "qualified appraisals".

3. Charitable Donations

a. Form 8283 to be filed (See Exhibit A).

b. Qualified appraisals required unless the deduction is \$5,000 or less. In determining the \$5,000 amount, all similar items are aggregated and treated as one property, even if donated to separate charities.

c. Art valued at \$20,000 or more requires a complete copy of the signed qualified appraisal to be attached to the income tax return.

d. Art valued at \$50,000 or more – taxpayer can request a "Statement of Value" from the IRS before filing the tax return. Rev. Proc. 96-15

   i. requires qualified appraisal

   ii. \$2,500 fee to IRS

   iii. completed Form 8283, Section B

e. Other property (besides art) – a qualified appraisal must be attached to the return if the deduction is more than \$500,000. Failure to attach the appraisal results in the denial of the deduction.

f. Requirements for a qualified appraisal:

   i. IRS Regulations set forth very detailed rules for the appraisal and the appraiser. Regulation Section 1.170A-13(c)(3) (qualified appraisal requirements) and Section 1.170a-13(c)(5) (qualified appraiser requirements)

ii. requirements summarized in pages 8-11 of IRS Publication 561. (See Exhibit B)

g. Substantial penalty for failure to comply with qualified appraisal requirements.

i. Mohamed v. Commissioner, T.C. Memo 2012-152 (May 29, 2012). Taxpayer, a real estate broker and real estate appraiser, was denied an $18,000,000 deduction for a charitable contribution of real estate.

ii. problem – was that the taxpayer prepared his own appraisal.

iii. regulations require appraisal by an unrelated third party.

iv. Tax Court upheld IRS Regulation

h. Appraisals not required for contributions of certain property:

i. stock in trade, inventory or property held primarily for sale to customers in the ordinary course of business

ii. publicly traded securities

iii. patents and other intellectual property

iv. vehicles where the donee organization sells the vehicle without a significant intervening use or material improvements of the vehicle by the organization (because the charitable deduction is limited to the amount received by the charity upon the sale)

IV INCOME TAX ISSUES

A. Sale during lifetime.

1. Is taxpayer a collector, investor or dealer?

2. A sale by a collector or investor qualifies as a sale of a capital asset – capital gain or loss.

3. However, there is a special capital gain rate for a sale of a collectible – as high as 28%.

4. Collectibles are defined in Internal Revenue Code §408(m).

5. Net Investment Income Tax (NIIT) of 3.8% also applies.

B. Like-Kind Exchange – Investors (but not collectors or dealers) can enter into a like-kind exchange of their collectibles.

1. Usual like-kind exchange rules under Internal Revenue Code §1031 apply.

2. Property has to be held for productive use in a trade or business or for investment.

3. Determining whether taxpayer is a collector or investor is based on the taxpayer's intent at the time of the exchange, not at the time of the initial purchase.

C. Charitable Contribution.

1. Long term capital gain property –

a. deduct fair market value

b. if to public charity – up to 30% of adjusted gross income

c. if to private charity – up to 20% of adjusted gross income

d. amount in excess of AGI limit can be carried forward and deducted for up to five years subject to the same annual AGI limits

2. Related use

a. donations of tangible personal property (i.e., artwork)

b. if the use of the property is related to the charity's exempt purpose, entitled to deduction based on fair market value

c. if unrelated use – deduction limited to the cost basis of the property

d. if the charity sells the property within three years of its receipt, deduction will be limited to cost basis – not FMV

e. charity can certify that it originally intended to put the property to a related use

3. Fractional gift

a. rules modified by the Pension Protection Act of 2006

b. gift of the entire interest must be completed by the earlier of 10 years from the date of the first fractional interest gift or death

c. donations of fractional interests in successive years are based on the original value of the first fractional gift

d. the charity must take actual possession of the property for its ownership period – if a 10% gift was made, charity must have possession of the property for 37 days each year.

4. Donation Agreement – set forth limitations on the use of the property

D. Sale upon death

1. Typical scenario

2. Collectible will get new basis upon death, thus eliminating capital gain tax and NIIT.

3. Will survivors really know the value/history of the collectible to set an accurate price for the sale?

4. Collectible will be included in the estate of the taxpayer and possibly subject to federal estate tax.

E. Basis – need to be able to prove cost basis for any lifetime sale or gift

V <u>GIFTING</u>

A. Gift is subject to gift tax to the extent the fair market value of the gift to the donee is more than $14,000.

B. Client may feel good in seeing her donee get enjoyment from the gift – or could make taxpayer decide not to make further gifts (lifetime or death) to the unappreciative done.

C. Outright gifts or gifts in trust.

D. Future appreciation is out of the taxpayer's estate – but donee gets the taxpayer's basis – no step up.

E. Difficult to take a discount on the value of the gift – but see Elkins v. Commissioner, 767 F3d 443 (5th Cir. 2014).

F. Must actually physically transfer the property.

G. Will need valuation – qualified appraisal.

VI ESTATE TAX

A. Collectibles owned by taxpayer upon the death of the taxpayer will be included in the taxpayer's estate.

B. Will be subject to estate tax to the extent taxpayer's overall estate is greater than $5,450,000 for 2016 ($5,490,000 for 2017).

C. Can qualify for marital deduction.

D. Will need qualified appraisal to determine value.

E. Collectibles should be owned in the taxpayer's revocable trust during the taxpayer's lifetime in order to avoid having to probate the collection.

F. Client can leave a written memorandum listing beneficiaries to receive specific items from the collection.

1. Can be changed easily.

2. Don't use "Post-It" method.

3. Written memorandum (or equivalent) will avoid the problem of requiring the Personal Representative or Trustee choosing who gets each particular piece of the collection.

G. Trustee must make sure that the collection is properly titled in the trust name and adequately insured while owned in the trust.

H. Charitable Donation.

1. Easier than a lifetime charitable donation as the income tax charitable deduction requirements don't apply – no AGI limits.

2. Estate receives an estate tax charitable deduction for the fair market value of the property.

3. With high estate tax exclusion amounts, taxpayer may be better off donating during lifetime to get an income tax deduction.

4. Terms and conditions for the donee's use of the property – can they sell it, must it be displayed, etc.

VII ART ADVISORY PANEL

A. Art Advisory Panel of the Commissioner makes recommendation to the Art Appraisal Services Unit in the Office of Appeals for the IRS.

B. Helps IRS review and evaluate appraisals in connection with income, estate and gift tax returns.

C. When a tax return being audited incudes an appraisal for a single work of art or cultural property valued at $50,000 or more, the local IRS office must refer the case to the Art Advisory Panel.

D. Panel is not informed as to the purpose of the valuation or who did the appraisal.

E. Panel's recommendations are advisory to the Art Appraisal Services Unit. Once approved by the Appraisal Services Unit, the valuation becomes the position of the IRS.

VIII AUCTIONEERS/APPRAISERS (in no particular order)

A. DuMouchelle Art Galleries – www.dumouchelle.com

B. Detroit Fine Art Appraisals, LLC - Terri Stearn (248) 672.3207

C. Doyle Auctioneers & Appraisers – www.doyle.com

D. Heritage Auctions – www.HA.com

E. Sotheby's – www.sothebys.com

F. Christie's – www.christies.com

G. Most art galleries

Exhibit A

Form **8283**

(Rev. December 2014)
Department of the Treasury
Internal Revenue Service

Noncash Charitable Contributions

▶ **Attach to your tax return if you claimed a total deduction of over $500 for all contributed property.**

▶ **Information about Form 8283 and its separate instructions is at *www.irs.gov/form8283*.**

OMB No. 1545-0908

Attachment Sequence No. **155**

Name(s) shown on your income tax return | **Identifying number**

Note. Figure the amount of your contribution deduction before completing this form. See your tax return instructions.

Section A. Donated Property of $5,000 or Less and Publicly Traded Securities—List in this section **only** items (or groups of similar items) for which you claimed a deduction of $5,000 or less. Also list publicly traded securities even if the deduction is more than $5,000 (see instructions).

Part I **Information on Donated Property**—If you need more space, attach a statement.

1	(a) Name and address of the donee organization	(b) If donated property is a vehicle (see instructions), check the box. Also enter the vehicle identification number (unless Form 1098-C is attached).	(c) Description of donated property (For a vehicle, enter the year, make, model, and mileage. For securities, enter the company name and the number of shares.)
A		☐	
B		☐	
C		☐	
D		☐	
E		☐	

Note. If the amount you claimed as a deduction for an item is $500 or less, you do not have to complete columns (e), (f), and (g).

	(d) Date of the contribution	(e) Date acquired by donor (mo., yr.)	(f) How acquired by donor	(g) Donor's cost or adjusted basis	(h) Fair market value (see instructions)	(i) Method used to determine the fair market value
A						
B						
C						
D						
E						

Part II **Partial Interests and Restricted Use Property**—Complete lines 2a through 2e if you gave less than an entire interest in a property listed in Part I. Complete lines 3a through 3c if conditions were placed on a contribution listed in Part I; also attach the required statement (see instructions).

2a Enter the letter from Part I that identifies the property for which you gave less than an entire interest ▶ ________
If Part II applies to more than one property, attach a separate statement.

b Total amount claimed as a deduction for the property listed in Part I: **(1)** For this tax year ▶ ________
(2) For any prior tax years ▶ ________

c Name and address of each organization to which any such contribution was made in a prior year (complete only if different from the donee organization above):

Name of charitable organization (donee)

Address (number, street, and room or suite no.)

City or town, state, and ZIP code

d For tangible property, enter the place where the property is located or kept ▶ ________

e Name of any person, other than the donee organization, having actual possession of the property ▶ ________

		Yes	No
3a	Is there a restriction, either temporary or permanent, on the donee's right to use or dispose of the donated property?		
b	Did you give to anyone (other than the donee organization or another organization participating with the donee organization in cooperative fundraising) the right to the income from the donated property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having such income, possession, or right to acquire?		
c	Is there a restriction limiting the donated property for a particular use?		

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 62299J Form **8283** (Rev. 12-2014)

Name(s) shown on your income tax return | **Identifying number**

Section B. Donated Property Over $5,000 (Except Publicly Traded Securities)—Complete this section for one item (or one group of similar items) for which you claimed a deduction of more than $5,000 per item or group (except contributions of publicly traded securities reported in Section A). Provide a separate form for each property donated unless it is part of a group of similar items. An appraisal is generally required for property listed in Section B. See instructions.

Part I Information on Donated Property—To be completed by the taxpayer and/or the appraiser.

4 Check the box that describes the type of property donated:

- a ☐ Art* (contribution of $20,000 or more)
- b ☐ Qualified Conservation Contribution
- c ☐ Equipment
- d ☐ Art* (contribution of less than $20,000)
- e ☐ Other Real Estate
- f ☐ Securities
- g ☐ Collectibles**
- h ☐ Intellectual Property
- i ☐ Vehicles
- j ☐ Other

*Art includes paintings, sculptures, watercolors, prints, drawings, ceramics, antiques, decorative arts, textiles, carpets, silver, rare manuscripts, historical memorabilia, and other similar objects.

**Collectibles include coins, stamps, books, gems, jewelry, sports memorabilia, dolls, etc., but not art as defined above.

Note. *In certain cases, you must attach a qualified appraisal of the property. See instructions.*

5	(a) Description of donated property (if you need more space, attach a separate statement)	(b) If tangible property was donated, give a brief summary of the overall physical condition of the property at the time of the gift	(c) Appraised fair market value
A			
B			
C			
D			

	(d) Date acquired by donor (mo., yr.)	(e) How acquired by donor	(f) Donor's cost or adjusted basis	(g) For bargain sales, enter amount received	See instructions (h) Amount claimed as a deduction	See instructions (i) Date of contribution
A						
B						
C						
D						

Part II Taxpayer (Donor) Statement—List each item included in Part I above that the appraisal identifies as having a value of $500 or less. See instructions.

I declare that the following item(s) included in Part I above has to the best of my knowledge and belief an appraised value of not more than $500 (per item). Enter identifying letter from Part I and describe the specific item. See instructions. ▶ ____________

Signature of taxpayer (donor) ▶ Date ▶

Part III Declaration of Appraiser

I declare that I am not the donor, the donee, a party to the transaction in which the donor acquired the property, employed by, or related to any of the foregoing persons, or married to any person who is related to any of the foregoing persons. And, if regularly used by the donor, donee, or party to the transaction, I performed the majority of my appraisals during my tax year for other persons.

Also, I declare that I perform appraisals on a regular basis; and that because of my qualifications as described in the appraisal, I am qualified to make appraisals of the type of property being valued. I certify that the appraisal fees were not based on a percentage of the appraised property value. Furthermore, I understand that a false or fraudulent overstatement of the property value as described in the qualified appraisal or this Form 8283 may subject me to the penalty under section 6701(a) (aiding and abetting the understatement of tax liability). In addition, I understand that I may be subject to a penalty under section 6695A if I know, or reasonably should know, that my appraisal is to be used in connection with a return or claim for refund and a substantial or gross valuation misstatement results from my appraisal. I affirm that I have not been barred from presenting evidence or testimony by the Office of Professional Responsibility.

Sign Here Signature ▶ Title ▶ Date ▶

Business address (including room or suite no.) | **Identifying number**

City or town, state, and ZIP code

Part IV Donee Acknowledgment—To be completed by the charitable organization.

This charitable organization acknowledges that it is a qualified organization under section 170(c) and that it received the donated property as described in Section B, Part I, above on the following date ▶ ____________

Furthermore, this organization affirms that in the event it sells, exchanges, or otherwise disposes of the property described in Section B, Part I (or any portion thereof) within 3 years after the date of receipt, it will file **Form 8282,** Donee Information Return, with the IRS and give the donor a copy of that form. This acknowledgment does not represent agreement with the claimed fair market value.

Does the organization intend to use the property for an unrelated use? . . . . ▶ ☐ Yes ☐ No

Name of charitable organization (donee)	**Employer identification number**	
Address (number, street, and room or suite no.)	City or town, state, and ZIP code	
Authorized signature	Title	Date

Exhibit B

a gift of a remainder interest that includes property that is part depletable and part not depletable. Take into account depreciation or depletion only for the property that is subject to depreciation or depletion.

For more information, see section 1.170A-12 of the Income Tax Regulations.

Undivided Part of Your Entire Interest

A contribution of an undivided part of your entire interest in property must consist of a part of each and every substantial interest or right you own in the property. It must extend over the entire term of your interest in the property. For example, you are entitled to the income from certain property for your life (life estate) and you contribute 20% of that life estate to a qualified organization. You can claim a deduction for the contribution if you do not have any other interest in the property. To figure the value of a contribution involving a partial interest, see Publication 1457.

If the only interest you own in real property is a remainder interest and you transfer part of that interest to a qualified organization, see the previous discussion on valuation of a remainder interest in real property.

Qualified Conservation Contribution

A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization to be used only for conservation purposes.

Qualified organization. For purposes of a qualified conservation contribution, a qualified organization is:

- A governmental unit,
- A publicly supported charitable, religious, scientific, literary, educational, etc., organization, or
- An organization that is controlled by, and operated for the exclusive benefit of, a governmental unit or a publicly supported charity.

The organization also must have a commitment to protect the conservation purposes of the donation and must have the resources to enforce the restrictions.

Conservation purposes. Your contribution must be made only for one of the following conservation purposes.

- Preserving land areas for outdoor recreation by, or for the education of, the general public.
- Protecting a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem.
- Preserving open space, including farmland and forest land, if it yields a significant public benefit. It must be either for the scenic enjoyment of the general public or under a clearly defined federal, state, or local governmental conservation policy.
- Preserving a historically important land area or a certified historic structure. There must be some visual public access to the property. Factors used in determining the type and amount of public access required include the historical significance of the property, the remoteness or accessibility of the site, and the extent to which intrusions on the privacy of individuals living on the property would be unreasonable.

Building in registered historic district. A contribution after July 25, 2006, of a qualified real property interest that is an easement or other restriction on the exterior of a building in a registered historic district is deductible only if it meets all of the following three conditions.

1. The restriction must preserve the entire exterior of the building and must prohibit any change to the exterior of the building that is inconsistent with its historical character.
2. You and the organization receiving the contribution must enter into a written agreement certifying, that the organization is a qualified organization and that it has the resources and commitment to maintain the property as donated.
3. If you make the contribution in a tax year beginning after August 17, 2006, you must include with your return:
   a. A qualified appraisal,
   b. Photographs of the building's entire exterior, and
   c. A description of all restrictions on development of the building, such as zoning laws and restrictive covenants.

If you make this type of contribution after February 12, 2007, and claim a deduction of more than $10,000, your deduction will not be allowed unless you pay a $500 filing fee. See Form 8283-V, Payment Voucher for Filing Fee Under Section 170(f)(13), and its instructions.

Qualified real property interest. This is any of the following interests in real property.

1. Your entire interest in real estate other than a mineral interest (subsurface oil, gas, or other minerals, and the right of access to these minerals).
2. A remainder interest.
3. A restriction (granted in perpetuity) on the use that may be made of the real property.

Valuation. A qualified real property interest described in (1) should be valued in a manner that is consistent with the type of interest transferred. If you transferred all the interest in the property, the FMV of the property is the amount of the contribution. If you do not transfer the mineral interest, the FMV of the surface rights in the property is the amount of the contribution.

If you owned only a remainder interest or an income interest (life estate), see *Undivided Part of Your Entire Interest,* earlier. If you owned the entire property but transferred only a remainder interest (item (2)), see *Remainder Interest in Real Property,* earlier.

In determining the value of restrictions, you should take into account the selling price in arm's-length transactions of other properties that have comparable restrictions. If there are no comparable sales, the restrictions are valued indirectly as the difference between the FMVs of the property involved before and after the grant of the restriction.

The FMV of the property before contribution of the restriction should take into account not only current use but the likelihood that the property, without the restriction, would be developed. You should also consider any zoning, conservation, or historical preservation laws that would restrict development. Granting an easement may increase, rather than reduce, the value of property, and in such a situation no deduction would be allowed.

Example. You own 10 acres of farmland. Similar land in the area has an FMV of $2,000 an acre. However, land in the general area that is restricted solely to farm use has an FMV of $1,500 an acre. Your county wants to preserve open space and prevent further development in your area.

You grant to the county an enforceable open space easement in perpetuity on 8 of the 10 acres, restricting its use to farmland. The value of this easement is $4,000, determined as follows:

FMV of the property before granting easement:		
$2,000 × 10 acres		$20,000
FMV of the property after granting easement:		
$1,500 × 8 acres	$12,000	
$2,000 × 2 acres	4,000	16,000
Value of easement		$4,000

If you later transfer in fee your remaining interest in the 8 acres to another qualified organization, the FMV of your remaining interest is the FMV of the 8 acres reduced by the FMV of the easement granted to the first organization.

More information. For more information about qualified conservation contributions, see Publication 526.

Appraisals

Appraisals are not necessary for items of property for which you claim a deduction of $5,000 or less. (There is one exception, described next, for certain clothing and household items.) However, you generally will need an appraisal for donated property for which you claim a deduction of more than $5,000. There are exceptions. See *Deductions of More Than $5,000,* later.

The weight given an appraisal depends on the completeness of the report, the qualifications of the appraiser, and the appraiser's demonstrated knowledge of the donated property. An appraisal must give all the facts on which to base an intelligent judgment of the value of the property.

The appraisal will not be given much weight if:

- All the factors that apply are not considered,
- The opinion is not supported with facts, such as purchase price and comparable sales, or

- The opinion is not consistent with known facts.

The appraiser's opinion is never more valid than the facts on which it is based; without these facts it is simply a guess.

The opinion of a person claiming to be an expert is not binding on the Internal Revenue Service. All facts associated with the donation must be considered.

Deduction over $500 for certain clothing or household items. You must include with your return a qualified appraisal of any single item of clothing or any household item that is not in good used condition or better, that you donated after August 17, 2006, and for which you deduct more than $500. See *Household Goods* and *Used Clothing*, earlier.

Cost of appraisals. You may not take a charitable contribution deduction for fees you pay for appraisals of your donated property. However, these fees may qualify as a miscellaneous deduction, subject to the 2% limit, on Schedule A (Form 1040) if paid to determine the amount allowable as a charitable contribution.

Deductions of More Than $5,000

Generally, if the claimed deduction for an item or group of similar items of donated property is more than $5,000, you must get a qualified appraisal made by a qualified appraiser, and you must attach Section B of Form 8283 to your tax return. There are exceptions, discussed later. You should keep the appraiser's report with your written records. Records are discussed in Publication 526.

The phrase "similar items" means property of the same generic category or type (whether or not donated to the same donee), such as stamp collections, coin collections, lithographs, paintings, photographs, books, nonpublicly traded stock, nonpublicly traded securities other than nonpublicly traded stock, land, buildings, clothing, jewelry, furniture, electronic equipment, household appliances, toys, everyday kitchenware, china, crystal, or silver. For example, if you give books to three schools and you deduct $2,000, $2,500, and $900, respectively, your claimed deduction is more than $5,000 for these books. You must get a qualified appraisal of the books and for each school you must attach a fully completed Form 8283, Section B, to your tax return.

Exceptions. You do not need an appraisal if the property is:

- Nonpublicly traded stock of $10,000 or less,
- A vehicle (including a car, boat, or airplane) for which your deduction is limited to the gross proceeds from its sale,
- Qualified intellectual property, such as a patent,
- Certain publicly traded securities described next,
- Inventory and other property donated by a corporation that are "qualified contributions" for the care of the ill, the needy, or infants, within the meaning of section 170(e)(3)(A) of the Internal Revenue Code, or
- Stock in trade, inventory, or property held primarily for sale to customers in the ordinary course of your trade or business.

Although an appraisal is not required for the types of property just listed, you must provide certain information about a donation of any of these types of property on Form 8283.

Publicly traded securities. Even if your claimed deduction is more than $5,000, neither a qualified appraisal nor Section B of Form 8283 is required for publicly traded securities that are:

- Listed on a stock exchange in which quotations are published on a daily basis,
- Regularly traded in a national or regional over-the-counter market for which published quotations are available, or
- Shares of an open-end investment company (mutual fund) for which quotations are published on a daily basis in a newspaper of general circulation throughout the United States.

Publicly traded securities that meet these requirements must be reported on Form 8283, Section A.

A qualified appraisal is not required, but Form 8283, Section B, Parts I and IV, must be completed, for an issue of a security that does not meet the requirements just listed but does meet these requirements:

1. The issue is regularly traded during the computation period (defined later) in a market for which there is an "interdealer quotation system" (defined later),
2. The issuer or agent computes the "average trading price" (defined later) for the same issue for the computation period,
3. The average trading price and total volume of the issue during the computation period are published in a newspaper of general circulation throughout the United States, not later than the last day of the month following the end of the calendar quarter in which the computation period ends,
4. The issuer or agent keeps books and records that list for each transaction during the computation period the date of settlement of the transaction, the name and address of the broker or dealer making the market in which the transaction occurred, and the trading price and volume, and
5. The issuer or agent permits the Internal Revenue Service to review the books and records described in item (4) with respect to transactions during the computation period upon receiving reasonable notice.

An interdealer quotation system is any system of general circulation to brokers and dealers that regularly disseminates quotations of obligations by two or more identified brokers or dealers who are not related to either the issuer or agent who computes the average trading price of the security. A quotation sheet prepared and distributed by a broker or dealer in the regular course of business and containing only quotations of that broker or dealer is not an interdealer quotation system.

The average trading price is the average price of all transactions (weighted by volume), other than original issue or redemption transactions, conducted through a United States office of a broker or dealer who maintains a market in the issue of the security during the computation period. Bid and asked quotations are not taken into account.

The computation period is weekly during October through December and monthly during January through September. The weekly computation periods during October through December begin with the first Monday in October and end with the first Sunday following the last Monday in December.

Nonpublicly traded stock. If you contribute nonpublicly traded stock, for which you claim a deduction of $10,000 or less, a qualified appraisal is not required. However, you must attach Form 8283 to your tax return, with Section B, Parts I and IV, completed.

Deductions of More Than $500,000

If you claim a deduction of more than $500,000 for a donation of property, you must attach a qualified appraisal of the property to your return. This does not apply to contributions of cash, inventory, publicly traded stock, or intellectual property.

If you do not attach the appraisal, you cannot deduct your contribution, unless your failure to attach the appraisal is due to reasonable cause and not to willful neglect.

Qualified Appraisal

Generally, if the claimed deduction for an item or group of similar items of donated property is more than $5,000, you must get a qualified appraisal made by a qualified appraiser. You must also complete Form 8283, Section B, and attach it to your tax return. See *Deductions of More Than $5,000*, earlier.

A qualified appraisal is an appraisal document that:

- Is made, signed, and dated by a qualified appraiser (defined later) in accordance with generally accepted appraisal standards,
- Meets the relevant requirements of Regulations section 1.170A-13(c)(3) and Notice 2006-96, 2006-46 I.R.B. 902 (available at *www.irs.gov/irb/2006-46_IRB/ar13.html*),
- Relates to an appraisal made not earlier than 60 days before the date of contribution of the appraised property,
- Does not involve a prohibited appraisal fee, and
- Includes certain information (covered later).

You must receive the qualified appraisal before the due date, including extensions, of the return on which a charitable contribution deduction is first claimed for the donated property. If the deduction is first claimed on an amended return, the qualified appraisal must be received before the date on which the amended return is filed.

Form 8283, Section B, must be attached to your tax return. Generally, you do not need to attach the qualified appraisal itself, but you should keep a copy as long as it may be relevant under the tax law. There are four exceptions.

- If you claim a deduction of $20,000 or more for donations of art, you must attach a complete copy of the appraisal. See *Paintings, Antiques, and Other Objects of Art*, earlier.
- If you claim a deduction of more than $500,000 for a donation of property, you must attach the appraisal. See *Deductions of More Than $500,000*, earlier.
- If you claim a deduction of more than $500 for an article of clothing, or a household item, that is not in good used condition or better, that you donated after August 17, 2006, you must attach the appraisal. See *Deduction over $500 for certain clothing or household items*, earlier.
- If you claim a deduction in a tax year beginning after August 17, 2006, for an easement or other restriction on the exterior of a building in a historic district, you must attach the appraisal. See *Building in registered historic district*, earlier.

Prohibited appraisal fee. Generally, no part of the fee arrangement for a qualified appraisal can be based on a percentage of the appraised value of the property. If a fee arrangement is based on what is allowed as a deduction, after Internal Revenue Service examination or otherwise, it is treated as a fee based on a percentage of appraised value. However, appraisals are not disqualified when an otherwise prohibited fee is paid to a generally recognized association that regulates appraisers if:

- The association is not organized for profit and no part of its net earnings benefits any private shareholder or individual,
- The appraiser does not receive any compensation from the association or any other persons for making the appraisal, and
- The fee arrangement is not based in whole or in part on the amount of the appraised value that is allowed as a deduction after an Internal Revenue Service examination or otherwise.

Information included in qualified appraisal. A qualified appraisal must include the following information:

1. A description of the property in sufficient detail for a person who is not generally familiar with the type of property to determine that the property appraised is the property that was (or will be) contributed,
2. The physical condition of any tangible property,
3. The date (or expected date) of contribution,
4. The terms of any agreement or understanding entered into (or expected to be entered into) by or on behalf of the donor that relates to the use, sale, or other disposition of the donated property, including, for example, the terms of any agreement or understanding that:
   a. Temporarily or permanently restricts a donee's right to use or dispose of the donated property,
   b. Earmarks donated property for a particular use, or
   c. Reserves to, or confers upon, anyone (other than a donee organization or an organization participating with a donee organization in cooperative fundraising) any right to the income from the donated property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having the income, possession, or right to acquire the property,
5. The name, address, and taxpayer identification number of the qualified appraiser and, if the appraiser is a partner, an employee, or an independent contractor engaged by a person other than the donor, the name, address, and taxpayer identification number of the partnership or the person who employs or engages the appraiser,
6. The qualifications of the qualified appraiser who signs the appraisal, including the appraiser's background, experience, education, and any membership in professional appraisal associations,
7. A statement that the appraisal was prepared for income tax purposes,
8. The date (or dates) on which the property was valued,
9. The appraised FMV on the date (or expected date) of contribution,
10. The method of valuation used to determine FMV, such as the income approach, the comparable sales or market data approach, or the replacement cost less depreciation approach, and
11. The specific basis for the valuation, such as any specific comparable sales transaction.

Art objects. The following are examples of information that should be included in a description of donated property. These examples are for art objects. A similar detailed breakdown should be given for other property. Appraisals of art objects—paintings in particular—should include all of the following.

1. A complete description of the object, indicating the:
   a. Size,
   b. Subject matter,
   c. Medium,
   d. Name of the artist (or culture), and
   e. Approximate date created.
2. The cost, date, and manner of acquisition.
3. A history of the item, including proof of authenticity.
4. A professional quality image of the object.
5. The facts on which the appraisal was based, such as:
   a. Sales or analyses of similar works by the artist, particularly on or around the valuation date.
   b. Quoted prices in dealer's catalogs of the artist's works or works of other artists of comparable stature.
   c. A record of any exhibitions at which the specific art object had been displayed.
   d. The economic state of the art market at the time of valuation, particularly with respect to the specific property.
   e. The standing of the artist in his profession and in the particular school or time period.

Number of qualified appraisals. A separate qualified appraisal is required for each item of property that is not included in a group of similar items of property. You need only one qualified appraisal for a group of similar items of property contributed in the same tax year, but you may get separate appraisals for each item. A qualified appraisal for a group of similar items must provide all of the required information for each item of similar property. The appraiser, however, may provide a group description for selected items the total value of which is not more than $100.

Qualified appraiser. A qualified appraiser is an individual who meets all the following requirements.

1. The individual either:
   a. Has earned an appraisal designation from a recognized professional appraiser organization for demonstrated competency in valuing the type of property being appraised, or
   b. Has met certain minimum education and experience requirements. For real property, the appraiser must be licensed or certified for the type of property being appraised in the state in which the property is located. For property other than real property, the appraiser must have successfully completed college or professional-level coursework relevant to the property being valued, must have at least 2 years of experience in the trade or business of buying, selling, or valuing the type of property being valued, and must fully describe in the appraisal his or her qualifying education and experience.
2. The individual regularly prepares appraisals for which he or she is paid.
3. The individual demonstrates verifiable education and experience in valuing the type of property being appraised. To do this, the appraiser can make a declaration in the

appraisal that, because of his or her background, experience, education, and membership in professional associations, he or she is qualified to make appraisals of the type of property being valued.

4. The individual has not been prohibited from practicing before the IRS under section 330(c) of title 31 of the United States Code at any time during the 3-year period ending on the date of the appraisal.
5. The individual is not an excluded individual.

In addition, the appraiser must complete Form 8283, Section B, Part III. More than one appraiser may appraise the property, provided that each complies with the requirements, including signing the qualified appraisal and Form 8283, Section B, Part III.

Excluded individuals. The following persons cannot be qualified appraisers with respect to particular property.

1. The donor of the property, or the taxpayer who claims the deduction.
2. The donee of the property.
3. A party to the transaction in which the donor acquired the property being appraised, unless the property is donated within 2 months of the date of acquisition and its appraised value is not more than its acquisition price. This applies to the person who sold, exchanged, or gave the property to the donor, or any person who acted as an agent for the transferor or donor in the transaction.
4. Any person employed by any of the above persons. For example, if the donor acquired a painting from an art dealer, neither the dealer nor persons employed by the dealer can be qualified appraisers for that painting.
5. Any person related under section 267(b) of the Internal Revenue Code to any of the above persons or married to a person related under section 267(b) to any of the above persons.
6. An appraiser who appraises regularly for a person in (1), (2), or (3), and who does not perform a majority of his or her appraisals made during his or her tax year for other persons.

In addition, a person is not a qualified appraiser for a particular donation if the donor had knowledge of facts that would cause a reasonable person to expect the appraiser to falsely overstate the value of the donated property. For example, if the donor and the appraiser make an agreement concerning the amount at which the property will be valued, and the donor knows that amount is more than the FMV of the property, the appraiser is not a qualified appraiser for the donation.

Appraiser penalties. An appraiser who prepares an incorrect appraisal may have to pay a penalty if:

1. The appraiser knows or should have known the appraisal would be used in connection with a return or claim for refund, and
2. The appraisal results in the 20% or 40% penalty for a valuation misstatement described later under *Penalty*.

The penalty imposed on the appraiser is the smaller of:

1. The greater of:
   a. 10% of the underpayment due to the misstatement, or
   b. $1,000, or
2. 125% of the gross income received for the appraisal.

In addition, any appraiser who falsely or fraudulently overstates the value of property described in a qualified appraisal of a Form 8283 that the appraiser has signed may be subject to a civil penalty for aiding and abetting as understatement of tax liability, and may have his or her appraisal disregarded.

Form 8283

Generally, if the claimed deduction for an item of donated property is more than $5,000, you must attach Form 8283 to your tax return and complete Section B.

If you do not attach Form 8283 to your return and complete Section B, the deduction will not be allowed unless your failure was due to reasonable cause, and not willful neglect, or was due to a good faith omission. If the IRS requests that you submit the form because you did not attach it to your return, you must comply within 90 days of the request or the deduction will be disallowed.

You must attach a separate Form 8283 for each item of contributed property that is not part of a group of similar items. If you contribute similar items of property to the same donee organization, you need attach only one Form 8283 for those items. If you contribute similar items of property to more than one donee organization, you must attach a separate form for each donee.

Internal Revenue Service Review of Appraisals

In reviewing an income tax return, the Service may accept the claimed value of the donated property, based on information or appraisals sent with the return, or may make its own determination of FMV. In either case, the Service may:

- Contact the taxpayer to get more information,
- Refer the valuation problem to a Service appraiser or valuation specialist,
- Refer the issue to the Commissioner's Art Advisory Panel (a group of dealers and museum directors who review and recommend acceptance or adjustment of taxpayers' claimed values for major paintings, sculptures, decorative arts, and antiques), or
- Contract with an independent dealer, scholar, or appraiser to appraise the property when the objects require appraisers of highly specialized experience and knowledge.

Responsibility of the Service. The Service is responsible for reviewing appraisals, but it is not responsible for making them. Supporting the FMV listed on your return is your responsibility.

The Service does not accept appraisals without question. Nor does the Service recognize any particular appraiser or organization of appraisers.

Timing of Service action. The Service generally does not approve valuations or appraisals before the actual filing of the tax return to which the appraisal applies. In addition, the Service generally does not issue advance rulings approving or disapproving such appraisals.

Exception. For a request submitted as described earlier under *Art valued at $50,000 or more*, the Service will issue a Statement of Value that can be relied on by the donor of the item of art.

Penalty

You may be liable for a penalty if you overstate the value or adjusted basis of donated property.

20% penalty. The penalty is 20% of the underpayment of tax related to the overstatement if:

- The value or adjusted basis claimed on the return is 200% (150% for returns filed after August 17, 2006) or more of the correct amount, and
- You underpaid your tax by more than $5,000 because of the overstatement.

40% penalty. The penalty is 40%, rather than 20%, if:

- The value or adjusted basis claimed on the return is 400% (200% for returns filed after August 17, 2006) or more of the correct amount, and
- You underpaid your tax by more than $5,000 because of the overstatement.

A FINANCIAL EVALUATION OF HOW TO COMPLY WITH THE WAGE & HOUR DEPARTMENT'S NEW OVERTIME RULE

By: Kaitlin A. Brown

I. EXEMPT EMPLOYEES: BEFORE AND AFTER THE NEW RULE

A. The Fair Labor Standards Act ("FLSA") establishes standards for minimum wage and requires that non-exempt employees be paid overtime compensation at a rate not less than one and one-half times the regular rate for any hours worked over 40 in a workweek (seven consecutive 24-hour periods). Exempt employees are not entitled to payment for overtime.

B. To be appropriately classified as an exempt employee, *certain salary requirements and job duties must be satisfied.*

1. Salary Requirement: Both of the following criteria must be met, unless an exception applies:

   a. Salary Basis Test: Employee must receive each pay period on a weekly, or less frequent basis, a predetermined amount constituting all or part of the employee's compensation, which amount is not subject to reduction because of variations in the quality or quantity of work performed. *See* 29 CFR § 541.602(a).

      i. Exceptions to the salary basis requirement include administrative, professional, computer, and highly compensated employees, who may meet the fee basis test. Employees are paid on a fee basis if paid an agreed upon sum for a single job regardless of the time required for its completion. Usually the job is a unique one, rather than a series of jobs repeated indefinitely, for which the employee is paid on an identical basis over and over again. Payments made based on the number of hours or days worked are not considered payments on a fee basis. 29 CFR § 541.500(c).

ii. Outside sales employees are not required to meet the salary or fee basis test. 29 CFR § 541.605(a).

b. Salary Level Test: The amount of the salary paid must meet a minimum amount, exclusive of board, lodging or other facilities. *See* 29 CFR § 541.600(a). This minimum level is currently $455 per week or $23,660 per year (last updated in 2004). **The New Overtime Rule modifies this salary level requirement, effective December 1, 2016, by: (i) increasing the minimum salary level to $913 per week or $47,476 per year; (ii) permitting employers to satisfy up to 10% of the minimum salary level amount through nondiscretionary bonuses, incentives, and commissions that are paid quarterly or more frequently; and (iii) permitting employers to make one final payment, no later than the next pay period after the end of the quarter, to achieve the required salary level if by the last pay period of the quarter the sum of the employee's weekly salary plus the nondiscretionary bonuses, incentives, and commissions does not equal 13 times the weekly minimum salary level. New 29 CFR § 541.602(a)(3). The new minimum salary level will increase every three years, beginning on January 1, 2020.** *See*

Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales, and Computer Employees, May 23, 2016 ("New Overtime Rule").

i. For employees who have the option of being paid on a fee basis, the minimum level is met if the fee equals $455 or more per week (or, as of December 1, 2016, equals $913 or more per week) when converted into a weekly rate based on working 40 hours (conversion is made by dividing the fee by the total number of hours worked to complete the job; and then multiplying that number by 40). 29 CFR § 541.605(b). Example: An artist who is paid $250 for a painting that took 20 hours to complete meets the current fee basis level requirement because the earnings divided by the hours worked equals $12.50/hr and that rate times 40 hours equals $500 per week. This artist would not meet the new requirement of $913 per week effective December 1, 2016.

ii. Outside sales employees are not required to meet the salary level test. 29 CFR § 541.605(a).

2. Job Duties: In addition to the salary requirement, certain duties must be performed to be exempt under FLSA Section 13(a)(1). The general rules for exempt duties include:

a. Executive: Employees (i) whose primary duty is management in the enterprise in which the employee is employed or of a customarily recognized department or subdivision thereof, (ii) who customarily and regularly directs the work of two or more other employees, and (iii) who has the authority to hire or fire other employees or whose suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees are given particular weight. 29 CFR § 541.100(a)(2–4). Executive employees must meet the salary level by being paid on a salary basis, not a fee basis. 29 CFR § 541.100(a)(1).

b. <u>Administrative:</u> Employees (i) whose primary duty is the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers; and (ii) whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance. 29 CFR § 541.200(a)(2–3). Administrative employees must meet the salary level by being paid either on a salary or fee basis. 29 CFR § 541.200(a)(1).

c. <u>Professional:</u> Employees whose primary duty is the performance of work (i) requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction or (ii) requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor. 29 CFR § 541.300(a)(2). Professional employees must meet the salary level by being paid either on a salary or fee basis. 29 CFR § 541.300(a)(1). Some professionals (*e.g.*, teachers, doctors and lawyers practicing in the area they are licensed or certified to practice) are not required to meet the minimum salary or fee level. 29 CFR § 541.600(e).

d. <u>Computer:</u> Employees in the computer field who have primary job duties such as (i) the application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specification, (ii) the design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications, (iii) the design, documentation, testing, creation or modification of computer programs related to machine operating systems, or (iv) a combination of the aforementioned duties, the performance of which requires the same level of skills. 29 CFR § 541.400(b)(1–4). Computer employees may meet the salary level by being paid on either a salary or fee basis; alternatively, they may be paid on an hourly basis at a rate of at least $27.63 per hour. 29 CFR § 541.400(b). Job titles are not determinative, but examples of positions that may be considered exempt include computer systems analysts, computer programmers, database administrators, and software engineers. 29 CFR § 541.400(a).

e. <u>Outside Sales:</u> Employees (i) whose primary duty is (1) making sales within the meaning of section 3(k) of the FLSA [making "sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition"], or (2) obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and (ii) who is customarily and regularly engaged away from the employer's place or places of business in performing such primary duty. 29 CFR § 541.500(a)(1–2). Salary requirements (basis and level) are not required. 29 CFR § 541.500(c).

f. Highly Compensated Employee: Employee who (i) earns a total compensation (including commissions, nondiscretionary bonuses and other nondiscretionary compensation; not including payments for board, lodging, facilities, medical insurance, life insurance, contributions to retirement plans, or cost of other fringe benefits) of at least $100,000* per year that includes payment of at least $455 per week **($913 per week after December 1, 2016)** on a salary or fee basis and (ii) customarily and regularly performs any one or more of the exempt duties or responsibilities of an executive, administrative, or professional employee. 29 CFR § 541.601(a), (b)(1), and (c). If the employee does not meet the threshold by the last pay period of the 52-week period, then the employer may, within one month after the end of the 52-week period, make a payment of at least $10,000** toward the prior year's total annual compensation. 29 CFR § 541.601(b)(2). It applies to employees performing office or non-manual work. 29 CFR § 541.601(d).

***The New Overtime Rule increases the highly compensated employee threshold to $134,004.**

**** The New Overtime Rule increases the annual catch up payment to at least $24,004.**

g. When evaluating "primary duty" consider whether the exempt duties are the principal, main, major, or most important duty that the employee performs (*e.g.,* consider the relative importance of the exempt duties as compared with other types of duties; the amount of time spent performing exempt work; the employee's relative freedom from direct supervision; and the relationship between the employee's salary and the wages paid to other employees for the kind of nonexempt work performed by the employee). 29 CFR § 541.700(a).

C. *Summary of how the New Overtime Rule modifies the exemption requirements under the FLSA, as of December 1, 2016:*

1. Increases the minimum amount required to meet the salary level test.

2. Permits up to ten percent of the minimum salary level to be satisfied by the payment of nondiscretionary bonuses, incentives, and commissions.

3. Permits quarterly catch-up payments to meet the minimum salary level required to maintain the exemption.

4. Increases the threshold and minimum catch-up payment for the highly compensated employees.

5. No change to the job duties tests.

II. IDENTIFY EMPLOYER GOALS AND EVALUATE EMPLOYEES AFFECTED

A. Identify the employer's goals. Possible goals include:

1. Maintain current employees with the same overall compensation package (*e.g.*, weekly earnings of salary converted directly into hourly; maintain bonus system).

2. Maintain current employees with different compensation package (*e.g.,* to avoid additional overtime owed due to increase in hourly rate upon payment of nondiscretionary periodic bonus; to improve employee morale).

3. Avoid paying overtime, monitoring overtime, and enforcing overtime policy (*e.g.,* restructuring workforce by increasing the number of employees and lowering the number of hours that each employee is expected to work).

4. Avoid liability for claims of disparate treatment by being sensitive to how employees are reclassified (*e.g.,* do not increase salaries for only one protected class).

B. Evaluate the employees impacted by the rule (currently exempt employees earning salaries between $23,660 and $47,475).

1. Do these employees work overtime?

2 Are these employees on the cusp of the minimum salary level?

3. If there are multiple employees working significant overtime, would it be in the employer's best interest to limit each employee's schedule to work 40 hours per week and hire additional staff, to avoid paying overtime?

4. Will these employees resist the transition to a non-exempt classification, which will require them to account for all time worked by either reporting their time worked in writing or punching in and out on a time clock?

5. Do these employees receive bonuses? Are the bonuses discretionary or nondiscretionary?

C. Understand the impact of a bonus on exempt and non-exempt employees.

1. <u>Discretionary bonus:</u> Incentive compensation in which the employer retains discretion as to both the fact that a payment will be made and the amount of the payment until at or near the point in time that the payment is to be made.

   a. <u>Exempt employees:</u> Discretionary bonuses may not be counted toward the minimum salary level requirement.

   b. <u>Non-exempt employees:</u> Discretionary bonuses are excluded from a non-exempt employee's regular rate of pay.

2. <u>Nondiscretionary bonus:</u> Any incentive compensation that does not meet the criteria for discretionary bonus (*e.g.*, employer promises to pay a bonus; contractual right to receive particular type of payment).

   a. <u>Exempt employees:</u> The current rule is that nondiscretionary bonuses may not be counted toward the minimum salary level requirement. After December 1, 2016, however, employers may use nondiscretionary bonuses, incentive payments, and commissions that are paid at least on a quarterly basis to satisfy up to ten percent of the minimum salary level requirement.

b. Non-exempt employees: Nondiscretionary periodic bonuses must be included in the regular rate of pay and additional overtime must be paid as a result of the increase in an employee's regular rate of pay.

3. Percentage bonus: Incentive compensation based on a contractual agreement made prior to the performance of services that provides for the payment of additional compensation at a certain percentage of the employee's straight-time and overtime earnings.

a. Percentage bonuses are nondiscretionary because they require a contractual agreement. As such, they affect exempt and non-exempt employees in the same way as a nondiscretionary bonus.

4. Catch-up Payment: After December 1, 2016, if the employee does not earn enough in nondiscretionary bonuses and incentive payments, employers may issue a catch-up payment by the first pay period after the quarter to meet or exceed 13 times the minimum weekly salary of $913.

III. OPTIONS AND CALCULATIONS FOR RECLASSIFYING EMPLOYEES AS EXEMPT OR NON-EXEMPT

A. Maintain the exemption by increasing salary to meet or exceed the new salary level threshold.

1. Requirements to maintain exemption:

a. Continue to pay employee predetermined amount of compensation each pay period on a weekly or less frequent basis, which cannot be reduced because of variations in quality or quantity of work performed.

b. Increase the employee's salary to $47,476 with weekly payments of at least $913; or increase the salary to at least $42,728.40 with weekly payments of at least $821.70 and provide a nondiscretionary bonus of at least $1,186.90 per quarter to make up the remaining ten percent ($91.30) per week necessary to meet the minimum salary level. If the employee does not earn the nondiscretionary bonus in at least this minimum amount, then employer may maintain the exemption by issuing a final catch-up payment making up the difference by the next pay period after the end of the quarter.

c. Make sure the employee continues to perform exempt job duties.

2. <u>Pros:</u> Avoid paying overtime, monitoring overtime, and enforcing overtime policy.

3. <u>Cons:</u> More expensive by guaranteeing additional salary on a salary basis, which requires payment regardless of the quality or quantity of work performed.

4. This option is best for employees who are already earning a salary close to the $47,476 salary level threshold, whom the employer expects to work overtime, and whom can be trusted to work the hours expected.

5. If maintaining an employee's exemption by increasing salary is not a practical option (*e.g.*, because the salary is not near the salary level threshold), employers will need to convert the employee to non-exempt classification (and pay overtime). If

the employee regularly works many hours of overtime, the employer may wish to consider hiring more employees to avoid overtime.

B. Reclassify presently exempt employees as non-exempt.

1. Convert salary to hourly rate, without nondiscretionary periodic bonus.

a. <u>Calculation for converting salary to hourly rate:</u>

i. Determine the number of hours worked per week.

ii. Determine the total number of units earned per week: multiply any hours 40 or less by 1 because paid at regular rate; multiply any hours over 40 by 1.5 because paid at overtime rate of one and one half times the regular rate; add the regular and overtime units of pay together to determine the total number of units of pay earned per week.

iii. Divide the current salary by 52 weeks; then divide that amount by the total number of units of pay earned per week. This will result in the appropriate hourly rate to pay the employee the same as his/her current salary, assuming the employee works the number of hours expected.

b. <u>Pros:</u> Maintain same overall compensation, assuming that employee works the number of hours expected. Avoid headache of calculating increases in regular rate and overtime owed, on account of nondiscretionary periodic bonuses.

c. <u>Cons:</u> Must enforce overtime policies and control overtime worked.

2. Convert salary to hourly rate and maintain the same nondiscretionary periodic bonus.

   a. Use same formula discussed in III(B)(1)(a) to convert the salary to an hourly rate. <u>Calculation for paying overtime based on maintaining a nondiscretionary periodic bonus:</u>

      i. Divide the nondiscretionary periodic bonus amount by the number of weeks in the period (weekly increase). For each week in which overtime was worked, divide the weekly increase by the number of hours worked in that week (hourly rate increase). Multiply the hourly rate increase by .5 and then multiply by the number of overtime hours worked to determine the additional overtime owed as a result of the nondiscretionary periodic bonus.

      ii. If employee receives a nondiscretionary periodic bonus in the form of a commission and the number of hours worked each week fluctuates significantly during the period, then the overtime is calculated by: dividing the total commission by the total number of hours worked in the period during which the commission was paid (hourly rate increase); and multiplying the hourly increase times .5 and then by the number of overtime hours worked in the period.

b. <u>Pros:</u> Improves employees' morale (if they work overtime) because they are paid slightly more for overtime worked.

c. <u>Cons:</u> Results in paying employees more in overall compensation because paying the same bonus amount <u>plus</u> overtime owed based on bonus amount. Must control overtime worked and enforce overtime policy. A headache to calculate increases in regular rate and overtime owed as a result.

d. This option is best for employees who presently have a nondiscretionary periodic bonus and who may be resistant to the conversion to non-exempt status.

3. Convert salary to hourly rate and reduce nondiscretionary periodic bonus, so that the reduced nondiscretionary periodic bonus plus the overtime owed as a result of that bonus equals the amount paid previously.

   a. <u>Calculation for reducing nondiscretionary bonus:</u>

      i. Divide the total number of hours worked per week by the total units of pay earned per week to determine what percentage of the original bonus should be paid as the reduced bonus amount.

      ii. Multiply the percentage times the original nondiscretionary periodic bonus amount. This will be your new reduced nondiscretionary periodic bonus. The remainder should be made up as additional overtime owed, assuming that the employee works the overtime expected.

iii. Upon each payment of a nondiscretionary periodic bonus, calculate and pay the additional overtime owed as a result (see calculation in III(B)(2)(a)).

b. <u>Pros:</u> Maintain same overall compensation, assuming that employee works the number of hours expected.

c. <u>Cons:</u> Need to control overtime worked and enforce overtime policy. A headache to calculate increases in regular rate and overtime owed as a result.

d. This option is best for employees who presently have a nondiscretionary periodic bonus and will not be disgruntled as a result of the conversion to non-exempt status.

4. Convert salary to hourly rate and provide a percentage bonus system that results in compensation equivalent to current compensation package

a. <u>Calculation for establishing a percentage bonus:</u>

i. Divide the total bonus previously earned divided by the total prior compensation (salary plus bonus).

ii. Multiply the total earnings in the period (regular and overtime) by the percentage previously agreed upon in the contractual agreement.

b. <u>Pros:</u> Eliminate the headache of calculating weekly increases in hourly rates and related overtime owed. Paying employee same as previously paid, assuming that employee is works the same number of expected hours.

c. Cons: To pay an employee on a percentage bonus requires a contract made prior to the performance of services that provides for the payment of additional compensation in the way of a bonus at a certain percentage of the employee's straight-time and overtime earnings. Need to control overtime worked.

5. In addition to any of the above options for converting an employee to non-exempt, the employer may choose to guarantee a certain number of hours paid per week, so the employee has the security, similar to a salary.

   a. If employer guarantees a certain number of hours paid per week, it must still pay for any hours worked in excess of the guaranteed amount along with any overtime for hours worked over 40.

6. Employer may also choose to add a discretionary bonus without affecting regular rate or overtime owed to a non-exempt employee.

IV. FINAL THOUGHTS

A. Determine the appropriate classification of employees.

B. Revise job descriptions to reflect the appropriate duties and classifications for each employee.

C. Evaluate the benefit of adjusting salaries to maintain exempt status.

D. Evaluate the impact of converting currently exempt employees to hourly non-exempt employees entitled to overtime.

E. Evaluate the benefits and drawbacks of offering a bonus (discretionary, nondiscretionary periodic, or percentage).

F. Restructure to efficiently staff based on company needs.

ROUNDUP OF RECENT TAX DEVELOPMENTS

By: William E. Sigler

Table of Contents

I. FEDERAL

A. 2016 Inflation Adjustments.

1. Kiddie tax. For purposes of determining whether a child's unearned income is taxed at the parent's tax rate under Code Sec. 1(g), the amount by which the child's net unearned income remains the same for 2016 at $1,050. The child's income can be reported on the parent's return if the child's gross income is more than $1,050, and less than $10,500. The exemption amount for purposes of the alternative minimum tax cannot exceed the sum of the child's earned income for the tax year, plus $7,400.

2. Adoption credit. The adoption credit is $13,460. The credit begins to phase out for taxpayers with modified adjusted gross income in excess of $201,920 and is completely phased out for taxpayers with modified adjusted gross income of $241,920 or more. The amounts of adoption assistance that can be excluded from an employee's gross income is also $13,460, with the same phaseout as the adoption credit.

3. Child Tax Credit. The value used to determine the amount of child tax credit under Code Sec. 24 that may be refundable is $3,000.

4. Education tax credits. The Hope Scholarship Credit under Code Sec. 25A(b)(1), as increased under Code Sec. 25A(i) (the American Opportunity Tax Credit), is 100 percent of qualified tuition and related expenses of up to $2,000, plus 25 percent of excess expenses not above $4,000. Thus, the maximum Hope Scholarship Credit allowable is $2,500. A taxpayer's modified adjusted gross income (MAGI) above $80,000 ($160,000 for a joint return) is used to determine the reduction under Code Sec. 25A(d)(2) in the amount of Hope Scholarship Credit otherwise allowable. A taxpayer's MAGI above $55,000 ($111,000 for a joint return) is used to determine the reduction under Code Sec. 25A(d)(2) in the amount of Lifetime Learning Credit otherwise allowable.

5. Earned Income Tax Credit. In 2016, the maximum EITC is $6,269 for taxpayers with three or more qualifying children, $5,572 for taxpayers with two qualifying children, $3,373 for taxpayers with one qualifying child, and $506 for taxpayers with no qualifying children. The credit amount begins to phase out at an income level of $18,190 ($8,270 for taxpayers with no qualifying children). The credit is not allowed if the aggregate amount of certain investment income exceeds $3,400.

6. Refundable Credit for Coverage Under a Qualified Health Plan. For taxable years beginning in 2016, the limitation on tax imposed under Code Sec. 36B(f)(2)(B) for excess advance credit payments is determined as follows: If household income (expressed as a percent of the poverty line) is less than 200 percent, the limitation amount for unmarried individuals is $300. The limit for married individuals, surviving spouses and head of household is $600. If household

income is 200 percent but less than 300 percent, the limit for unmarried individuals is $750 and for all other taxpayers is $1,500. If household income is 300 percent but less than 400 percent, the limit for unmarried individuals is $1,275 and for all other taxpayers it is $2,550.

7. Low-Income Housing Credit. The amount used to calculate the 2016 state housing credit ceiling for the low-income housing credit under Code Sec. 42(h)(3)(C)(ii) is the greater of $2.35 multiplied by the state population or $2,690,000.

8. Employee health insurance expense of small employers. For calendar year 2016, the dollar amount in effect under Code Sec. 45R(d)(3)(B) is $25,900.

9. Alternative Minimum Tax. The AMT exemption amounts are: $53,900 (single, head-of-household), $41,900 (married filing separately), $83,800 (married filing jointly, surviving spouses) and $23,900 (estates, trusts). The exemption amounts phase out when AMTI exceeds $159,700 (married filing jointly, surviving spouses), $119,700 (single, head-of-household), $79,850 (married filing separately, estates and trusts).

10. Standard deduction. The standard deduction amounts under Code Sec. 63(c)(2) for 2016 are $12,600 (married filing jointly, surviving spouses), $9,300 (head of household), and $6,300 (unmarried and married filing separately). The standard deduction that can be claimed as a dependent by another taxpayer cannot exceed the greater of $1,050 or the sum of $350 plus the individual's earned income. The additional standard deduction amount for the aged or blind is $1,250 ($1,550 if the individual is also unmarried and not a surviving spouse).

11. Limitation on itemized deductions. For 2016, the applicable amounts under Code Sec. 68(b) are $311,300 (married filing jointly, surviving spouses), $285,350 (head of household), $259,400 (unmarried and not a surviving spouse or head of household) and $155,650 (married filing separately).

12. Cafeteria plans. The dollar limitation under Code Sec. 125(i) on voluntary employee salary reductions for contributions to health flexible spending arrangements is $2,550.

13. Transportation fringe benefit. The monthly limitation under Code Sec. 132(f)(2)(A) regarding the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass is $130. The monthly limitation under Code Sec. 132(f)(2)(B) regarding the fringe benefit exclusion for qualified parking is $255.

14. Savings bond education exclusion. The exclusion under Code Sec. 135 for taxpayers who pay qualified higher education expenses begins to phase out for modified adjusted gross income (MAGI) above $116,300 for joint

returns and $77,550 for other returns. The exclusion phases out completely at MAGI levels of $146,300 for joint returns and $92,550 for other returns.

15. Private activity bonds volume cap. The calendar-year 2016 amounts used under Code Sec. 146(d)(1) to calculate the state ceiling for the volume cap for private activity bonds is the greater of (1) $100 multiplied by the state population, or (2) $302,875,000.

16. Personal exemption. The personal exemption is $4,050. The personal exemption phaseout begins when AGI exceeds $259,400 (single), $285,350 (head-of-household), $311,300 (married filing jointly and surviving spouses) and $155,650 (married filing separately). Personal exemptions completely phase out at $381,900 (single), $407,850 (head-of-household), $433,800 (married filing jointly) and $216,900 (married filing separately).

17. Long-term care premiums. The limitations under Code Sec. 213(d)(10) regarding eligible long-term care premiums includible in the term "medical care" are $390 (attained age of 40 or less before close of tax year), $730 (41-50), $1,460 (51-60), $3,900 (61-70) and $4,870 (over 70).

18. Medical savings accounts. For tax years beginning in 2016, the term "high deductible health plan" as defined in Code Sec. 220(c)(2)(A) means, for self-only coverage, a health plan that has an annual deductible that is not less than $2,250 and not more than $3,350, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $4,450. For family coverage, the term means a health plan that has an annual deductible that is not less than $4,450 and not more than $6,700, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $8,150.

19. Interest on education loans. The $2,500 maximum deduction for interest paid on qualified education loans under Code Sec. 221 begins to phase out for taxpayers with modified adjusted gross income in excess of $65,000 ($130,000 for joint returns), and is completely phased out for taxpayers with modified adjusted gross income of $80,000 or more ($160,000 or more for joint returns).

20. Low-cost article. For purposes of defining the term "unrelated trade or business" for certain exempt organizations under Code Sec. 513(h)(2), "low cost articles" are those costing $10.60 or less.

21. Foreign earned income exclusion. The foreign earned income exclusion amount under Code Sec. 911(b)(2)(D)(i) is $101,300.

22. Property exempt from levy. The value of property exempt from levy under Code Sec. 6334(a)(2) (fuel, provisions, furniture, other household personal effects, arms for personal use, livestock and poultry) cannot exceed $9,120. The value of property exempt from levy under Code Sec. 6334(a)(3) (books

and tools necessary for the trade, business or profession of the taxpayer) cannot exceed $4,560.

23. Attorney fee award. For fees incurred in calendar year 2016, the attorney fee award limitation under Code Sec. 7430(c)(1)(B)(iii) is $200 per hour.

24. Periodic payments received under certain contracts. The 2016 dollar amount of the per diem limitation under Code Sec. 7702B(d)(4), regarding periodic payments received under either a qualified long-term care insurance contract or a life insurance contract that are treated as paid by reason of the death of a chronically ill individual, is $340.

B. Federal Tax Lien Superior to Homeowner Association's Lien. A U.S. district court in Arizona has held that a company that purchased property sold as a result of the foreclosure of a homeowner association's lien wasn't entitled to quiet title to the property or damages from the IRS for the IRS's refusal to release a federal tax lien, finding that the federal tax lien was superior to the homeowner association's lien. *Neighborhood Improvement Projects LLC v. United States et al.*; No. 2:15-cv-00523.

C. How to Calculate Overassessment Interest. In TAM 201548019, the IRS determined how to calculate interest that accrues on an overassessment attributable to various adjustments to taxable income from previous years. The taxpayer filed a federal income tax return and paid the taxes due but later filed a tentative refund claim based on the carryback of a net operating loss. The IRS issued a tentative refund, paid within 45 days of the taxpayer's request, so no overpayment interest was required under section 6611(e)(2). In subsequent examinations, the IRS disallowed most of the NOL carryback and assessed an underpayment, but on the same day it made a general adjustment that decreased the tax due on the taxpayer's original return, resulting in an overpayment. The amount of the overpayment from the general adjustment decrease was more than the underpayment resulting from the disallowed NOL carryback. The IRS allowed interest on a portion of the overpayment that was equal to the underpayment from the filing and payment due date for the original return to the due date for the loss year return. It also allowed interest on the remaining amount from the filing and payment due date for the original return to the date of the tentative refund. The taxpayer argued that interest on the portion of the overpayment equal to the underpayment should also be allowable to the date on which the IRS issued the tentative refund. The IRS concluded that when an "overpayment was extinguished by an underpayment due to an excessive tentative carryback allowance, interest is allowable on the overpayment from the date the overpayment arose . . . to the due date of the loss year return."

D. New Partnership Audit Rules. On November 2, 2015, President Obama signed the Bipartisan Budget Act of 2015 (the "BBA") into law, effecting significant changes to the rules governing audits of entities treated as partnerships for U.S. federal income tax purposes.

1. Current Audit Regimes. Currently there are three different partnership audit regimes.

a. Most commonly, the "TEFRA" rules provide unified audit procedures that determine the tax treatment of all "partnership items" at the partnership level, after which the IRS may assess each audited-year partner individually based on such partner's share of any such adjustment. The TEFRA rules also include procedures for notice to and participation by partners.

b. A partnership with more than 100 partners can elect application of a simplified set of audit rules (the "electing large partnership" rules) under which partnership-level adjustments generally also flow through to partners, but to those partners who are partners in the year the adjustment takes effect (not, as under the TEFRA rules, in the earlier audited year).

c. For certain small partnerships not subject to the foregoing, adjustments to partnership items of income, gain, loss, deduction or credit are determined in separate proceedings for each partner under generally applicable audit procedures.

2. Repeal and Replacement of TEFRA and Electing Large Partnership Rules. Effective for tax years beginning after December 31, 2017, the BBA repeals both the TEFRA and electing large partnership rules and replaces them with a new partnership audit regime applicable to all partnerships. A narrowly defined category of small partnerships is eligible to elect out of the provisions for a given taxable year, with the result that any adjustments to such a partnership's items can be made only at the partner level. This election may be made only by partnerships with 100 or fewer partners, each of which is an individual, a C corporation, an S corporation1 or an estate of a deceased partner. Thus, for example, any partnership having another partnership as a partner is not eligible to elect out of the new audit regime.

a. Many practitioners presumed that having a disregarded entity (DRE) as a partner could not by itself disqualify a partnership from opting out of the new partnership audit rules, but the Joint Committee on Taxation's blue book released March 14, 2016, seems to interpret the statute as providing otherwise.

b. According to an example on page 60 of the JCT's technical explanations for all tax legislation enacted in 2015 (JCS-1-16), if a partnership has a single-member DRE owned by a corporation as one of its partners, the IRS may -- by regulation or other guidance -- provide "that the partnership can make the election if the partnership includes . . . a disclosure of the name and taxpayer identification number of each of the disregarded entity and the corporation that is its sole member, and each of them is taken into account as if each were a statement recipient in determining whether the 100-or-fewer statements criterion is met."

c. The JCT's position may have its origin in at least two authorities:

i. Section 6231(a)(1)(B) states that the TEFRA partnership audit rules generally don't apply to partnerships "having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner." The language in the new section 6221(b) opt-out is very similar, though the threshold of 10 was raised to 100, with a focus on statement recipients rather than partners.

ii. Rev. Rul. 2004-88 concluded that the section 6231(a)(1)(B) TEFRA small partnership exception doesn't apply to a partnership that has a DRE as a partner, reasoning that the DRE is considered a "passthrough partner" as defined in the TEFRA regulations. The ruling states that "although the regulations under [reg. sections] 301.7701-1 through 301.7701-3 provide that a disregarded entity is disregarded for all federal tax purposes, these regulations do not alter state law, which determines a partner's status as a general partner."

d. It is hoped that the IRS will exercise its discretion and allow for look-through with DREs.

3. Partnership-Level Audit Determinations under the BBA. Under the new rules, any adjustment to items of partnership income, gain, loss, deduction or credit, and any partner's distributive share thereof, are determined at the partnership level. Thus, the BBA in general does not make distinctions (of critical importance under the TEFRA rules) among partnership items, non-partnership items and items affected by partnership items.

4. Default Rule: Partnership-Level Tax at Maximum Statutory Rate. The new rules provide partnerships flexibility in determining how (and against whom) audit adjustment-related tax is calculated and ultimately assessed. Notably, specific factual circumstances such as the various partners' tax profiles or changes in partner interests between the audited year and a subsequent adjustment could significantly impact both the total amount of tax collected and the portion that various partners (whether current or former) bear. As a default, the "imputed underpayment" – the tax deficiency arising from a partnership-level adjustment with respect to an audited partnership tax year – is calculated using the maximum statutory income tax rate and is assessed against and collected from the partnership in the year that such audit (or any judicial review) is completed. In addition, the partnership is directly liable for any related penalties and interest, calculated as if the partnership had been originally liable for the tax in the audited year. These default rules are subject to two primary exceptions:

a. *Potential Reduction in Partnership Liability*. A partnership's imputed underpayment may be reduced to the extent partners voluntarily file amended tax returns and pay any tax due for the audited year, or if the partnership demonstrates that partnership items are allocable to partners either not subject to tax (in the case of a tax-exempt entity) or taxed at reduced corporate or capital gain rates. Treasury is delegated with implementing procedures to take into account these and other partner-specific reductions, but the scope of any additional reductions is unknown (including the extent to which a partner's non-U.S. status will be a permitted basis to apply reduced tax rates, and whether partners filing amended returns must pay any associated interest and penalties). Based on the legislation itself, most partner-specific characteristics (such as the existence of net operating losses) would not reduce the imputed underpayment. Nor does the legislation contemplate how the IRS would adjust partnership items otherwise determined solely with respect to individual partners (such as percentage depletion or partner-specific basis adjustments).

b. *Partnership Elects to Shift Liability to Partners*. Alternatively, partnership-level assessment may generally be avoided altogether if the partnership elects to issue adjusted information returns to each of the audited-year partners and the IRS, with such partners taking any adjustment into account on their individual returns in the year in which they receive the adjusted information return. Under this alternative, the audited-year partners (rather than the partnership) are liable for any related penalties and interest, but with deficiency interest calculated at an increased rate and running from the audited year.

5. Procedural Changes. The BBA also effects significant changes to procedural aspects of partnership audits:

a. *"Partnership Representative" granted considerable power*. The "tax matters partner" role under prior law is replaced with an expanded "partnership representative" role. The partnership representative is not required to be a partner, has sole authority to act on behalf of the partnership in an audit proceeding, and binds both the partnership and the partners with its actions in the audit.

b. *Partner rights significantly curtailed*. The IRS is no longer required to notify partners of partnership audit proceedings or adjustments, and partners are bound by determinations made at the partnership level. Partners no longer have rights to participate in partnership audits or related judicial proceedings, nor standing to bring a judicial action if the partnership representative does not challenge an assessment.

c. *Partnership deposit required*. Partnerships challenging an assessment in a District Court or the Court of Federal Claims are required to deposit the entire amount of the partnership's imputed liability (in contrast to existing rules that only require a deposit of the petitioning partner's liability).

d. *Single statute of limitations*. The statute of limitations for adjustments will be calculated solely with reference to the date the partnership filed its return.

6. Effective Date. The BBA's new partnership audit regime applies for partnership taxable years beginning after December 31, 2017.

E. Protecting Americans from Tax Hikes Act of 2015 (Select Provisions).

1. Permanent Extensions.

a. Families and Individuals.

Enhanced child tax credit made permanent. The child tax credit (CTC) is a $1,000 credit. To the extent the CTC exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula). Until 2009, the threshold dollar amount was $10,000 indexed for inflation from 2001 (which would be roughly $14,000 in 2015). Since 2009, however, this threshold amount has been set at an unindexed $3,000 and is scheduled to expire at the end of 2017, returning to the $10,000 (indexed for inflation) amount. The provision permanently sets the threshold amount at an unindexed $3,000.

Enhanced American opportunity tax credit made permanent. The Hope Scholarship Credit is a credit of $1,800 (indexed for inflation) for various tuition and related expenses for the first two years of post-secondary education. It phases out for AGI starting at $48,000 (if single) and $96,000 (if married filing jointly) – these amounts are also indexed for inflation. The American Opportunity Tax Credit (AOTC) takes those permanent provisions of the Hope Scholarship Credit and increases the credit to $2,500 for four years of post-secondary education, and increases the beginning of the phase-out amounts to $80,000 (single) and $160,000 (married filing jointly) for 2009 to 2017. The provision makes the AOTC permanent.

Enhanced earned income tax credit made permanent. Low- and moderate-income workers may be eligible for the earned income tax credit (EITC). For 2009 through 2017, the EITC amount has been temporarily increased for those with three (or more) children and the EITC marriage penalty has been reduced by increasing the income phase-out range by $5,000 (indexed for inflation) for those who are married and filing jointly. The provision makes these provisions permanent.

Extension and modification of deduction for certain expenses of elementary and secondary school teachers. The provision permanently extends the above-the-line deduction (capped at $250) for the eligible expenses of elementary and secondary school teachers. Beginning in 2016, the provision also modifies the deduction to index the $250 cap to inflation and include professional development expenses.

Extension of parity for exclusion from income for employer-provided mass transit and parking benefits. The provision permanently extends the maximum monthly exclusion amount for transit passes and van pool benefits so that these transportation benefits match the exclusion for qualified parking benefits. These fringe benefits are excluded from an employee's wages for payroll tax purposes and from gross income for income tax purposes.

Extension of deduction of State and local general sales taxes. The provision permanently extends the option to claim an itemized deduction for State and local general sales taxes in lieu of an itemized deduction for State and local income taxes. The taxpayer may either deduct the actual amount of sales tax paid in the tax year, or alternatively, deduct an amount prescribed by the Internal Revenue Service (IRS).

b. Charitable Giving.

Extension of tax-free distributions from individual retirement plans for charitable purposes. The provision permanently extends the ability of individuals at least 70½ years of age to exclude from gross income qualified charitable distributions from Individual Retirement Accounts (IRAs). The exclusion may not exceed $100,000 per taxpayer in any tax year.

Extension and modification of charitable deduction for contributions of food inventory. The provision permanently extends the enhanced deduction for charitable contributions of inventory of apparently wholesome food for non-corporate business taxpayers. The provision modifies the deduction beginning in 2016 by increasing the limitation on deductible contributions of food inventory from 10 percent to 15 percent of the taxpayer's AGI (15 percent of taxable income (as modified by the provision) in the case of a C corporation) per year. The provision also modifies the deduction to provide special rules for valuing food inventory.

Extension of basis adjustment to stock of S corporations making charitable contributions of property. The provision permanently extends the rule providing that a shareholder's basis in the stock of an S corporation is reduced by the shareholder's pro rata share of the adjusted basis of property contributed by the S corporation for charitable purposes.

c. Business.

Extension and modification of research credit. The provision permanently extends the research and development (R&D) tax credit. Additionally, beginning in 2016 eligible small businesses ($50 million or less in gross receipts) may claim the credit against alternative minimum tax (AMT) liability, and the credit can be utilized by certain small businesses against the employer's payroll tax (i.e., FICA) liability.

Extension and modification of employer wage credit for employees who are active duty members of the uniformed services. The provision permanently extends the 20-percent employer wage credit for employees called to active military duty. Beginning in 2016, the provision modifies the credit to apply to employers of any size, rather than employers with 50 or fewer employees, as under current law.

Extension of 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements. The provision permanently extends the 15-year recovery period for qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property.

Extension and modification of increased expensing limitations and treatment of certain real property as section 179 property. The provision permanently extends the small business expensing limitation and phase-out amounts in effect from 2010 to 2014 ($500,000 and $2 million, respectively). These amounts currently are $25,000 and $200,000, respectively. The special rules that allow expensing for computer software and qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property) also are permanently extended. The provision modifies the expensing limitation by indexing both the $500,000 and $2 million limits for inflation beginning in 2016 and by treating air conditioning and heating units placed in service in tax years beginning after 2015 as eligible for expensing. The provision further modifies the expensing limitation with respect to qualified real property by eliminating the $250,000 cap beginning in 2016.

Extension of exclusion of 100 percent of gain on certain small business stock. The provision extends the temporary exclusion of 100 percent of the gain on certain small business stock for non-corporate taxpayers to stock acquired and held for more than five years. This provision also permanently extends the rule that eliminates such gain as an AMT preference item.

Extension of reduction in S-corporation recognition period for built-in gains tax. The provision permanently extends the rule reducing to five years (rather than ten years) the period for which an S corporation must hold its assets following conversion from a C corporation to avoid the tax on built-in gains.

2. <u>Extensions through 2019</u>.

Extension of new markets tax credit. The provision authorizes the allocation of $3.5 billion of new markets tax credits for each year from 2015 through 2019.

Extension and modification of work opportunity tax credit. The provision extends through 2019 the work opportunity tax credit. The provision also modifies the credit beginning in 2016 to apply to employers who hire qualified long-term unemployed individuals (i.e., those who have been unemployed for 27 weeks or more) and increases the credit with respect to such long-term unemployed individuals to 40 percent of the first $6,000 of wages.

Extension and modification of bonus depreciation. The provision extends bonus depreciation for property acquired and placed in service during 2015 through 2019 (with an additional year for certain property with a longer production period). The bonus depreciation percentage is 50 percent for property placed in service during 2015, 2016 and 2017 and phases down, with 40 percent in 2018, and 30 percent in 2019. The provision continues to allow taxpayers to elect to accelerate the use of AMT credits in lieu of bonus depreciation under special rules for property placed in service during 2015. The provision modifies the AMT rules beginning in 2016 by increasing the amount of unused AMT credits that may be claimed in lieu of bonus depreciation. The provision also modifies bonus depreciation to include qualified improvement property and to permit certain trees, vines, and plants bearing fruit or nuts to be eligible for bonus depreciation when planted or grafted, rather than when placed in service.

3. Extensions through 2016.

Extension and modification of exclusion from gross income of discharge of qualified principal residence indebtedness. The provision extends through 2016 the exclusion from gross income of a discharge of qualified principal residence indebtedness. The provision also modifies the exclusion to apply to qualified principal residence indebtedness that is discharged in 2017, if the discharge is pursuant to a written agreement entered into in 2016.

Extension of mortgage insurance premiums treated as qualified residence interest. The provision extends through 2016 the treatment of qualified mortgage insurance premiums as interest for purposes of the mortgage interest deduction. This deduction phases out ratably for a taxpayer with AGI of $100,000 to $110,000.

Extension of above-the-line deduction for qualified tuition and related expenses. The provision extends through 2016 the above-the-line deduction for qualified tuition and related expenses for higher education. The deduction is capped at $4,000 for an individual whose AGI does not exceed $65,000 ($130,000 for joint filers) or $2,000 for an individual whose AGI does not exceed $80,000 ($160,000 for joint filers).

Extension and modification of empowerment zone tax incentives. The provision extends through 2016 the tax benefits for certain businesses and employers operating in empowerment zones. Empowerment zones are economically distressed areas, and the tax benefits available include tax-exempt bonds, employment credits, increased expensing, and gain exclusion from the sale of certain small-business stock. The provision modifies the incentive beginning in 2016 by allowing employees to meet the enterprise zone facility bond employment requirement if they are residents of the empowerment zone, an enterprise community, or a qualified low-income community within an applicable nominating jurisdiction.

Extension and modification of credit for nonbusiness energy property. The provision extends through 2016 the credit for purchases of nonbusiness energy property. The provision allows a credit of 10 percent of the amount paid or incurred by the taxpayer for qualified energy improvements, up to $500.

Extension of credit for energy-efficient new homes. The provision extends through 2016 the tax credit for manufacturers of energy-efficient residential homes. An eligible contractor may claim a tax credit of $1,000 or $2,000 for the construction or manufacture of a new energy efficient home that meets qualifying criteria.

Extension of energy efficient commercial buildings deduction. The provision extends through 2016 the above-the-line deduction for energy efficiency improvements to lighting, heating, cooling, ventilation, and hot water systems of commercial buildings.

Extension of credit for new qualified fuel cell motor vehicles. The provision extends through 2016 the credit for purchases of new qualified fuel cell motor vehicles. The provision allows a credit of between $4,000 and $40,000 depending on the weight of the vehicle for the purchase of such vehicles.

4. Family Tax Relief.

Exclusion for amounts received under the Work Colleges Program. The provision exempts from gross income any payments from certain work-learning-service programs that are operated by a work college as defined in section 448(e) of the Higher Education Act of 1965. The provision is effective for amounts received in tax years beginning after date of enactment.

Improvements to section 529 accounts. The provision expands the definition of qualified higher education expenses for which tax-preferred distributions from 529 accounts are eligible to include computer equipment and technology. The provision modifies 529-account rules to treat any distribution from a 529 account as coming only from that account, even if the individual making the distribution operates more than one account. The provision treats a refund of tuition paid with amounts distributed from a 529 account as a qualified expense if such amounts are re-contributed to a 529 account within 60 days. The provision is effective for distributions made or refunds after 2014, or in the case of refunds after 2014 and before the date of enactment, for refunds re-contributed not later than 60 days after date of enactment.

Elimination of residency requirement for qualified ABLE programs. The provision allows ABLE accounts (tax-preferred savings accounts for disabled individuals), which currently may be located only in the State of residence of the beneficiary, to be established in any State. This will allow individuals setting up ABLE accounts to choose the State program that best fits their needs, such as with regard to investment options, fees, and account limits. The provision is effective for tax years beginning after December 31, 2014.

Rollovers permitted from other retirement plans into simple retirement accounts. The provision allows a taxpayer to roll over amounts from an employer-sponsored retirement plan (e.g., 401(k) plan) to a SIMPLE IRA, provided the plan has existed for at least two years. The provision applies to contributions made after the date of enactment.

Church Plan Clarification. The provision prevents the IRS from aggregating certain church plans together for purposes of the non-discrimination rules, which prevent highly compensated participants from receiving disproportionate benefits under the plan, and it provides flexibility for church plans to decide which other church plans with which they associate. The provision also prevents certain grandfathered church defined-benefit plans from having to meet certain requirements relating to maximum benefit accruals, and it allows church plans to offer auto-enroll accounts similar to 401(k)s. Additionally, the provision make it easier for church plans to engage in certain reorganizations and allows church plans to invest in collective trusts. The provision generally is effective on or after the date of enactment.

5. Revenue Provisions.

Updated ASHRAE standards for energy efficient commercial buildings deduction. The provision modifies the deduction for energy efficient commercial buildings by updating the energy efficiency standards to reflect new standards of the American Society of Heating, Refrigerating, and Air Conditioning Engineers beginning in 2016.

Clarification of valuation rule for early termination of certain charitable remainder unitrusts. The provision clarifies the valuation method for the early termination of certain charitable remainder unitrusts. The provision is effective for the termination of trusts after the date of enactment.

Prevention of transfer of certain losses from tax indifferent parties. The provision modifies the related-party loss rules, which generally disallow a deduction for a loss on the sale or exchange of property to certain related parties or controlled partnerships, to prevent losses from being shifted from a tax-indifferent party (e.g., a foreign person not subject to U.S. tax) to another party in whose hands any gain or loss with respect to the property would be subject to U.S. tax. The provision generally is effective for sales and exchanges of property acquired after 2015.

6. Tax Administration.

Release of information regarding the status of certain investigations. The provision allows taxpayers who have been victimized by the IRS, for example, through the unauthorized disclosure of private tax information, to find out basic facts, such as whether the case is being investigated or whether the case has been referred to the Justice Department for prosecution. The provision applies to disclosures made on or after the date of enactment.

Administrative appeal relating to adverse determinations of tax-exempt status of certain organizations. The provision requires the IRS to create procedures under which a 501(c) organization facing an adverse determination may request administrative appeal to the IRS Office of Appeals. This includes determinations relating to the initial or continuing classification of (1) an organization as tax-exempt under section 501(a); (2) an organization under section 170(c)(2); (3) a private foundation under section 509(a); or (4) a private operating foundation under section 4942(j)(3). The provision applies to determinations made after May 19, 2014.

Extend Internal Revenue Service authority to require truncated Social Security numbers on Form W-2. The provision requires employers to include an "identifying number" for each employee, rather than an employee's SSN, on Form W-2. This change will permit the Department of the Treasury to promulgate regulations requiring or permitting a truncated SSN on Form W-2. The provision is effective on the date of enactment.

Clarification of enrolled agent credentials. The provision permits enrolled agents approved by the IRS to use the designation "enrolled agent," "EA," or "E.A." The provision is effective on the date of enactment.

F. Taxation of Identity Protection Services. On December 30, 2015 the IRS released Announcement 2016-02 extending tax relief for identity protection services provided prior to the detection of a data breach. Notice 2016-02 is an extension of the relief provided in Announcement 2015-22 for identity protection services provided after the discovery of a data breach.

G. Identity Protection PIN letters. The IP PIN listed on the CP 01A Notice, dated January 4, 2016, sent out to many taxpayers is valid for use on all individual tax returns filed in 2016. The notice incorrectly indicates the IP PIN issued is to be used for filing the 2014 tax return when the number is actually to be used for the 2015 tax return. The IRS emphasizes that taxpayers and their tax professionals should use this PIN number for 2015 tax returns, which the IRS began accepting from taxpayers starting January 19, 2016.

H. Non-Guarantor Partner Isn't Allocated Basis for Partnership Debt. In legal memorandum ILM 201606027, the IRS concluded that a non-guarantor partner isn't allocated basis under section 752, and isn't at risk under section 465 for partnership debt that another partner guaranteed, due to provisions in the operating agreement about making additional capital contributions to the partnership. Some of the corporate subsidiaries of a partnership took out a loan to acquire and renovate two hotels -- an activity that the IRS concluded constitutes an "activity of holding real property" within the meaning of section 465(b)(6)(A). One of the three individuals who owned the partnership guaranteed the loan in the event that, among other things, one or more of the subsidiaries enters into bankruptcy or admits to insolvency. Some years later, one of the non-guarantor partners claimed a net operating loss deduction. The individual claimed that he is entitled to the deduction because the loss stemmed from the partnership's business activity funded by the loan, which qualifies as nonrecourse under section 465(b)(6), and that the other partner's guarantee should be disregarded because it's a contingent liability. The

IRS explained that the possible triggering conditions for the guarantee are "not so remote" as to cause the obligation to be considered "likely to never be discharged" and, therefore, don't fall within the definition of "contingencies" to disregard the guarantee under reg. section 1.752-2(b)(3). The IRS also disagreed with the taxpayer's interpretation of the partnership operating agreement, concluding that because the agreement doesn't require the non-guarantor partners to make additional capital contributions to the partnership, the non-guarantor partners are not "payors of last resort in a worst case scenario" and aren't at risk for the guaranteed debt for purposes of section 465.

I. Penalties Upheld Against Firm that Eliminated Income by Deducting Shareholder "Bonuses." In *Brinks Gilson & Lione PC*, TC Memo 2016-20, the Tax Court has upheld IRS's imposition of accuracy-related penalties against a law firm in respect to underpayments resulting from the firm's conceded mischaracterization of dividends that it paid to shareholder-attorneys as deductible compensation for services. The Court found that the law firm lacked substantial authority for its treatment of the payments and failed to establish reasonable cause for the underpayments and that it acted in good faith.

1. Facts. For the years in issue, consistent with past practice, the board set the yearly compensation to be paid to shareholder-attorneys. In general, the way that compensation was calculated and paid meant that the shareholder-attorneys would receive a percentage of their expected compensation over the course of the year, with an additional bonus paid at year-end that was intended to exhaust the firm's book income (i.e., reduce it to zero). The shareholder-attorneys are also entitled to dividends as declared by the board, but for at least 10 years before and including the years in issue, no dividends had been paid. The firm also had invested capital, measured by the book value of its shareholders' equity, of about $8 million at the end of 2007 and $9.3 million at the end of 2008. The law firm treated all amounts paid to the shareholder-attorneys as deductible employee compensation, including the year-end bonuses.

2. Decision. The Tax Court determined that owners of an enterprise with significant capital are entitled to a return on their investment, and that a corporation's consistent payment of salaries to shareholder-employees in amounts that leave insufficient funds available to provide an adequate return to the shareholders on their invested capital indicates that a portion of the "salaries" is in fact distributions of earnings (i.e., dividends). This practice of zeroing out a corporation's earnings clearly fails the "independent investor test", especially considering the firm's millions of dollars worth of invested capital-as investors in such a situation would expect a return on their investment.

J. IRS Finalizes Domestic Entity Reporting Regulations. The IRS on February 22, 2016. issued final regulations (T.D. 9752) implementing reporting rules for U.S. entities holding foreign financial assets, almost two years after they were left off a set of final regulations covering individuals. The regulations provide guidance to U.S. entities that may be required to report information to the IRS under section 6038D regarding their foreign financial assets. The updates include matching the passive income definition under section 6038D with those under the section 1472 withholding regulations and eliminating the principal purpose test for determining reporting.

K. Debt-Equity Reclassification.

1. Proposed Regulations. Treasury's proposed regulations (REG-108060-15) under Section 385 were released April 4, 2016. The regulations address six types of transactions that raise policy concerns, including that they possess little nontax significance and are to be treated as stock under the new rules, subject to exceptions. The proposed regulations basically include three sets of rules that would cause debt between related corporations to be treated instead as equity:

a. The Bifurcation Rule would generally permit the IRS not just to recharacterize debt of a corporation as stock of a corporation, but also to treat an interest in a corporation as in part stock and in part debt;

b. The Documentation Rule would impose extensive substantiation and documentation requirements on corporate groups that are publicly traded or whose total assets or revenues exceeded certain thresholds; and

c. The Distributions Rule would treat as stock certain debt that is distributed to or received by another group member or exchanged for stock or assets in another group member, or that is treated as "funding" a distribution covered by the "funding rule".

2. Final and Temporary Regulations. The IRS subsequently issued final and temporary regulations (T.D 9790) under Section 385. Effective October 21, 2016, the final regulations adopt portions of proposed regulations (REG-108060-15) issued in April 2016. Portions of the proposed regulations that were substantially revised based on comments are being issued as temporary regulations, which serve as the text of concurrently issued proposed regulations (REG-130314-16). Also, T.D 9790 reserves on the application of specified portions of the April 2016 proposed regulations pending further study. The final regulations respond to certain criticisms of the proposed regulations. In particular, the final regulations:

a. Omit the Bifurcation Rule;

b. Generally limit the Documentation Rule and Distributions Rule to domestic borrowers;

c. Generally exempt S corporations and non-controlled regulated investment companies (RICs) and real estate investment trusts (REITs) from the new rules;

d. Clarify that a "snapshot" approach is taken when determining the status of a corporation as a member of an expanded group;

e. Relax the timing requirements set forth in the Documentation Rule and replace its "per se" characterization rule for failures to meet the documentation and substantiation requirements with a "rebuttable presumption" recharacterization rule;

f. Alter the treatment under the Documentation Rule of an "expanded group instrument" issued by certain disregarded entities and partnerships, treating the recharacterized expanded group instrument as stock in the "regarded" corporate owner of the disregarded entity or a partnership interest;

g. Provide exemptions from the Distributions Rule for cash pooling and other short-term loans and generally for regulated financial entities, financial groups, and insurance entities; and

h. Make substantial modifications to the Distributions Rule by expanding the exception for distributions of earnings and profits, exempting the first US$50 million of debt (i.e., not treating the $50 million threshold as a "cliff"), permitting netting of distributions and contributions in certain cases, and providing an exception for stock issued as equity compensation to employees, directors and independent contractors

L. Professional Employer Organizations. The IRS announced (IR-2016-74) the release of temporary and proposed regulations (T.D. 9768, REG-127561-15) implementing a voluntary certification program for professional employer organizations, which handle payroll administration and tax reporting responsibilities for business clients for a fee based on payroll costs. The temporary regulations apply on and after July 1, 2016, and expire on or before May 3, 2019. To become and remain certified under the program, PEOs must meet tax status, background, experience, business location, financial reporting, bonding, and other requirements described in the regulations. The application process opened July 1, 2016. The IRS will publish lists of certified PEOs and those whose certification has been revoked or suspended.

M. Get Transcript Online.

1. On June 7, 2016, the IRS announced general access to its Get Transcript Online tax record application, and access for previous users of the identity protection personal identification number (IP PIN), online payment agreement (OPA), and e-postcard services, all via its new multifactor e-authentication process. In addition to a Social Security number, Get Transcript Online's authentication process requires the following from a taxpayer:

a. Access to an email account to receive a confirmation code;

b. Name, birth date, mailing address, and filing status from the taxpayer's most recent tax return;

c. An account number from a credit card, auto loan, mortgage, home equity loan, or home equity line of credit; and

d. A mobile phone number with the taxpayer's name on the account.

2. Get Transcript by Mail will require only a taxpayer's SSN or individual taxpayer identification number, date of birth, and mailing address of record.

3. Landlines, Skype, Google Voice or similar virtual phones and phones with pay-as-you-go plans cannot be used to receive the second confirmation code required to complete authentication for Get Transcript Online.

4. Users who have completed the process once will have to provide a confirmation code sent to their phone each time they log back in as well as their user name and password.

5. Previous users with login credentials for the IP PIN, OPA, or Form 990-N, "Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or Form 990EZ," will now be required to provide a financial account number and mobile phone number, if they have not already done so, to access those functions online.

N. New Guidance on Tax-Free Spinoffs. On July 14, 2016, the U.S. Department of the Treasury and the Internal Revenue Service released proposed regulations addressing spinoffs involving significant nonbusiness assets or de minimis qualifying business assets (the so-called "hot dog stand" issue). The proposed regulations also provide additional guidance on the application of the "device" test. The guidance follows last year's IRS announcements in Notice 2015-59 and Revenue Procedure 2015-43 that it is studying these issues and would cease issuing private letter rulings on these issues pending further review. In general, the proposed regulations would restrict companies (including REITs) from effecting tax-free pro rata spinoffs involving significant nonbusiness assets. The proposed regulations would also require each of the spinning corporation (Parent) and spun off corporation (Spinco) to hold assets of a qualifying trade or business with a fair market value of at least five percent of its total assets. The proposed regulations are not yet effective and contain a generous transition rule for transactions that are in advanced stages prior to the publication of final regulations in the Federal Register. In addition, on July 15, 2016, the IRS issued additional spinoff guidance in the form of Revenue Procedure 2016-40.[3] This Revenue Procedure provides a two-year safe harbor for unwinding high-vote/low-vote structures commonly used in connection with spinoffs.

O. Shareholders Liable as Transferees for Corporate Taxes and Penalties. In *Thomas L. Weintraut et al. v. Commissioner*, T.C. Memo. 2016-142; Nos. 6505-12, 6715-12,6751-12, the Tax Court held that a dissolved corporation's shareholders are liable as transferees for the corporation's unpaid taxes and an accuracy-related penalty, finding that the shareholders, who engaged in a transaction with MidCoast Credit Corp., were transferees of the corporation's assets under section 6901 and under Indiana fraudulent transfer law. Tax Court Judge Carolyn P. Chiechi found that an opinion (Feldman v. Commissioner, 779 F.3d 448 (7th Cir. 2015)) by the Seventh Circuit, where an appeal would lie, provided strong support for concluding that the shareholders were transferees under section 6901, noting the similarity between the cases and the state fraudulent transfer laws. The court found that the shareholders were transferees under the substance over form, economic substance, and sham transaction doctrines for purposes of section 6901 and that they had constructive knowledge that the corporation's federal income tax liability for the tax year at issue would not be paid.

P. PATH Act Real Property Change. The Protecting Americans from Tax Hikes (PATH) Act, enacted in December 2015 as part of that year's extenders law (P.L. 114-113), increased withholding under the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) from 10 percent to 15 percent. An April 2015 Senate Finance Committee report explained the reasoning behind the withholding rate increase, saying there were concerns that some foreign taxpayers would underpay their taxes or fail to file returns, "if the current 10 percent withholding tax on gross sales proceeds is less than the amount of tax that would be due on the actual gain on the disposition." A Form 8288-A, "Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests," is filed for each such transaction.

Q. Partnership Disguised Sales.

1. The IRS has issued final regulations under Code Sec. 707 regarding disguised sales and the allocation of excess partnership nonrecourse liabilities to a partner under Code Sec. 752; temporary regulations concerning a partner's share of partnership liabilities for purposes of Code Sec. 707 and the treatment of certain payment obligations under Code Sec. 752; and proposed regulations addressing when certain obligations to restore a deficit balance in a partner's capital account are disregarded under Code Sec. 704 and when a partnership's liabilities are treated as recourse liabilities under Code Sec. 752 (T.D. 9787, T.D. 9788, NPRM REG-122855-15). The final and temporary regulations are effective on October 4, 2016. The proposed regulations provided in NPRM REG-119305-11 (2014 proposed regulations) are withdrawn in part.

2. The Temporary Regulations effectively treat all partnership liabilities (with limited exceptions) as nonrecourse liabilities for disguised sale purposes. This change significantly limits a contributing partner's ability to be allocated a disproportionate share of a partnership's debt, thereby limiting the opportunity for such partner to receive tax-free cash distributions from a partnership

related to a contribution of appreciated property. The Final Regulations also expand several exceptions to the disguised sale rules and clarify many aspects of the disguised sale rules where there had previously been uncertainty.

3. In addition, the new regulations affect the allocation of partnership liabilities outside of the disguised sale context. In particular, (i) the Temporary and New Proposed Regulations do not recognize "non-commercial" guarantees and similar arrangements (including so-called "bottom-dollar" guarantees), and (ii) the New Proposed Regulations would add and expand an anti-abuse rule that would limit when a partner's guarantee of a partnership's liability would be respected for purposes of treating such liability as recourse to the partner.

II. MICHIGAN

A. City of Detroit income tax returns and withholding for partnerships, trusts and estates. Partnerships, trusts and estates must file their annual city income tax returns with the City of Detroit for tax year 2015 or fiscal year ending in 2015. Businesses must file their withholding for 2016 with the City of Detroit. The State of Michigan will collect income tax from partnerships and trusts and estates beginning January 1, 2017. (City of Detroit Business Income Tax FAQs—Announcements, 01/01/2016.)

B. Michigan Personal Property Tax Exemptions.

1. Background. In 2012, legislation was enacted that, subject to voter approval, revised Mich. Comp. Laws Ann. § 211.9m and Mich. Comp. Laws. Ann. § 211.9n to provide for the future personal property tax exemption of what is termed "Eligible Manufacturing Personal Property." In 2014, Michigan voters approved Proposal 1, which activated the previously-enacted exemption for Eligible Manufacturing Personal Property (EMPP), effective January 1, 2016.

2. Exemption. As of December 31, 2015, the General Property Tax Act provides an exemption from tax for qualified new personal property and qualified previously existing personal property that constitutes eligible manufacturing personal property (EMPP).

a. EMPP is defined as "...all personal property located on occupied real property if that personal property is predominantly (greater than 50 percent) used in industrial processing or direct integrated support."

b. Qualified New Personal Property is defined as:

i. Property that was initially placed in service in this state or outside of the state after Dec. 31, 2012, or

ii. Property that was construction in progress on or after Dec. 31, 2012 that had not been placed in service in this state or outside of this state before 2013 and is eligible manufacturing personal property.

c. Qualified Previously Existing Personal Property is defined as personal property that was first placed in service within this state or outside of this state more than 10 years before the current calendar year and is eligible manufacturing personal property. (Note that personal property tax will still be assessed on EMPP that was first placed in service in 2006 through 2012.)

3. Amount of Exemption.

a. All qualified new personal property initially placed in service after 2012 is exempt from property tax beginning in 2016.

b. "Qualified previously existing personal property" is not exempt immediately, but is instead subject to a phased-in exemption:

PROPERTY PURCHASED BY FIRST OWNER IN	100% EXEMPTION GOES INTO EFFECT IN
Pre-2006	2016
2006	2017
2007	2018
2008	2019
2009	2020
2010	2021
2011	2022

4. Essential Services Assessment. While EMPP may be exempt from "property tax", exempt EMPP will now be subject to the Essential Services Assessment (ESA). The ESA is a specific assessment that replaces the personal property tax that helps reimburse lost revenue to local units.

a. The tax base is the fair market value of EMPP at the time of acquisition. For property acquired 1-5 years before the tax year, the tax rate will be 2.4 mills. Property acquired 6-10 years before the tax year will be levied 1.25 mills. Property acquired more than 10 years before the tax year will be levied 0.9 mills.

b. Taxpayers are required to submit electronically to the Treasury Department a completed statement and full payment by August 15. For an eligible claimant's first assessment year, the penalty will be waived if the statement and full payment are submitted by September 15. If the assessment is not paid, Treasury will send a notice by October 15 and impose up to a 15 percent penalty.

c. For any assessment year in which an eligible claimant does not submit payment in full and any penalty due by October 15, the State Tax Commission (STC) will issue an order to rescind no later than the first Monday in December for the assessment year. The eligible claimant must file with the assessor of the township or city within 30 days of the date of the STC order to rescind a personal property statement, for all property for which the exemption has been rescinded under this section. Within 60 days of an order of rescission by the STC, the treasurer of the local tax collecting unit shall issue amended tax bills for any taxes, including penalty and interest, that were not billed under the general property tax act and that are owed as a result of the order of rescission.

d. An eligible claimant may appeal a rescission to the STC by filing a petition not later than December 31 in that tax year. In the case of an audit, an eligible claimant may appeal a rescission by filing a petition with the STC within 30 days of the date of that assessment's issuance. Any eligible claimant may appeal the determination of the STC to the Michigan Tax Tribunal within 35 days of the date of the determination.

e. An eligible claimant may appeal an assessment levied or a penalty to the STC by filing a petition not later than December 31 in that tax year. In the case of an audit, an eligible claimant may appeal an assessment issued, including penalties or interest, by filing a petition with the STC within 30 days of the date of that assessment's issuance. Any eligible claimant may appeal the determination of the State Tax Commission to the Michigan Tax Tribunal within 35 days of the date of the determination.

f. For taxpayers making a minimum of $25 million in additional EMPP investment, the Michigan Strategic Fund Board may provide a 50 percent or 100 percent exemption from the ESA for the new investment.

5. What to Do. One of three options exists for all businesses that have personal property:

a. If the true cash value of the personal property held in a taxing jurisdiction is less than $80,000 at December 31, 2015, file Form 5076 by February 10, 2016, to claim an exemption from personal property tax;

b. If you are a manufacturer and hold EMPP, file Form 5278 by February 20, 2016 (extended until Tuesday, May 31, 2016, for 2016 only). You will then be assessed property tax on the non-exempt EMPP and assessed the ESA on the exempt EMPP; or

c. If you are a non-manufacturer, file Form 632 (Personal Property Statement) by February 20, 2016.

C. Michigan ABLE Savings Program Established. L. 2015, H4542 (P.A. 160), effective 10/28/2015, enacts the Michigan Achieving a Better Life Experience (ABLE) Program Act. The Act establishes the Michigan ABLE savings program in the Department of Treasury, which allows an individual to open an ABLE savings account to pay the qualified disability expenses of a designated beneficiary.

1. Each account can have only one designated beneficiary, and only one account can be opened for any one designated beneficiary.

2. Cumulative contributions to an ABLE Account may not exceed the amount of the annual gift tax exclusion in a given year.

3. The maximum account balance limit for an ABLE account cannot exceed the maximum amount allowed for an education savings account pursuant to § 10 of the Michigan Education Savings Program Act.

4. Contributions to, and interest earned on, an ABLE savings account are exempt from taxation, and withdrawals used to pay for "qualified disability expenses" will not be counted as income to the beneficiary.

5. Contributions, earnings, and distributions for qualified disability expenses are disregarded in a determination of eligibility to receive, or the amount of, any assistance program offered by Michigan that required consideration of the financial circumstances of an individual, for any period during which the individual maintains, contributes to, or receives distributions from an ABLE savings account.

6. ABLE savings accounts may technically be established beginning January 1, 2016. However, the Michigan Department of Treasury's Student Financial Services Bureau entered into an agreement with TSA Consulting Group for the management, administration and investment services for MiABLE much later than that. They are currently building the infrastructure for this program and expect to begin enrolling customers by November 1, 2016.

D. New Procedure for Identity Verification to Combat Identity Theft. The Michigan Department of Treasury has announced that will be using a new procedure for taxpayers to verify their identity in order to combat identity theft. (Michigan Treasury Update, Vol. 1, Issue 1, 11/01/2015.)

1. <u>Current identity verification process</u>. Each year the Department, through its discovery division, selects tens of thousands of returns for verification due to potential tax-related identity theft. The Department will always begin the identity verification process by sending a Letter of Inquiry. A return envelope with the return address "PO Box 30771" will be included. The Department will not initiate any requests for information via email, telephone, text, or fax, and will only follow up with taxpayers by telephone or other means after having sent the initial Letter of Inquiry. A taxpayer who has filed a Form MI-1040 (Individual Income Tax Return) may receive a letter requesting a copy of their picture ID, copies of W2s, 1099s, K1s, and other documents. These documents are needed by the Department to

confirm a taxpayer's identity. The Department will not use a Social Security number in any letter that it sends, and the Department will not ask a taxpayer to provide a copy of their Social Security card via U.S. mail. After successful authentication of a taxpayer's identity, the Department will begin processing that taxpayer's tax return. If a taxpayer did not file a return and receives a Letter of Inquiry, this means that a Michigan tax return was filed using that taxpayer's name and address. The Department cannot confirm that a taxpayer's identity was stolen, but will provide concerned taxpayers with information regarding how to take precautions and what steps to take in order to file a return.

2. <u>MILogin</u>. In the coming months, the Department will begin asking taxpayers who have been selected for identity verification to use MILogin. This is a Michigan-wide service that will also be used by other departments in the future. In order to use MILogin, taxpayers will be asked to first create an account, and then enter certain information found on the Department's Letter of Inquiry, as well as information from the taxpayer's tax return. Taxpayers will then be asked to enter their name and the last four digits of their Social Security number. This information will not be stored on the website. Taxpayers will then need to correctly answer four or five questions that pertain only to them. These questions are similar to the questions that are asked in order to obtain a free credit report. Once implemented, the MILogin service will help speed up the verification process, yet will require minimal effort from taxpayers. The implementation of the new system will allow tax refunds to get to the correct taxpayers more quickly.

E. Exception to Uncapping Taxable Value for Certain Life Estates. Public Act 243 of 2015, enacted on January 13, 2016, allows property that was subject to a life estate or life lease to be transferred to a relative after the life estate or life lease has expired or terminated without being considered a "transfer of ownership," thus preventing the taxable value of that property from being uncapped and re-established based on market value. This only applies to residential property not used for commercial purposes after the transfer. The transferee of the property can be the mother, father, brother, sister, son, daughter, adopted son, adopted daughter, grandson, or granddaughter of the transferor or transferor's spouse. Upon request by the Department of Treasury or the local assessor, the transferee must furnish proof within 30 days that the transferee meets the requirements specified above. A transferee who fails to comply with such a request is subject to a fine of $200.

F. Taxability of Cloud Computing Products. The Michigan Department of Treasury has issued a release announcing a change in its policy on the taxation of certain prewritten computer software delivered electronically in light of the Michigan Court of Appeals decision in *Auto-Owners Insurance Co. v. Department of Treasury*, Dkt. No. 321505, 10/27/2015 (*see,* Notice to Taxpayers Regarding Auto-Owners Insurance Co. v. Department of Treasury, 01/06/2016). As a result of this and other decisions, the Department has announced it will give these judicial decisions full retroactive effect, and announced procedures for taxpayers to claim refunds. At issue in *Auto-Owners* was whether certain products were subject to the imposition of use tax on prewritten computer software delivered in any manner under Mich. Comp. Laws Ann. § 205.92b(o). The Court of Appeals found in favor of the taxpayers. Essentially, the court found that there were two different categories of products at issue in the case. One category consisted of products that did not include the delivery of "code that enabled" the vendor's system to operate. The court found these products did not satisfy the requirement that prewritten computer software must be delivered, in any manner, because there was no proof that code was electronically delivered to the taxpayer, or that the taxpayer exercised any incidence of ownership over the vendor's code. The second category consisted of products where the court found that some prewritten computer software was electronically delivered to the taxpayers. The court found that the electronic delivery of a "local client" or "desktop agent" was sufficient to constitute an "ownership-type right" over the product. However, even though the court found that some software had been delivered, the court determined that under the "incidental to service" test under *Catalina Marketing Sales Corp. v. Department of Treasury*, 470 Mich 13, 678 NW2d 619 (2004), the software was merely incidental to the vendor's "rendering of professional services." Based on the foregoing, the Department, in accordance with *Auto-Owners* and consistent with a series of cases that require the Department to give judicial decisions full retroactive effect—even in the presence of contrary guidance issued by the Department prior to the date of the decision—indicates in the release that *Auto-Owners* will be applied to all open tax years. Consequently, those portions of Michigan Revenue Administrative Bulletin No. 1999-5, 09/28/1999 that suggest that access to software over the internet without also the delivery of either "the code that enables the program" to operate or a "desk top client" are inconsistent with *Auto-Owners* and no longer represent the Department's policy. If only a portion of a software program is electronically delivered to a customer, the "incidental to service" test will be applied to determine whether the transaction constitutes the rendition of a nontaxable service rather than the sale of tangible personal property. However, if a software program is electronically downloaded in its entirety, it will be taxable. A taxpayer seeking a refund of taxes paid for a product falling within the *Auto-Owners* opinion should file a written refund request with the Department within the statute of limitations. The request should include any necessary documentation to support the refund. If the refund is for a prior year, the taxpayer must include amended Annual Returns for the years involved with the refund request. It should be noted that if the tax was paid to a vendor, the taxpayer must request a refund from the vendor. All refund requests filed pursuant to *Auto-Owners* and this Notice must be sent to the following addresses: Department of Treasury, Attn: Technical Services, P.O. Box 30698, Lansing, MI 48909-8198.

G. Flow-Through Entity Withholding.

1. The governor has signed House Bill 5131 (L. 2016, P.A. 158) that eliminates the requirement for a pass-through entity to withhold State of Michigan income taxes on non-resident members or stockholders of the pass through entity.

2. Previously, Michigan law imposed several withholding requirements on flow-through entities. A flow-through entity with nonresident individual owners was required to withhold Michigan tax on the distributive share of Michigan income for each such owner. Additionally, every flow-through entity expecting more than $200,000 of Michigan business in the year were required to withhold Michigan tax on the distributive share of income for each owner that is a corporation or another flow-through entity. In the case of tiered flow-through entity structures, the withholding was required at each tier level. Effective for tax years beginning on or after July 1, 2016, those members or shareholders are expected to pay their estimated taxes directly to the state.

3. House Bill 5131 also includes a new requirement that any person required to deduct and withhold taxes for a tax year on income, other than distributive share of income from a flow-through entity, must furnish to the person who received the income a statement of the total income paid during the tax year and the amount deducted or withheld by January 31st of the next year.

3. Previously, "taxpayer" was defined as any person subject to taxes imposed by Part 1 of the Michigan Income Tax Act, any employer required to withhold taxes on salaries and wages, or any flow-through entity required to withhold taxes on a nonresident member's share of income available for distribution. The bill changes the definition of "taxpayer" to mean any person subject to the taxes imposed by Part 1 or subject to the withholding requirements under Part 3.

4. The Michigan Department of Treasury subsequently issued guidance that provides examples on how the repeal affects taxpayers with tax years that begin before or after July 1, 2016, and the filing of composite returns. (Notice: Repeal of Flow-Through Withholding on Members' Distributive Share of Income, 2016 PA 158, Mich. Dept. Treasury, 07/18/2016.)

a. Flow-through entities with a tax year beginning on June 1, 2016, and ending on May 31, 2017. In the case of a flow-through entity whose tax year begins on June 1, 2016, and ends on May 31, 2017, since the flow-through entity's tax year begins before July 1, 2016, the flow-through entity must file quarterly withholding on distributive share of income of nonresident members who are individuals and, if it has not received exemption certificates, from its members that are C corporations or other flow-through entities. Quarterly returns on form 4917 are due September 15, 2016, December 15, 2016, March 15, 2017 and June 15, 2017. An annual flow-through withholding reconciliation Form 4918 is due on July 31, 2017. The flow-through entity is not required to withhold on members' distributive share of income that is attributed to the tax year that begins on June 1, 2017.

b. Flow-through entities with a tax year beginning on August 1, 2016, and ending on July 31, 2017. In the case of a flow-through entity whose tax year begins on August 1, 2016, and ends on July 31, 2017, the flow-through entity is not required to withhold on members' distributive share of income that is attributed to the tax year that begins on August 1, 2017.

c. A flow-through entity may file a composite income tax return for nonresident members who are individuals. Flow-through entities are not required to file composite returns. For tax years that begin before July 1, 2016, the flow-through entity may claim a credit on the composite return for any flow-through withholding paid on behalf of its participating members. For tax years that begin on or after July 1, 2016, the flow-through entity may claim a credit on the composite return for any estimated tax payments made by the flow-through entity on behalf of its participating members. Quarterly estimated payments may be made on Fiduciary Voucher Form MI-1040ES.

5. The Michigan Department of Treasury issued additional guidance in Michigan Treasury Update, Vol. 1, Issue 4, Mich. Dept. of Treasury, 08/01/2016.

a. Under L. 2016, Public Act 158 (PA 158), flow-through withholding is no longer required for flow-through entities effective for tax years beginning after June 30, 2016. This means that a flow-through entity with a calendar tax year ending December 31, 2016, for example, that was required before PA 158 to withhold under Part 3 of the Income Tax Act must continue to withhold on behalf of its members for its full tax year. Withholding is no longer required for tax years after the calendar 2016 tax year. A flow-through entity with a tax year beginning July 1, 2016, and ending June 30, 2017, however, is not required to withhold for that tax year or any succeeding tax year. Flow-through entities in a tiered structure should withhold and apply the cut-off based on their own tax year.

b. If a taxpayer under the Corporate Income Tax (CIT) or the Individual Income Tax (IIT) has a distributive share of business income attributable to a flow-through entity's tax year beginning after June 30, 2016, that taxpayer will not have withholding from that flow-through entity to claim on its annual return. This should be considered by the CIT or IIT taxpayer when determining its quarterly estimated payments. Flow-through entities filing Form 807 (Composite Individual Income Tax Return) on behalf of nonresident individuals may now be required to file quarterly estimated payments, and should pay them using Form MI-1041ES (Fiduciary Voucher for Estimated Income Tax).

c. Regardless of the requirement to withhold, a flow-through entity must continue to report certain information to its members, because both individuals and CIT taxpayers require this information to complete their income tax returns. A flow-through entity may use any method to report the information to its members, but the Department recommends that the information be provided as a supplemental attachment to the member's federal Schedule K-1. The following information must be conveyed: (i) the FEIN of the flow-through entity; (ii) the tax year of the flow-through entity; (iii) the amount of flow-through withholding paid on behalf of that member, except for nonresident individual members that will participate in a Composite Individual Income Tax Return (Form 807), report instead the member's share of the tax paid by the flow-through entity on the composite return; (iv) for members subject to IIT, the member's distributive share of taxable income attributable to the flow-through entity, but for members subject to CIT, the member's distributive share of business income and the member's share of statutory additions and subtractions before apportionment, attributable to the flow-through entity; (v) the amount of the flow-through entity's sales that are sourced to Michigan; (vi) the flow-through entity's total sales; and (vii) for members that are corporations or other flow-through entities, the amount of the flow-through entity's gross receipts (members will report their proportionate share of allocated or apportioned gross receipts from flow-through entities on their CIT returns).

H. Principal Residence Exemption Extended to Military Members. L. 2016, S606 (P.A. 144), effective 06/07/2016, allows an individual to continue to claim a principal residence exemption if he or she is deployed or stationed elsewhere for active duty as a member of the U.S. Armed Forces if: (i) the owner continues to own that property while absent in active duty; (ii) the owner has not established a new principal residence; (iii) the owner maintains or provides for the maintenance of that property while absent in active duty; and (iv) except as otherwise provided in Mich. Comp. Laws Ann. § 211.7dd(c), the property is not used for any business or commercial purpose. The bill also allows a member of the Armed Forces who owns a principal residence while deployed or an individual who did not occupy his or her principal residence while residing in a nursing home or assisted living facility to file an appeal when an exemption was not on the tax roll.

I. Effect of Michigan Supreme Court Order in Apportionment Formula Case. Reversing a Michigan Court of Claims order which had granted the Treasury Department's motion for summary disposition against International Business Machines Corporation (IBM), the Michigan Court of Appeals held that the Court of Claims did not have the authority to examine the effect on these litigants of a 2014 law (L. 2014, P.A. 282) enacted after the Michigan Supreme Court's decision in International Business *Machines Corp. v. Dept. of Treasury*, 496 Mich 642 , 852 NW2d 865 (2014). In its IBM decision, the Supreme Court determined that IBM could apportion its business income tax base and modified gross receipts tax base under the Michigan Business Tax (MBT) using the 3-factor apportionment formula provided in the Multistate Tax Compact and was not required to use the sales-factor apportionment formula under the MBT when calculating its Michigan taxes for tax year 2008. L. 2014, P.A. 282 retroactively rescinded Michigan's membership in the Compact and prevented foreign corporations such as IBM from using the 3-factor apportionment formula that had been available under the Compact. Here, the Michigan Court of Appeals determined that the Court of Claims did not have any discretion or authority to rule in favor of the Department. The Supreme Court's IBM decision had specifically instructed the Court of Claims, on remand, to enter an order granting summary disposition in favor of IBM, and the Court of Claims had erred by ultimately failing to do so. The Court of Claims was simply ordered to perform the nondiscretionary, ministerial task of entering judgment in favor of IBM. Although the terminology "rule of mandate" has apparently not been used in Michigan caselaw, it quite plainly embodies the well-accepted principle in Michigan jurisprudence that a lower court must strictly comply with, and may not exceed the scope of, a remand order. Accordingly, the Michigan Court of Appeals reversed the Court of Claims order and remanded the case for entry of judgment in favor of IBM. *International Business Machines Corp. v. Dept. of Treasury*, Mich. Ct. App., Dkt. No. 327359, 07/21/2016.

J. Tax Tribunal Had Jurisdiction Over Valuation Case. The Tax Tribunal, and not the circuit court, had jurisdiction over the taxpayers' argument that township did not re-adjust the taxable value of the taxpayers' land to remove the unconstitutional basis for the increase in taxable value. Before building on their properties, the taxpayers constructed private roads and added water mains, sanitary sewers, storm sewers, and other utilities. Based on those improvements, and acting in reliance on Mich. Comp. Laws Ann. § 211.34d(1)(b)(viii), the township increased the taxable value of plaintiffs' properties. In 2006, a panel of this Court struck down the statute as unconstitutional in *Toll Northville, Ltd. v Northville Township*,272 Mich App 352, 726 NW2d 57 (2006). After the 2006 Toll Northville decision, the township did not re-adjust the taxable value of the taxpayers' land to remove the now-unconstitutional basis for the increase in taxable value. The taxpayers did not, however, contest the taxable value of their properties until 2013, when they sought relief from the township board of review. The board lowered each taxpayers' taxable value but only for the year 2013 and going forward. The taxpayers then appealed to the Tax Tribunal, which dismissed their appeals for the years 2006 through 2012 because the taxpayers had failed to seek relief for those years within the time frame provided by law. After the Tribunal denied their motion for reconsideration, the taxpayers filed the instant case in the circuit court, alleging that the township deprived them of due process by charging them taxes pursuant to an unconstitutional statute. The Michigan Court of Appeals found that the taxpayers were not challenging how the taxes were used or the constitutionality of the statute that authorized the assessments, which was declared unconstitutional in 2006. Rather, the taxpayers challenged the validity of the taxable value of their land and how it was calculated. That issue required a factual determination regarding the accuracy of the taxable values and the method of calculating them, which is solidly within the Tax Tribunal's area of expertise. Therefore the Tax Tribunal, and not the circuit court, has jurisdiction over the action, and the Tribunal issued its final ruling. The appeals court also rejected the taxpayers' argument that the Tax Tribunal did not have jurisdiction because they sought damages beyond reimbursement of their taxes because when proceeding under Mich. Comp. Laws Ann. § 205.731(a) , the Tribunal's jurisdiction is determined by the subject matter of the proceeding, not on the type of relief requested. *Johns Family Limited Partnership et al. v. Charter Township of Chesterfield et al.*, Mich., Ct. App., Dkt. No. 326649, 08/02/2016 (unpublished).

K. Application of Michigan Sales and Use Tax to Digital Products. The Michigan Department of Treasury notes that a digital product for sales and use tax purposes is a product that is accessed or obtained electronically. By statute, Michigan imposes tax on the sale or use of certain prewritten computer software products. However, there is no specific tax imposition on the sale or use of other types of digital products. Consequently, it is the Department's current position that the sale of digital goods such as e-books, podcasts, electronic music (such as that purchased through iTunes) and telephone ringtones are not taxable under Michigan law. This is true whether the goods are downloaded, streamed, or accessed through a subscription service. The following are some examples of taxable tangible personal property versus non-taxable digital goods: (i) recorded music produced and sold in the form of a vinyl LP, cassette tape, or compact disk is taxable tangible personal property while recorded music that is sold in an MP3 or other electronic format and is transferred electronically to the purchaser is considered a digital good and is not taxable in Michigan; (ii) a movie purchased in DVD form from a retailer is taxable tangible personal property, while a movie that is "streamed" over the Internet by the retailer to the purchaser (the purchaser watches the movie as it is being "streamed") is a digital good and therefore is not taxable in Michigan; and (iii) a book sold in hardcover or paperback form is taxable as a sale of tangible personal property, while the sale of the same book in any of the various e-book formats is the sale of a digital good and is not taxable in Michigan.While Michigan does not impose a tax on the sale of these types of digital goods, consumers should be aware that many other states do. Michigan Treasury Update, Volume 1, Issue 4, 08/01/2016.

L. **Transfer of Controlling Interest**. The Michigan Department of Treasury in reminding taxpayers that the transfer of a controlling interest in an entity that owns real property may trigger liability for the State Real Estate Transfer Tax (SRETT). Subject to certain exemptions, most transfers of real property in Michigan are subject to SRETT. Some are also subject to a county real estate transfer tax. The transfer tax burden is placed upon the seller or grantor of any interest in real property and is due at the time the deed, easement, assignment, or other instrument of conveyance is offered to the Register of Deeds for recording. The tax is levied at the rate of $3.75 for each $500 or fraction of $500 of the total value of real property transferred. One transaction subject to SRETT that taxpayers often overlook is the acquisition or transfer of a controlling interest in an entity that owns real property. "Controlling interest" means more than 80% of the total value of all classes of stock of a corporation; more than 80% of the total interest in capital and profits of a partnership, association, limited liability company, or other unincorporated form of doing business; or more than 80% of the beneficial interest in a trust. To trigger the tax, real property must comprise 90% or more of the fair market value of the entity's assets as determined under generally accepted accounting principles (GAAP). The SRETT exempts from tax a transfer of a controlling interest in an entity with an interest in real property if the transfer of the property would have otherwise qualified for exemption if the transfer was one that could have been accomplished by deed between the parties to the transfer. For example, a conveyance of real property from a parent to child is exempt from SRETT. Accordingly, the transfer from parent to child of a controlling interest in an entity holding 90% or more of its GAAP assets in real property is likewise exempt from SRETT. The purchase contract, transfer agreement, or Valuation Affidavit (Form 2705) must be presented to the Register of Deeds for recording and SRETT must be paid to the County Treasurer in the county where the real property is located. The tax must be paid within 15 days of the transfer of the controlling interest. Michigan Treasury Update, Volume 1, Issue 4, 08/01/2016.

M. Unitary Business Groups. The Michigan Department of Treasury has modified its position on the impact of the Michigan Court of Appeals' decision in *LaBelle Management Inc. v. Department of Treasury*, Dkt. No. 324062, 03/31/2016, which dealt with the meaning of indirect ownership as used in the unitary business group (UBG) definition of Mich. Comp. Laws Ann. § 208.1117(6) of the Michigan Business Tax (MBT). The Department has announced that since the court of appeals on May 5, 2016 entered an order staying the effect of its March 31, 2016 decision, the Department will not consider the LaBelle Management decision as binding precedent until the stay is lifted. Previously, the Department had decided the decision was binding on the Department and it would be applied to all open tax years (Notice to Taxpayers Regarding *Labelle Management Inc. v. Department of Treasury*, Mich. Dept. Treasury, 05/11/2016.) A UBG is a group of related U.S. persons, other than a foreign operating entity, whose business activities or operations are interdependent. Specifically, it is two or more persons that satisfy both a control test and one of two relationship tests. The control test is satisfied when one person owns or controls, directly or indirectly, more than 50% of the ownership interest with voting or comparable rights of the other person or persons. In LaBelle Management, the taxpayer challenged the Department's interpretation of the control test, as set forth in Michigan Revenue Administrative Bulletin No. 2010-1, 02/05/2010. Specifically, the taxpayer challenged the Department's reliance upon IRC §318 to define indirect ownership to include constructive ownership, or ownership through attribution. Reversing the court of claims, the court of appeals found in favor of the taxpayer, holding that indirect ownership as used in the MBT definition of a UBG means ownership "through an intermediary." On May 5, 2016, the court of appeals entered an order staying the effect of its March 31, 2016, decision until the Department's appeal rights have been exhausted. Thus, until the stay is lifted, the Department will not consider the LaBelle Management decision as binding precedent.

N. Nexus Standards.

1. General. The Michigan Department of Treasury has issued a release that explains the nexus standards for business taxes. The release covers the sales and use tax presumption for out-of-state sellers; the nexus standards for the corporate income tax; and the nexus standards for flow-through entity withholding. Michigan Nexus Standards for Business Taxes, Mich. Dept. Treasury, 5477, 08/01/2016.

2. Sales and Use Tax Presumption for Out-Of-State Sellers.

a. Effective October 1, 2015, a seller is subject to use tax collection responsibility under the Use Tax Act if it has physical presence in Michigan. An out-of-state seller will be presumed engaged in the business of making retail sales in Michigan which creates nexus under the Michigan Compiled Law (MCL), if the seller, or another person, including an affiliated person, performs any of the following activities in Michigan (see Mich. Comp. Laws Ann. § 205.52b in the General Sales Tax Act or Mich. Comp. Laws Ann. § 205.95a in the Use Tax Act):

i. Sells a similar line of products as the seller and does so under the same business name as the seller or a similar business name as the seller.

ii. Uses its employees, agents, representatives, or independent contractors in Michigan to promote or facilitate sales by the seller to purchasers in Michigan.

iii. Maintains, occupies, or uses an office, distribution facility, warehouse, storage place, or similar place of business in Michigan to facilitate the delivery or sale of tangible personal property sold by the seller to the seller's purchasers in Michigan.

iv. Uses, with the seller's consent or knowledge, trademarks, service marks, or trade names in Michigan that are the same or substantially similar to those used by the seller.

v. Delivers, installs, assembles, or performs maintenance or repair services for the seller's purchasers in Michigan.

vi. Facilitates the sale of tangible personal property to purchasers in Michigan by allowing the seller's purchasers in Michigan to pick up or return tangible personal property sold by the seller at an office, distribution facility, warehouse, storage place, or similar place of business maintained by that person in Michigan.

vii. Shares management, business systems, business practices, or employees with the seller, or in the case of an affiliated person, engages in intercompany transactions related to the activities occurring with the seller to establish or maintain the seller's market in Michigan.

viii The seller enters into an agreement, directly or indirectly, with one or more residents of Michigan under which the resident, for a commission or other consideration, directly or indirectly, refers potential purchasers, whether by a link on an Internet website, in-person oral presentation, or otherwise, to the seller, if all of the following conditions are satisfied: (i) the cumulative gross receipts from sales by the seller to purchasers in Michigan who are referred to the seller by all residents of Michigan with an agreement with the seller are greater than $10,000 during the immediately preceding 12 months; and (ii) the seller's total cumulative gross receipts from sales to purchasers in Michigan exceed $50,000 during the immediately preceding 12 months.

xi. Conducts any other activities in Michigan that are significantly associated with the seller's ability to establish and maintain a market in Michigan for the seller's sales of tangible personal property to purchasers in Michigan.

b. The presumption may be rebutted by showing that an activity is not significantly associated with the seller's ability to establish or maintain a market in Michigan. An "affiliated person" includes: (i) a person that is part of the seller's controlled group of corporations; or (ii) any other person that bears the same ownership relationship to the seller as a corporation that is a member of the seller's controlled group of corporations. "Controlled group of corporations" means that term as defined under IRC §1563(a).

3. <u>Corporate Income Tax</u>. The Michigan corporate income tax (CIT) became effective January 1, 2012. Taxpayers whose activities are limited to those protected by Public Law (P.L.) 86-272 are not subject to CIT. There are three nexus standards under the CIT. A taxpayer has nexus with Michigan if it: (i) has a "physical presence" in Michigan for more than one day; (ii) "actively solicits" sales in Michigan and has gross receipts of $350,000 or more sourced to Michigan; or (iii) has an ownership or beneficial interest in a flow-through entity (directly or indirectly through one or more flow-through entities) which has substantial nexus in Michigan. Taxpayers should refer to Michigan Revenue Administrative Bulletin No. 2014-5, 01/29/2014 for the definition of "physical presence" and "actively solicit." The CIT is levied on all corporations with nexus in Michigan at a rate of 6% of the Corporate Income Tax Base, after allocation or apportionment. A corporation is an entity that is required or has elected to file as a C corporation under the Internal Revenue Code. Insurance companies are subject to a tax equal to 1.25% of gross direct premiums written on property or risk located or residing in Michigan. Financial institutions are subject to a tax equal to 0.29% of their apportioned net capital. Taxpayers include a single corporation, insurance company, financial institution, or a unitary business group. A unitary business group means a group of U.S. persons, other than a foreign operating entity, one of which owns or controls, directly or indirectly, more than 50% of the ownership interest with voting or comparable rights of the other U.S. persons and that: (i) has business activity resulting in a flow of value between or among persons in the group; or (ii) has business activities that are integrated with, are dependent upon, or contribute to each other.

4. <u>Flow-through Withholding (Ending July 1, 2016)</u>.

a. Flow-through entities with business activities beyond those protected by Federal P.L. 86-272 are required to withhold Individual Income Tax on every member that is a nonresident. This withholding is done at the individual income tax rate on the distributive share (after allocation or apportionment) that is reasonably expected to accrue to the nonresident individual. Also, effective January 1, 2012, a flow-through entity with business activities beyond those protected by Federal P.L. 86-272 and that reasonably expects to accrue more than $200,000 in apportioned or allocated business income for the tax year is required to withhold CIT on the distributive share of its members that are C corporations or other flow-through entities in a tiered structure.

b. Legislation enacted in 2016 (L. 2016, P.A. 158) eliminated the requirement that flow-through entities withhold income tax on members' distributive share of income for tax years that begin on or after July 1, 2016. For tax years that begin before July 1, 2016, a flow-through entity must withhold on members' distributive share of income for the entire fiscal year if it has nonresident members who are individuals or if it has not received exemption certificates from its members that are C corporations or other flow-through entities under Mich. Comp. Laws Ann. § 206.703(16).

O. Sourcing for Advertising and Direct Mail for Sales and Use Tax. The Governor has signed legislation that amends the state's General Sales Tax and Use Tax Acts to clarify sourcing for advertising and promotional direct mail and other direct mail to ensure Michigan is in compliance with the Streamlined Sales and Use Tax Agreement. The bill repeals the existing law and enacts new provisions (L. 2016, H5132 (P.A. 159), effective 90 days after the date enacted into law; L. 2016, H5133 (P.A. 160), effective 90 days after the date enacted into law.) The bills repeal Mich. Comp. Laws Ann. § 205.71 and Mich. Comp. Laws Ann. § 205.103 of the General Sales Tax Act and the Use Tax Act, respectively, regarding the obligation of a seller or purchaser of direct mail to collect, pay, or remit sales or use tax. The bills enact new provisions that:

1. Require a seller to source the sale of advertising and promotional direct mail to the jurisdictions to which the mail was to be delivered to recipients, and pay the applicable tax, if the purchaser provided that information.

2. Require the purchaser to source the sale of advertising and promotional direct mail to the jurisdictions to which it was to be delivered, and pay the applicable tax, if the purchaser provided the seller with a direct payment authorization or exemption form from the Department of Treasury.

3. Require a sale of advertising and promotional direct mail to be sourced as provided in the General Sales tax and Use Tax Acts, if the purchaser did not provide information about the delivery jurisdictions or provide a direct payment authorization or an exemption form.

4. Require the purchaser to source the sale of other direct mail and pay the applicable tax, if the purchaser provided the seller with a direct payment authorization or exemption form.

5. Require a sale of other direct mail to be sourced as provided in the General Sales Tax and Use Tax Acts, if the purchaser did not provide a direct payment authorization or exemption form.

6. Relieve the seller of any obligation to collect, pay, or remit the applicable tax in situations in which the purchaser was required to pay the tax and source the sale.

7. Describe the circumstances under which the above provisions apply.

P. Michigan Net Operating Loss Deduction. The Michigan Department of Treasury has issued guidance to taxpayers on how to calculate the Michigan net operating loss (NOL) deduction for individuals, trusts and estates.(Mich. Treasury Update, Vol. 1, Issue 3, 05/01/2016 .)

1. Background. Under the Michigan Income Tax Act, a Michigan NOL is created when business losses exceed gains in a particular tax year. An individual, a trust, or an estate can sustain an NOL, which may be carried to certain other years to offset positive income in those years. The resulting offset to income in those other tax years is referred to as the "NOL deduction." The Michigan NOL is calculated using the same general formula as the federal NOL, but it is computed independently of the federal NOL and starts with modified federal adjusted gross income rather than federal taxable income. Like its federal tax counterpart, the Michigan NOL deduction is a legislatively created mechanism which allows taxpayers to "smooth" fluctuating income from year to year for tax purposes. Once a NOL has been computed for a given tax year, the Michigan Income Tax Act allows a taxpayer to carry the loss back two years and then forward 20 years, chronologically, until the entire amount of the Michigan NOL is consumed. A taxpayer may also elect to forgo the carryback and apply the Michigan NOL in the 20 succeeding years only (these carryback and carryforward years apply for all tax years after August 5, 1997).

2. Claiming the Michigan NOL. To establish a Michigan NOL and claim a Michigan NOL deduction and a refund in the carryback or carryforward years, a taxpayer must file Form MI-1045 (Application for Michigan Net Operating Loss Refund). Form MI-1045 is required because the Michigan NOL deduction is subject to miscalculation by taxpayers. The form provides step-by-step instructions to help taxpayers make the correct calculation, thereby avoiding processing delays and refund adjustments. When miscalculations do occur, the cause can frequently be traced to confusion of computation of the NOL with computation of the taxpayer's Michigan taxable income. Some taxpayers erroneously understand their Michigan NOL to simply equal their loss year's negative taxable income. However, while a taxpayer is permitted to subtract items such as interest from federal bonds and state tax refunds to compute and reduce their Michigan taxable income, the taxpayer may not also include these adjustments to adjusted gross income when computing their Michigan NOL.

3. Adjustments. While the Michigan NOL permits a taxpayer to smooth income from year to year, it is also a product of legislative grace, and may only be used only as statutorily prescribed. The statute specifically limits

adjustments to adjusted gross income in the calculation of the Michigan NOL to only those adjustments related to allocation and apportionment of income attributed to other states.

4. Effect of a Disallowance. The disallowance of MI-1040 Schedule 1 adjustments in the calculation of a Michigan NOL does not result in a "backdoor" tax of these items. Bearing in mind that no tax is incurred on income in the loss year because reported income was less than zero, excluding items from the Michigan NOL calculation in the loss year merely reduces the size of the deduction available for use in another tax year. When that Michigan NOL is carried to another tax year with positive income, the taxpayer is still permitted to use all Schedule 1 adjustments for that year to reduce taxable income before applying the Michigan NOL deduction.

III. EMPLOYEE BENEFITS

A. 2016 Defined Contribution Plan Limits.

1. The limit on 401(k), 403(b) and profit-sharing plan elective deferrals stays at $18,000.

2. The catch-up contribution limit for participants age 50 or older stays at $6,000 (The catch-up limit applies from the start of the year to those turning 50 at any time during the year).

3. The annual defined contribution limit from all sources (employer and employee) stays at the lessor of $53,000 (plus $6,000 catch-up if age 50 or older) or 100 percent of the employee's compensation.

4. The amount of employee compensation that can be considered in calculating contributions to defined contribution plans remains at $265,000.

5. The limit used in the definition of a highly compensated employee for the purpose of 401(k) nondiscrimination testing remains at $120,000.

6. The limit used in the definition of a key employee for the purpose of 401(k) nondiscrimination testing remains at $170,000.

B. 2016 Defined Benefit Plan Limits.

1. The maximum annual benefit that may be provided through a defined benefit plan remains unchanged at $210,000.

2. The 2016 premium rates for single-employer and multiemployer pension plans are:

a. For single-employer plans, the per-participant flat premium rate for plan years beginning in 2016 is $64, up from a 2015 rate of $57.

b. For multiemployer plans, the per-participant flat premium rate for plan years beginning in 2016 is $27, up from a 2015 rate of $26.

c. Underfunded single-employer plans will see their variable-rate premium (VRP) increase to $30 per $1,000 of unfunded vested benefits in 2016, up from $24 in 2015. The VRP is capped at $500 times the number of participants in 2016, up from a 2015 cap of $418. Plans sponsored by small employers (generally fewer than 25 employees) may be subject to an even lower VRP cap. Multiemployer plans do not pay a VRP.

3. The PBGC annual maximum guaranteed benefits for terminated plans (single-employer) will stay the same in 2016, at $60,136 for a 65-year-old retiree.

C. Other 2016 Adjustments.

1. For SIMPLE (savings incentive match plan for employees of small employers) retirement accounts, the maximum contribution limit remains unchanged at $12,500.

2. For simplified employee pensions (SEPs), the minimum compensation amount remains unchanged at $600, and the maximum compensation limit will remain unchanged at $265,000. The annual contribution limit stays at $53,000.

3. In an employee stock ownership plan (ESOP), the maximum account balance in the plan subject to a five-year distribution period will remain unchanged at $1,070,000, while the dollar amount used to determine the lengthening of the five-year distribution period remains unchanged at $210,000.

4. The limit on annual contributions to an IRA will stay at $5,500. The additional catch-up contribution limit for individuals ages 50 and over is not subject to an annual cost-of-living adjustment and remains $1,000.

5. The AGI phase-out range for taxpayers making contributions to a Roth IRA is $184,000 to $194,000 for married couples filing jointly, up from $183,000 to $193,000. For singles and heads of household, the income phase-out range is $117,000 to $132,000, up from $116,000 to $131,000.

6. For an IRA contributor not covered by a workplace retirement plan but married to someone who is covered, the deduction is phased out if the couple's income is between $184,000 and $194,000, up from $183,000 and $193,000.

7. The adjusted gross income limit for the saver's credit (also known as the retirement savings contributions credit) for low- and moderate-income workers will rise to $61,500 for married couples filing jointly, up from $61,000 in 2015; $46,125 for heads of household, up from $45,750; and $30,750 for singles

and married couples filing separately, up from $30,500. The saver's credit helps offset part of the initial contribution workers voluntarily make to 401(k) plans, similar workplace retirement programs or IRAs.

D. Revisions to Determination Letter Process and User Fees.

1. New Guidance. The IRS released several key pieces of guidance January 4 relating to determination letters. The guidance makes several important changes and clarifications to the determination letter process, particularly in light of the IRS's previously announced intention (Announcement 2015-19) to restrict determination letters for individually designed plans to initial adoption and plan termination. Specifically, there are three key pieces of guidance:

a. Rev. Proc. 2016-6 is the annual Revenue Procedure regarding the process of issuing determination letters. The IRS has updated this procedure in accordance with Announcement 2015-19.

b. Rev. Proc. 2016-8 is the annual Revenue Procedure regarding IRS user fees.

c. Notice 2016-3 extends the deadline to convert an individually designed defined contribution plan to a preapproved plan and makes other clarifications.

2. Expiration Dates. For years, individual determination letters have had expiration dates. These dates were designed to tie into the 5-year cycle. They forced an employer to restate and resubmit plan documents every 5 years to have ongoing reliance. With the elimination of the 5-year cycle, there is no need for the expiration date. The IRS will no longer include an expiration date on determination letters it issues. Expiration dates in previously issued letters are no longer operative.

3. Cycle A. Individually designed plans in Cycle A will be able to restate and submit for a determination letter during the period from February 1, 2016 to January 31, 2017. There are two groups of plans in Cycle A: those for whom the last digit of the sponsor's employer ID number is 1 or 6 and certain plans maintained by controlled groups. The new guidance clarifies that controlled group plans can take advantage of this Cycle A option if all members of the controlled group had made the election to file in Cycle A in by January 31, 2012 (the end of the prior Cycle A). In other words, if the group did not elect to use Cycle A for the EGTRRA document, it cannot switch to it for the PPA document.

4. Extension. The deadline for employers to restate existing preapproved defined contribution plans to comply with PPA (and submit for a determination letter, if allowed and desired), is generally April 30, 2016. For employers currently using a preapproved plan, that deadline is not changing. However, if an employer is using an individually designed document for a defined contribution plan, the employer will have until April 30, 2017 to restate to a

preapproved plan and submit for a determination letter (if allowed and desired). This relief is particularly important for those individually designed plans which use special provisions that are difficult to replicate in a preapproved document. The employer frequently can restate to a volume submitter plan, make the necessary modifications, and submit to the IRS for a determination letter on Form 5307. The extra time gives employers an opportunity to find a suitable document, draft the necessary modifications, and prepare the determination letter paperwork without being pushed against a four month deadline.

5. User fees, rulings and letters.

Matter	2015 Fee	2016 Fee
Determination letter Form 5300	$2,500	$2,500
Determination letter Form 5307	$500	$800
Determination letter Form 5310	$2,000	$2,300
Waiver of 60-day rollover period	$500 – $3,000	$10,000
Multiple employer plan	$3,000 – $15,000	$4,000

6. VCP compliance fees.

Number of participants	2015 Fee	2016 Fee
Fewer than 21	$750	$500
21 – 50	$1,000	$750
51 – 100	$2,500	$1,500
101 – 1,000	$5,000 - $8,000	$5,000
1,001 – 10,000	$15,000 – $20,000	$10,000
More than 10,000	$25,000	$15,000

E. Nondiscrimination Relief for Some Defined Benefit Plans. The IRS has issued proposed regulations (REG-125761-14) that modify the nondiscrimination requirements applicable to specified retirement plans that provide additional benefits to a grandfathered group of employees following some changes in the coverage of a defined benefit (DB) plan or formula.

1. Background. Since amendments were made to the section 401(a)(4) rules in 2001, some employers have moved away from providing retirement benefits through traditional DB plans, closing the plans to new employees or significantly changing the types of benefit formulas. The employers may have allowed "grandfathered" employees already participating in the plan (or who are older or have longer service) to continue to earn benefits under the plan while closing the plan or formula to all other employees. "Closed" plans must meet the coverage and the nondiscrimination rules but may find it hard to satisfy those requirements due to increases over time in the proportion of grandfathered employees who are highly compensated compared to the employer's total workforce.

2. Prior Guidance. Guidance (Notice 2014-5) issued in January 2014 provided temporary nondiscrimination relief for some closed plans. Notice 2015-28 extended that relief by applying it to plan years beginning before 2017. Notice 2016-57 further extended the temporary nondiscrimination relief for plan years beginning before 2018 if specified conditions are satisfied. Treasury and the IRS agree with commentators that permanent changes to the nondiscrimination rules should be made to help employers and plan sponsors preserve the retirement expectations of some grandfathered employees. Thus, the proposed regulations modify many provisions in the current section 401(a)(4) rules to address various situations and plan designs, including closed plans and formulas. The regulations also include changes that are not limited to closed plans and formulas.

3. Proposed Regulations. The proposed regulations provide special rules that allow closed plans and similar arrangements to satisfy the nondiscrimination rules in additional situations. The special rules are based on the current rules for defined benefit replacement allocations (DBRAs), with some changes in response to stakeholders' concerns about the current rules. The proposed regulations modify the rules applicable to DBRAs that allow some defined contribution (DC) plan allocations to be disregarded when determining whether a DC plan has broadly available allocation rates. The changes are meant to allow more allocations to fit within the DBRA rules. The proposed regulations add a new exception to the requirement that a DB/DC plan must satisfy the minimum aggregate allocation gateway -- a minimum allocation rate for each non-highly compensated employee -- once the other applicable conditions under the section 401(a)(4) rules are not met. The proposed regulations establish a special nondiscrimination testing rule that applies if a benefit, right, or feature is made available only to a grandfathered group of employees for a closed plan. The special rule provides relief in specified circumstances from some nondiscrimination testing for a benefit, right, or feature provided under the closed plan, or for a rate of matching contributions provided to a grandfathered group under a DC plan. Also, the proposed regulations generally ease the rules under which any DB/DC plan can satisfy the "nondiscrimination in amount" requirement on the basis of benefits, and they provide a new alternative to the minimum aggregate allocation gateway. The regulations include other changes to address some arrangements that take advantage of the flexibility in the current nondiscrimination rules to provide a special benefit formula for selected employees without extending that formula to a classification of employees that is reasonable and is established under objective business criteria.

4. Partial Withdrawal of Proposed Regulations. The IRS later said in Announcement 2016-16 that it will partially withdraw the proposed regulations. The provisions that will be withdrawn are those that were intended to address some qualified retirement plan designs that take advantage of flexibility in the existing nondiscrimination rules to provide a special benefit formula for selected employees without extending that formula to a classification of employees that is reasonable and established under objective business criteria. After additional consideration of the potential effects of those provisions on the adoption and continued maintenance

of qualified retirement plans with a variety of designs, the IRS and Treasury concluded that further study is necessary and that withdrawal of those sections is appropriate.

F. **New Rule Permits Most Midyear Safe Harbor Amendments**. The IRS has released Notice 2016-16 which allows employers to adopt mid-year amendments to safe harbor 401(k) and 403(b) plans. It includes traditional safe harbor plans and Qualified Automatic Contribution Arrangements (QACA). The new rule eliminates much of the uncertainty which has plagued this popular plan design for years.

1. Amendments Permitted. In general, the Notice permits almost all "mid-year changes," defined as a change that is either:

a. Effective on a day other that the first day of a plan year,

or

b. A change effective on the first day of a plan year but adopted after the beginning of the year.

Because of the way the IRS defined a mid-year change, the Notice allows changes an employer adopts during the plan year, as well as retroactive corrective amendments adopted after the end of a year.

2. Updated Notice and Change of Election. If the mid-year change would affect required safe harbor notice content, then:

a. The plan must provide all participants required to receive a safe harbor notice with an updated safe harbor notice which describes the mid-year change and its effective date; and

b. The participants must have a reasonable opportunity after receipt of the updated notice to change their deferral elections.

The updated notice must generally be given a reasonable time before it goes into effect. A notice given 30 – 90 days before the effective date is deemed reasonable. If that is impractical (such as for a retroactive change to the beginning of the plan year), then a notice provided as soon as practical (and not later than 30 days) after adoption is deemed reasonable.

3. Prohibited Mid-Year Changes and Special Rules. The Notice provides that a few mid-year changes are not permitted:

a. A change from a traditional safe harbor to a QACA, or vice versa; however the addition of an automatic enrollment feature to a traditional safe harbor plan is permitted;

b. A change lengthening the vesting schedule for QACA safe harbor contributions; or

c. A change reducing the number or otherwise narrowing group of employees eligible to receive safe harbor contributions. However, this does not limit the ability of the employer to amend a plan mid-year to change eligibility requirements for employees who have not yet become eligible to receive safe harbor contributions.

4. Special Rules. Special rules apply if the employer wishes to:

a. Add a new fixed match to a plan;

b. Increase a fixed match to a plan;

c. Add a new discretionary match to a plan; or

d. Change the definition of compensation used to compute matching contributions (if it would have the effect of increasing the match).

In these cases, both of the following conditions must be satisfied:

a. The plan must follow the rules above for an updated safe harbor notice and change in deferral elections. The updated notice must be given at least 3 months before the end of the plan year.

b. The change must be retroactively effective for the entire year. If the plan calculates the match on a periodic basis, the retroactive effective date may require that the employer retroactively amend the plan to calculate the match on a full plan year basis, with true-up.

5. Not Applicable To. There are several mid-year changes already addressed in the regulations, which have their own regulatory requirements and limitations. The Notice does not apply to these changes, which remain subject to their specific regulatory requirements:

a. Mid-year adoption of a new safe harbor plan;

b. Adoption of a short plan year or a mid-year change in the plan year;

c. Mid-year reduction or suspension of safe harbor contributions (exiting);

d. Mid-year plan termination; or

e. Use of the maybe notice to change to safe harbor status.

6. Caveat. The Notice reminds that other rules, such as the anti-cutback rule, could impact the ability to make mid-year changes.

G. Treasury Proposes Change in Cross-testing Rules. One of the most popular ways of designing cross-tested retirement plans is to put each participant in a separate allocation group. This method allows the employer to customize allocations, to reward individual participants based on merit, or to find cost effective solutions for nondiscrimination issues. Moreover, this method affords Plan Sponsors significant flexibility in terms of allocations without the need to amend the plan. Newly proposed regulations would change the way these plans are tested. The regulations would apply to any design where one or more HCEs has an allocation formula that is not part of a "reasonable classification." This is merely a proposed regulation and does not change anything today. It would go into effect for plan years beginning after the date the Treasury issues the final regulation.

H. Failure to Adopt the Pre-approved Plan.

1. Options. Previously, the only way an employer could correct not signing a pre-approved defined contribution (DC) retirement plan by the deadline was to complete a submission under the Voluntary Correction Program (VCP) as outlined in 1 below. New option (b) below, allows the financial institution or service provider that offers the plan document to request a closing agreement on behalf of all adopters who missed the deadline.

a. You can restore the tax-favored status of your plan by adopting a restated plan document and filing a VCP submission with the IRS. If approved, the IRS treats the plan as entitled to tax-favored status. See sample VCP Submission kit to help you with your VCP submission.

b. To reduce employers' burden of submitting VCP applications, the IRS invites financial institutions or other service providers to submit proposals for umbrella closing agreements that cover individual employers affected by the failure to update their plans by the deadline. These would be similar to a group submission under the VCP, but under these closing agreements the organization doesn't need to have made a systemic error.

2. Deadlines.

a. April 30, 2016 - deadline for employers using a pre-approved 401(k), profit-sharing or other defined contribution (DC) retirement plans to sign an updated version.

b. April 30, 2017 - deadline for new adopters of pre-approved DC plans. A "new adopter" is any plan adopted on or after January 1, 2016 (other than one adopted as a modification and restatement of a DC pre-approved plan that an employer had prior to January 1, 2016). The April 30, 2017 extension is to help plan sponsors who want to switch from an individually designed plan to a current DC pre-approved plan. A "current DC pre-approved plan" is one that IRS approved based on the 2010 Cumulative List. See Notice 2016-3.

c. Pre-approved plans - These are purchased from a financial institution, advisor, or similar provider. They allow limited customization but give the employer the reassurance that IRS approved the plan's wording. See Deadline to Adopt Pre-Approved Plans for more information.

3. Consequences of failing to adopt the pre-approved plan by the applicable deadline. If you didn't sign a restated DC plan document by the deadline, your plan is no longer entitled to tax-favored treatment. This may reduce your deduction for contributions to the plan, and make it harder for your employees to save for their retirement and make tax-favored rollovers of distributions to other plans or individual retirement accounts.

I. The Kline-Miller Multiemployer Pension Reform Act of 2014. On December 16, 2014, the Kline-Miller Multiemployer Pension Reform Act of 2014 (Kline-Miller) was enacted into law. In Kline-Miller, Congress established a new process for multiemployer pension plans to propose a temporary or permanent reduction of pension benefits if a plan is projected to run out of money before paying all promised benefits. On April 26, 2016, the Treasury Department released final regulations implementing the Kline-Miller Multiemployer Pension Reform Act (Kline-Miller). These regulations finalize the proposed and temporary regulations that were issued in June 2015 and September 2015 and address stakeholder comments. The final regulations do not change the basic requirements for applications to reduce pension benefits. They provide further clarifications based on information received during the public comment period.

J. DOL's New Fiduciary Rules. The U.S. Department of Labor (DOL) has issued a final package of rules to regulate individuals and entities that provide investment advice to retirement plans and IRA investors. The new rules are effective April 10, 2017.

1. "Fiduciary." Key to the DOL's final rule is a new regulation that determines when an investment adviser is a "fiduciary" under ERISA and the prohibited transaction excise tax rules under the Code. The general rule is that a person is a fiduciary if he or she provides recommendations or advice for a fee to a plan, a plan fiduciary, plan participant or IRA owner regarding: (i) the advisability of acquiring, holding, disposing or exchanging plan or IRA assets, (ii)the investment of assets after those assets are rolled over, transferred or distributed form a plan or IRA, (iii) the management of such assets, including recommendations on investment policies or strategies, portfolio composition, and the selection of persons providing investment advice or investment management services and investment account arrangements, or (iv) the management of assets rolled over or otherwise

distributed from a plan or IRA to another plan or an IRA; provided the person, directly or indirectly, represents or acknowledges acting as an ERISA fiduciary in furnishing such advice or furnishes this advice pursuant to a written or verbal agreement, arrangement or understanding that this advice is "individualized" OR directs the advice to a specific advice recipient. The new definition differs materially from the DOL's 1975 final regulations. Significantly, it no longer requires that the advice be provided on a regular basis, or that the advice be provided according to a mutual understanding that it will serve as the primary basis for decision making.

2. "Recommendation." A "recommendation" under the new rules is a communication that would reasonably be viewed as a suggestion that the recipient take or refrain from a particular action. The following would not constitute a recommendation for this purpose:

a. Employees. An employee of a plan sponsor who, while working in an employee capacity and receiving no fee other than normal compensation for work performed as an employee, provides advice to a plan fiduciary is not considered a fiduciary.

b. Platform Provider. A person who merely markets and makes available to a plan (without regard to the plan's or its participants' individualized needs) a platform that provides a menu of available investment alternatives from which a plan fiduciary can select/monitor investment alternatives made available for participant-directed investments is not considered a fiduciary, if the platform provider discloses to the plan fiduciary in writing that it is not providing impartial investment advice or giving advice in a fiduciary capacity.

c. Selection and Monitoring Assistance. A person who, in connection with platform provider-related services, merely: (i) identifies investment alternatives that meet objective criteria set by the plan fiduciary; or (ii) provides the plan fiduciary with objective financial data and comparisons with independent benchmarks for investment alternatives, will not be considered a fiduciary.

d. Investment Education. Persons who make available investment education materials generally are not considered fiduciaries. To be considered investment education, the information provided must not be individualized or specific to a participant's needs and situation.

3. Exceptions. The following situations are excluded from the definition of fiduciary:

a. Advice to an Independent Fiduciary. Advice provided to an independent fiduciary of a plan or IRA is excepted from the new rules if that independent fiduciary is either a licensed or regulated provider of financial services or is responsible for the management of at least $50 million in assets if certain conditions are met. The DOL intended to capture true arm's length transactions in which the independent fiduciary is not relying on the other party to provide impartial advice. The $50 million threshold is based on FINRA's institutional account concept and allows all plan and non-plan assets under management to be included in meeting the threshold. Generally, this exception will apply to banks, insurance companies, registered advisors, and broker-dealers.

b. Execution of Securities Transactions. A person who executes buy/sell securities transactions (e.g., a broker or dealer, reporting broker or a bank) is not considered a fiduciary solely by reason of executing these transactions in the ordinary course of its business if: (i) the fiduciary providing the instructions is not such broker, dealer or bank; and (ii) the instructions specify the price range for the purchase or sale of the security, the time span (not more than five days) within which the transaction is to be effected, and the minimum or maximum quantity of the security to be purchased or sold.

4. Valuations and Appraisals. The definition of fiduciary in the earlier proposed regulations included providers of appraisals, fairness or similar statements of the value of an asset. The DOL decided that issues related to valuations would be addressed later. The DOL did reiterate in the preamble to the Regulations its position that a proper valuation of "hard-to-value" assets is the "single most important factor in determining the prudence of the transaction."

5. Class Exemptions. The Regulations will confer fiduciary status on certain persons who previously were not fiduciaries. As a result, the DOL also has also finalized two new prohibited transaction class exemptions and made amendments to several existing class exemptions to enable DC plans and IRA owners to receive services without giving rise to a prohibited transaction:

a. "Best Interest Contract" Exemption. The purpose of this exemption is to broadly allow financial institutions, advisers, and their respective affiliates and related parties to receive compensation that would otherwise give rise to prohibited transactions as a result of advice to DC Plan participants, beneficiaries and certain fiduciaries (including small DC Plan sponsors), and IRA owners. The exemption requires that the financial institution and/or adviser undertake certain protective measurements, which include acknowledgement of fiduciary status and compliance with impartial conduct standards. In addition, the financial institution must enter into an enforceable written contract with IRA owners providing for the required protective conditions. On the other hand, the DOL does not require an enforceable written contract with respect to ERISA plans and ERISA fiduciaries, because these parties have a cause of action under ERISA. Finally, the financial institution must notify the DOL regarding its intention to rely on the exemption.

b. "Principal Transaction" Exemption. The purpose of the exemption is to allow principal transactions or riskless principal transactions in debt securities, certificates of deposit or interests in a unit investment trust, between an adviser or financial institution and a plan, participant or beneficiary account, or IRA. Financial institutions and advisers seeking to rely on the exemption must acknowledge fiduciary status; adhere to impartial conduct standards; disclose material conflicts of interest; adopt certain policies and procedures and retain certain records. For principal transactions and riskless principal transactions involving IRAs and plans not covered by Title I of ERISA, a written contract is required.

c. Prohibited Transaction Class Exemptions. Certain existing prohibited transaction class exemptions have been amended to bring them into conformity with the Regulations.

K. Cash Balance Plans that Pay Lump Sums Greater than the Account Balance. On April 22, 2016, the IRS issued Chief Counsel Advice (CCA) 201617006 addressing whether a cash balance plan that pays a lump sum that is greater than the account balance satisfies the age discrimination safe harbor for "lump-sum based" plans in IRC §411(b)(5)(A). The CCA concludes that this type of plan is not eligible for the lump-sum based plan safe harbor from age discrimination, but generally would be eligible for the safe harbor for indexed plans found in the IRC §411(b)(5)(E).

L. Cafeteria Plan Reimbursement Fundamentals. The IRS has issued three information letters confirming and calling attention to fundamental principles of cafeteria plan design and administration:

1. Health FSAs Cannot Reimburse Insurance Premiums. Information Letter 2016-0001 confirms that health FSAs cannot be used to reimburse or pay health insurance premiums. The letter notes that this is a long-standing rule, citing the 2007 proposed cafeteria plan regulations and Publication 969.

2. No Income Exclusion for Reimbursement of Spouse's Pre-Tax Premiums. Letter 2016-0009 responds to an inquiry about whether an employee can be reimbursed for health premiums paid pre-tax by the employee's spouse. Citing Chief Counsel Advice 201547006, the letter explains that amounts paid to an employee to reimburse a spouse's health premiums may not be excluded from the employee's income if the spouse paid the premiums on a pre-tax basis, such as through salary reduction under a cafeteria plan.

3. Documentation Required Before Reimbursing Expenses. Letter 2016-0013 addresses a health FSA participant who questioned whether the TPA could ask for certain information from his doctor before reimbursing his claim for "supplements related to a medical condition." The letter explains that health FSAs can only reimburse medical expenses that the employee substantiates, and that reimbursement of ineligible expenses puts the health FSA's nontaxable status at risk. Concluding that the TPA's request for information was reasonable, the letter notes that if an administrator determines that documents from a physician's office are inadequate, it is the employee's responsibility to submit any additional documentation needed for reimbursement.

M. New Determination Program Rev. Proc. 2016-37. On June 29, 2016, Revenue Procedure 2016-37, generally effective January 1, 2017, was released changing the Determination Letter Program for tax-qualified individually designed plans (IDPs), and the requirements for when plan amendments must be adopted under IRC Section 401(b). While the Rev. Proc. covers many changes, most relate to when an IDP must be amended for law and other guidance changes and when an IDP may request a determination letter.

1. Background. Rev. Proc. 2007-44 provided a 5-year remedial amendment cycle (RAC) system for amended IDPs to request a determination letter generally every 5 years. Under that system, plans had to adopt interim amendments for items on the Cumulative List of required plan changes. This system required IDPs to amend on an interim basis by the end of the year in which the amendments became effective. IDPs would then have to make final conforming amendments at the end of their 5-year RAC cycle. Announcement 2015-19 stated that the RAC system would end, and a replacement system for the IRC Section 401(b) period would be created. Rev. Proc. 2016-37 ends the RAC system and replaces it with a new approach to the remedial amendment period.

2. When must IDPs be amended? An IDP's IRC Section 401(b) remedial amendment period for required amendments will be tied to a Required Amendment List (RA List) unless legislation or other guidance states otherwise. Interim amendments will no longer be required for IDPs. The RA List is the annual list of all the amendments for which an IDP must be amended to retain its qualified plan status. IRS will publish the RA List after October 1 of each year. Generally, plan sponsors must adopt any item placed on RA List by the end of the second calendar year following the year the RA List is published. For example, plan amendments for items on the 2016 RA List generally must be adopted by December 31, 2018. Discretionary amendments will still be required by the end of the plan year in which the plan amendment is operationally put into effect, as under Rev. Proc. 2007-44. Rev. Proc. 2016-37 doesn't change a plan's operational compliance standards. Employers need to operate their plans in compliance with any change in qualification requirements from the effective date of the change, regardless of the plan's 401(b) period for adopting amendments. To assist employers, IRS intends to provide annually an Operational Compliance List to identify changes in qualification requirements that are effective during a calendar year.

3. When may a plan apply for a Determination Letter? Under Rev. Proc. 2016-37, a plan can request a determination letter only if any of these apply:

a. It has never received a letter before;

b. The plan is terminating; or

c. The IRS makes a special exception.

IRS anticipates making exceptions based on program capacity to work additional applications, and the need for rulings in certain areas.

N. Missing Plan Participants. On September 20, 2016, PBGC proposed regulations revising the existing missing participant program and adding three new missing participant programs for (i) DC plans, (ii) PBGC-insured multiemployer DB plans, and (iii) professional service employer DB plans that are not PBGC-insured. The program would be mandatory for PBGC-insured DB plans (including multiemployer plans), but would be voluntary for DC plans and DB plans that PBGC does not insure. Though required to participate in the program, PBGC-insured plans would have the choice of transferring the benefit to the PBGC or purchasing an annuity contract and reporting relevant information to the agency. PBGC anticipates that the program would be available in 2018 for plans that terminate in 2017. As an alternative to establishing an IRA at a financial institution for each missing participant or beneficiary, the proposal would allow administrators of terminated DC plans to transfer benefits to the PBGC.

O. Proposed 457(f) and 409A Regulations.

1. The Proposed 409A Regulations - Key Provisions.

a. A common feature for employee stock options is not deferred compensation. A common feature of stock options is that the exercise price of the option will be less fair market value if an employee is terminated for cause or violates a noncompete/nondisclosure agreement, in order to avoid a scenario of an employee taking action with respect to stock that might be detrimental to the employer. However, until now, such a feature would have triggered deferred compensation under 409A. The proposed regulations clarify that such a feature would not subject a stock option to 409A.

b. Granting stock options (or other rights, such as stock appreciation rights) to an employee as part of pre-employment contract negotiation is not deferred compensation. A quirk under 409A was the fact that the exemption from 409A for stock rights arrangements only applied to active employees. Again, the proposed regulations eliminate this quirk, allowing employers to provide options to prospective employees, a common tactic to attract key employees.

c. Involuntary separation pay agreements are not deferred compensation, plans even if the employee works less than a year. In another 409A quirk, compensation in an employee's prior year of service was needed to calculate whether an involuntary separation pay agreement was exempt from 409A. But what if an employee worked less than a year? The proposed regulations address this anomaly by stating that, in such cases, compensation in the year of termination can be used to calculate whether the arrangement was exempt from 409A, as opposed to prior year compensation (which would not exist for the employee in question).

d. College and university faculty, and other employees who do not work a full twelve months out of the year, do not create deferred compensation plans if they choose to spread their compensation out over a 12-month period for cash flow or other reasons. Under the prior 409A regulations, there was a deferred compensation plan subject to 409A in this scenario. The IRS addressed this problem in Notice 2008-62, but that Notice placed a cap of $18,000 on the amount of the pay that was deferred from one year to another (which obviously created an issue for higher education faculty, since they are paid for the academic year and the "deferred" amount could easily exceed $18,000). The proposed regulations eliminate the issue once and for all, eliminating the $18,000 cap. However, calendar year compensation cannot exceed the current 401(a)(17) compensation limit ($265,000 for 2016) under this exception.

e. In general, payments that are taxable under 457(f) due to their no longer being subject to a "substantial risk of forfeiture" are taxable under 409A as well. This eliminated a prior conflict between 457(f) and 409A, where taxation under 457(f) was not considered to be a taxable payment under 409A and was, thus, taxable under one set of rules, but not the other. Since it was unknown as to what set of rules took precedence, this guidance eliminates any uncertainty. Note that there are some limited exceptions to the rule. For example, non-compete triggers that are not structured in a manner to create a substantial risk for forfeiture under 457(f) will create a taxable payment under 457(f), but not under 409A.

f. Rules that apply to payments upon death also apply to payment upon the beneficiary's death, and the time period for payment has been extended to allow for issues such as probate. The deadline for payment is extended to December 31st following the calendar year of death.

2. <u>The Proposed 457 Regulations - Key Provisions</u>.

a. Although the 457 proposed regulations cover 457(b) as well as 457(f) plans, there is not much in the proposed regulations about which a 457(b) plan sponsor should be concerned. The only provisions that affect 457(b) in the proposed regulations were to update 457(b) to reflect changes in the law (e.g., adding Roth as an option for governmental plans, incorporating HEART act provisions related to qualified military service, etc.)

b. Additional guidance is provided as to how certain leave payment plans (severance pay, vacation/sick/leave pay, etc.) need to be constructed in order to avoid 457(f). For those entities that sponsor such plans, the regulations should be required reading to confirm that such plans are structured so as to be exempt from 457(f), which would defeat the purposes of offering such plans.

c. An exemption from 457(f) for "short term deferral" plans was carried over from 409A. This means that certain types of short-term deferrals are not subject to 457(f) (or 409A) at all. These arrangements are generally defined as bonuses or other compensation arrangements where the compensation is paid no later than the 15th of the third month following the later of the employee's or employer's tax year in which the compensation is no longer subject to a substantial risk of forfeiture.

d. Section 457(f) has been historically vague as to what a "substantial risk of forfeiture" actually means. This is important, since compensation can only be deferred until it is no longer subject to what is called a "substantial risk of forfeiture," at which point the compensation is no longer deferred and is taxable to the employee. In addition, 409A brought its own definition of "substantial risk of forfeiture" to the table, creating confusion as to whether that definition would take precedence over the 457(f) definition, or vice versa. The proposed 457(f) regulations clarify the definition that applies to 457(f) plans, and it is not the 409A definition. The new definition states that substantial services must be provided in the future (in other words, the hours worked must be significant relative to the compensation provided) and that a condition which is related to a purpose of the compensation must occur in order for a substantial risk of forfeiture to exist. Examples of what constitutes a substantial risk of forfeiture include involuntary termination, termination for "good reason" (a "safe harbor" definition of good reason is provided), and certain covenants not to compete that satisfy the requirements of the regulations.

e. When IRC section 409A and its related regulations came into being, it was thought that this might be the beginning of the end for the use of so-called "rolling risks" for forfeiture in 457(f) plans. This historically popular feature allowed an executive to extend the date that the expiration of the substantial risk of forfeiture would have been scheduled to occur, thus further delaying the taxation of deferred compensation. The proposed 457(f) regulations make it clear that rolling risks of forfeiture continue to be permitted, but that substantial future services must generally be performed for at least two years (among other restrictions), and that the present value of the deferred compensation must be at least 125% of the compensation that the employee would have received had not the agreement been extended. The proposed regulations also provide flexibility as to timing, allowing agreements to be extended if a written agreement is executed at least 90 days prior to the expiration of the existing substantial risk of forfeiture.

f. Employee elective deferrals of current compensation are permitted. It was previously unclear whether elective deferrals were permitted, but again the new proposed regulations provide important clarification that such deferrals are indeed allowed. Agreements to defer compensation must be in place prior to the initial calendar year of compensation deferral, with an exception for new hires, where the agreement must be in place within 30 days of hire.

P. Waiver of 60-Day Rollover Requirement.

1. Rev. Proc. 2016-47 provides guidance concerning waivers of the 60-day rollover requirement contained in sections 402(c)(3) and 408(d)(3) of the

Internal Revenue Code. Specifically, it provides for a self-certification procedure (subject to verification on audit) that may be used by a taxpayer claiming eligibility for a waiver under Sections 402(c)(3)(B) or 408(d)(3)(I) with respect to a rollover into a plan or individual retirement arrangement (IRA). It provides that a plan administrator, or an IRA trustee, custodian, or issuer may rely on the certification in accepting and reporting receipt of a rollover contribution. It also modifies Rev. Proc. 2003-16 by providing that the IRS may grant a waiver during an examination of the taxpayer's income tax return. An appendix contains a model letter that may be used for self-certification.

2. To qualify under the Revenue Procedure, the IRS must not have previously denied a waiver request on the requested rollover and the taxpayer must meet one of the following specified reasons:

a. An error was made by the financial institution receiving the contribution or making the distribution to which the contribution relates;

b. The distribution check was misplaced and never cashed;

c. The distribution was deposited into and remained in an account that the taxpayer mistakenly believed was an eligible retirement plan account;

d. The taxpayer's principal residence was severely damaged;

e. A member of the taxpayer's family died;

f. The taxpayer or a member of the taxpayer's family was seriously ill;

g. The taxpayer was incarcerated;

h. Restrictions were imposed by a foreign country;

i. A postal error occurred;

j. The distribution was made on account of a levy and the proceeds of which have been returned to the taxpayer; or

k. The party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite the taxpayer's reasonable efforts to obtain the information.

3. Once the reasons listed above no longer prevent the taxpayer from making the contribution, the rollover contribution must be made to the IRA or plan as soon as possible. There is a 30-day safe harbor to make the delayed contribution.

Q. Final Regulations Modify Minimum Present Value Requirements.

1. The IRS has issued final regulations (T.D. 9783) that modify the minimum present value requirements for defined benefit plan distributions to allow plans to simplify the treatment of some optional forms of benefit that are paid partly in the form of an annuity that is excepted from the minimum present value requirements and also in a more accelerated form. The final regulations apply to distributions with annuity starting dates in plan years beginning after December 31, 2016. A taxpayer may also apply the regulations to earlier periods.

2. The final regulations provide rules under which the participant's accrued benefit can be bifurcated so that the minimum present value requirements apply to only the portion of the participant's accrued benefit that is paid in an accelerated form. The proposed regulations provided for three different approaches to bifurcating the accrued benefit. Under the first approach, a plan could provide for two separate portions of the accrued benefit that are determined without regard to any election of optional form of benefit and allow a participant to choose different distribution options for each of those portions of the accrued benefit. Under the second approach, a plan could provide for proportionate benefits for each distribution option equal to the pro rata portion of the amount of the distribution that would be determined if that option had been applied to the entire accrued benefit. Under the third approach, the plan could provide for a specified amount to be distributed as a single sum, but only if the plan satisfied a minimum benefit requirement for the distribution that wasn't paid in a single sum.

3. The final regulations combine the first two bifurcation approaches from the proposed regulations. Under the final regulations, a plan may explicitly bifurcate the accrued benefit so that it provides that the requirements of Treas. Reg. 1.417(e)-1(d) apply to a specified portion of a participant's accrued benefit as if that portion were the participant's entire accrued benefit. This rule doesn't impose any requirements on the distribution options for the remaining portion of the accrued benefit. An alternative rule, that is generally the same as the third approach under the proposed regulations, provides that a plan that distributes a specified single-sum amount to a participant satisfies the requirements of reg. section 1.417(e)-1(d) for that payment, if the remaining portion of the participant's accrued benefit satisfies a minimum requirement.

R. Updated Plan Correction Program. The IRS has issued Rev. Proc. 2016-51, which supersedes Rev. Proc. 2013-12, and updates its qualified plan correction program known as the Employee Plans Compliance Resolution System ("EPCRS"). EPCRS may be used to correct plan qualification issues affecting certain types of retirement plans, such as 401(k) and profit sharing plans, pension plans, 403(a) plans, 403(b) annuities, SEPs, and SIMPLE plans. Generally, this updated EPCRS revenue procedure does not introduce new concepts, but (i) incorporates "correction" guidance previously issued by the IRS in 2015 (Rev. Proc. 2015-27 (addressing, among other items, the correction of overpayments) and Rev. Proc. 2015-28 (addressing the correction of auto-enrollment and other elective deferral failures)) and (ii) modifies EPCRS to take into account the major changes to the determination letter program for individually designed plans, reflected in Rev. Proc. 2016-37. For example, in light of the elimination of the staggered 5-year determination letter cycles for individually-designed plans, the new EPCRS provides that an individually-designed plan need not have a current determination letter in order to qualify for the self-correction of a significant error. In addition, the new guidance deletes the "user fees" section previously in the EPCRS revenue procedure (and lowered the fee for a late amendment upon which a favorable letter was conditioned that is adopted within 3 months from $1,000 to $750) – the user fees will now be included in the annual "user fee" revenue procedure (currently, Rev. Proc. 2016-8). Rev. Proc. 2016-51 is effective January 1, 2017.

S. Distributions from Decedent's Roth IRA. In an informational letter (INFO 2016-0071), the IRS has advised on whether a non-spouse beneficiary's failure to begin minimum required distributions within one year of a Roth IRA owner's death makes the life expectancy rule inapplicable and requires that distributions be made under the five-year rule described in Section 401(a)(9). According to the letter:

1. Post-death distributions from a Roth IRA to a designated beneficiary generally must be made in accordance with the required minimum distribution rules under section 401(a)(9)(B) as if the Roth IRA owner died before his or her required beginning date. Under these rules, if an employee dies before the employee's required beginning date, distribution of the employee's entire interest must be made either (1) in full within 5 years of the employee's death (the 5-year rule), or (2) over a period not extending beyond the beneficiary's life expectancy, beginning within one year of the employee's death (the life expectancy rule). Special rules apply if the beneficiary is the employee's spouse.

2. Whether the life expectancy rule or the 5-year rule applies in a particular situation is governed by § 1.401(a)(9)-3, Q&A 4 of the Treasury regulations. The regulations provide that if there is a designated beneficiary, distributions are to be made in accordance with the life expectancy rule, unless the terms of the plan either (a) require that distributions be made under the 5-year rule, or (b) permit the beneficiary to elect to use the 5 year rule. If the plan permits such elections by the beneficiary, the life expectancy rule will apply unless the beneficiary makes such election within a specific time period, or the plan provides that distributions will be made under the 5-year rule if no such election is made. The determination of which distribution period applies is made in accordance with these rules, and is not based on whether distributions in fact begin timely under the applicable rule.

3. Section 4974 of the Code imposes a 50% excise tax on any amounts that were required to be distributed under section 401(a)(9) but were not timely distributed, unless the imposition of such tax is waived. Publication 590-B provides that a taxpayer may request a waiver of the excise tax by attaching a

statement of explanation and completing Form 5329 as instructed under Waiver of tax in the Instructions for Form 5329.

IV. HEALTH CARE

A. New ACA Health Coverage Reporting.

1. Overview.

a. The Affordable Care Act (ACA) created a new reporting regime, which requires "large" employers to report certain information to the IRS about each of their full-time employees, including whether they offered the employees and their dependents the opportunity to enroll in health coverage, and information about that coverage. "Small" employers are generally exempt from these new IRS reporting requirements, unless they sponsor a self-insured health plan such as a Health Reimbursement Arrangement (HRA).

b. An employer is a large employer subject to the ACA reporting requirements if it had on average at least 50 full-time and full-time-equivalent employees (FTEs) in the previous calendar year (FTEs are part-time employees who count as a fraction of a full-time employee). The monthly FTE count is calculated by adding together all part-time employee hours for a month, up to 120 hours per employee, and dividing the sum of the hours by 120. Employers also need to count employees of certain commonly owned companies or entities (sometimes including those companies owned by spouses or children) to determine whether the aggregated group qualifies as a large employer.

c. ACA reporting requirements apply to full-time status and coverage offered on or after January 1, 2015, with the first information returns due in early 2016. Large employers will report on new IRS forms 1094-C (IRS transmittal) and 1095-C (employee return). The deadlines for these returns are the same as those that apply to Form W-2 reporting. Employers must be prepared to give their employees forms 1095-C by January 31. The IRS will expect transmittal of employers' paper returns by February 28 or electronic returns by March 31 of each year. Electronic filing is mandatory for employers that file at least 250 of such returns. Small employers sponsoring self-insured health plans must file returns on forms 1094-B and 1095-B and furnish 1095-B forms to employees by the same dates. However, the due dates for 2015 have been extended as follows:

i. The due date for furnishing the 2015 Form 1095-B, Health Coverage, was changed from January 31, 2016, to March 31, 2016; and

ii. The due date for filing with the Service the 2015 Form 1094-B, Transmittal of Health Coverage Information Returns, and the 2015 Form 1095-B, Health Coverage, was changed from February 29, 2016, to May 31, 2016. If filing electronically, the due date was changed from March 31, 2016, to June 30, 2016.

iii. The due date for furnishing the 2015 Form 1095-C, Employer-Provided Health Insurance Offer and Coverage, was changed from January 31, 2016, to March 31, 2016; and

iv. The due date for filing with the Service the 2015 Form 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns, and the 2015 Form 1095-C, Employer-Provided Health Insurance Offer and Coverage, was changed from February 29, 2016, to May 31, 2016. If filing electronically, the due date was changed from March 31, 2016, to June 30, 2016.

d. The IRS will use the information reported to enforce the ACA penalties that may apply to employers who do not offer affordable minimum value health coverage to their full-time employees (for this purpose, those who work 30 hours per week or 130 hours per month) and their dependents, and the individual mandate penalties that apply to individuals who fail to obtain health coverage. In addition, using the reporting information, the IRS will verify individuals' eligibility for health premium subsidies available on the health insurance exchanges pursuant to the ACA. Because this information is critical for the IRS in administering ACA penalties and subsidies, it will closely monitor employers' compliance with the reporting requirements. Penalties for failure to file or provide accurate information can add up to as much as $6 million per year. In 2016, however, the IRS will not impose accuracy penalties on employers that file and furnish the reports timely and complete them in good faith.

2. Extensions. Except for 2015 reporting as noted above, Form 1095-C must be furnished to employees by January 31 each year. An employer that cannot meet the deadline may send a letter to the IRS requesting a 30-day extension of the deadline, but employers should keep in mind that the IRS generally grants extensions for furnishing similar employee statements only in extraordinary circumstances. An extension is unlikely because the information is critical for administering exchange subsidies. Therefore, employers should furnish the statements to employees on time. Fortunately, it is much easier to secure an extension of the IRS transmission deadline. Employers must transmit paper forms to the IRS by February 28 and electronic forms by March 31 each year. However, employers that file Form 8809 by the original filing deadline receive an automatic 30-day extension for the IRS transmission. The IRS may also grant an additional 30-day extension on account of hardship.

3. Penalties. The penalties for filing to timely issue, transmit, or provide accurate information on the returns are significant. A $250 per return penalty applies to failures to timely furnish correct statements to employees, and another $250 penalty applies for failure to timely file accurate returns with the IRS, with each type of penalty (furnishing and filing) subject to a separate maximum of $3 million per year. This penalty also applies separately to original returns and corrected returns. These penalties can add up quickly. Where a filer intentionally disregards the requirement to furnish a statement to an individual, the per-return

and maximum penalties may be elevated. Timely filing is even more important for the 2016 requirement. Solely for this first filing, the IRS will not impose accuracy penalties on employers that can demonstrate good faith efforts to report accurate information on the new forms. To qualify for this relief, employers must also timely file and furnish the inaccurate reports. The IRS may also waive the penalties if employers can show reasonable cause for failure to comply with the reporting requirements.

4. Electronic Filing and Providing Statements Electronically. Employers that file 250 or more forms of the same type (e.g., Form 1095-C) are required to file the reports electronically with the IRS's ACA Information Return system ("AIR system"). For these purposes, the IRS has developed guidelines for software developers and transmitters (including employers that undertake their own electronic filing). The guidelines are found in Publication 5165, and the Extensible Markup Language (XML) Schemas that the transmitters must use are published on IRS.gov. Employers may request a hardship waiver from electronic filing by submitting Form 8508 to the IRS at least 45 days before the due date for the return, but most employers have engaged third-party vendors, such as an accountant, payroll company, or consultant, to transmit the filing on their behalf. An employer that fails to file a return electronically when required to do so or to obtain a waiver will be subject to a $250 per-return penalty. Employers can also deliver the new 1095-Cs to their employees by electronic means, but only if they obtain prior affirmative consent from the employee in accordance with the procedures for electronic delivery of Form W-2s. Employers reporting coverage under expatriate plans may use negative consent for these purposes (i.e., they may default to electronic delivery as long as the employee does not affirmatively refuse consent). The IRS has announced that a reporting entity that missed the June 30, 2016 filing deadline will generally not be assessed late filing penalties if it: (i) made "legitimate efforts" to register with the AIR system and file its ACA information returns, and (ii) continues to make such efforts and completes the process as soon as possible.

5. Practice Guidelines.

a. The following chart can be used to help determine what IRC section applies:

	Health Plan	IRC Section 6055 (IRS Form 1094-B and 1095-B)	IRC Section 6056 (IRS Form 1094-C and 1095-C)
Less than 50	None	n/a	n/a
Less than 50	Insurance Company	n/a	n/a
Less than 50	Self-insured	YES	
Less than 50, but affiliated group > 50	None		YES
Less than 50, but affiliated group > 50	Insurance Company		YES
Less than 50, but affiliated group > 50	Self-insured	YES	YES
50 or more	None		YES
50 or more	Insurance Company		YES

b. After determining what code section is applicable, the following chart can be used to help determine what tax forms need to be filed and when:

Section	Transmittal	Employee Information	Due Date
IRC Section 6055	1094-B	1095-B	02/28/2016
IRC Section 6056	1094-C		02/28/2016 (paper copy) 03/31/2016 (e-file)
IRC Section 6056		1095-C	01/31/2016 (employee 02/28/2016 (paper copy) 03/31/2016 (e-file)

B. Guidance on Health Coverage Tax Credit. The IRS has issued guidance (Notice 2016-2) on the health coverage tax credit (HCTC) under section 35, explaining who may claim the HCTC, the amount of the credit, and the procedures to claim the HCTC for tax years 2014 and 2015. The notice also provides guidance for taxpayers eligible to claim the HCTC who enrolled in a qualified health plan (QHP) offered through a health insurance marketplace (also known as an exchange) in tax years 2014 or 2015, and who claimed or are eligible to claim the premium tax credit (PTC) under section 36B, including taxpayers who received the benefit of advance payments of the PTC. A QHP offered through an exchange is qualified health coverage for the HCTC for months in tax years beginning in 2014 or 2015. Therefore, an individual enrolled in a QHP who is both an eligible individual for purposes of the HCTC and eligible for the PTC in a month may claim either the HCTC or the PTC for the month. Once the HCTC election is made for an eligible coverage month, the individual is ineligible to claim the PTC for the same coverage in that coverage month and for all subsequent months in the tax year for which the individual is eligible for the HCTC. However, a taxpayer may claim the PTC and the HCTC in the same month for different coverage. The IRS noted that a unique situation arises, as addressed in Notice 2005-50, if qualifying health insurance covers individuals eligible for the HCTC as well as other individuals for whom the HCTC is not elected. However, section 36B and its accompanying regulations, which were issued after Notice 2005-50, include special rules for allocating premium amounts when a QHP covers individuals in more than one tax family. For simplification purposes, Notice 2016-2 provides that to determine the allowable HCTC, taxpayers should apply the rules under section 36B to allocate premium amounts and advance payments of the PTC among tax families instead of the rule described in Notice 2005-50. Accordingly, if the individuals enrolled in a QHP belong to different tax families, one family may claim the HCTC for the HCTC-eligible individuals in the plan, and the other family may claim the PTC for the other individuals enrolled in the plan, and each family determines their portion of the enrollment premiums and advance payments of the PTC using the allocation rules provided under section 36B. Notice 2005-50 is modified to the extent that it is inconsistent with this rule. A taxpayer who receives advance payments of the PTC in excess of the allowable PTC must generally repay the difference as additional tax. Although the amount of additional tax that must be repaid may be limited by section 36B(f)(2), the repayment limitations do not apply to coverage for 2014 or 2015 if the taxpayer elects the HCTC for any month in that year for that coverage. Therefore, Notice 2016-2 provides that a taxpayer who elects the HCTC for coverage in 2014 or 2015 and who received the benefit of an advanced payment of the PTC for that coverage must repay all advance payments in excess of the allowable PTC. Notice 2016-2 also includes a list of frequently asked questions regarding the credits.

C. **Final Insurance Market Reforms**. On November 18, 2015, the "Departments published final regulations regarding what are informally known as the Affordable Care Act's ("ACA") "market reforms" (the "Final Rule"). 80 Fed. Reg. 72192. These "market reform" requirements relate to grandfathered health plans, preexisting condition exclusions, lifetime and annual dollar limits on benefits, rescissions, coverage of dependent children to age 26, internal claims and appeal and external review processes, and patient protections under the ACA. The Final Rule applies to group health plans and health insurance issuers beginning on the first day of the first plan year (or, in the individual market, the first day of the first policy year) beginning on or after January 1, 2017. Important clarifications regarding the market reform rules include:

1. <u>Adding an Employer to a Grandfathered Multiemployer Plan Will Not Affect Grandfathered Status</u>. The addition of a new contributing employer

or new group of employees of an existing contributing employer to a grandfathered multiemployer plan will not affect the plan's grandfathered status, provided that the multiemployer plan has not made any other changes that would cause the plan to relinquish grandfathered status.

2. Prohibiting HMOs from Excluding Dependents Under Age 26 Because They Live Outside the Service Area. Eligibility restrictions requiring participants to live, work, or reside in the service area violate the ACA, to the extent such restrictions are applicable to dependent children up to age 26.

3. Right to Receive New or Additional Evidence or Rationale Automatically in Connection with Appeal. Plans and issuers must provide the claimant, free of charge, with new or additional evidence considered, relied upon, or generated by the plan or issuer in connection with the claim, as well as any new or additional rationale as soon as possible and in advance of the notice of final adverse benefit determination. The Final Rule clarifies that this information must be provided automatically. Notice of new information is insufficient.

4. Health Reimbursement Account ("HRA") Integration Rules. The Final Rule allows HRA integration with Medicare for employers with fewer than 20 employees that are not required to offer their group health plan coverage to employees who are eligible for Medicare coverage, and clarifies that for purposes of the HRA integration rules generally, forfeiture or waiver occurs even if the forfeited amounts or waived reimbursements may be reinstated upon a fixed date, a participant's death, or the earlier of the two events (the reinstatement event).

D. Delay in Cadillac Tax and HIF Moratorium. On December 18, 2015, the President signed H.R. 2029, a massive year-end spending and tax bill containing a number of provisions affecting health and welfare plans. Issues of particular note to health and welfare plans include:

1. High Cost Employer-sponsored Health Coverage Excise Tax ("Cadillac Tax"). The CAA includes a two-year delay of the high cost employer-sponsored health coverage excise tax (commonly dubbed the "Cadillac tax"). The tax will now not be effective until 2020. The CAA also makes the excise tax deductible for employers, and commissions a study by the General Accounting Office on the appropriate benchmark for adjustments in the excise tax threshold based on the employer's workforce age and gender characteristics as compared to the national workforce.

2. Health Insurer Fee Moratorium. The CAA imposes a one-year moratorium, for 2017, on the annual fee on health insurance providers (ACA sec. 9010).

E. IRS "Potluck" Guidance on Employer Group Health Plans. On December 16, 2015, the IRS released Notice 2015-87, the so-called "Potluck Notice", addressing various unresolved issues under the ACA relating to employer-provided coverage. Highlights of the Notice include the following regarding the employer mandate provisions of the ACA:

1. Opt Out Credits. Future regulations will provide that cash incentives offered to an employee for opting-out of group health coverage, often referred to as "opt out credits", will count against the affordability of the health coverage (effectively making the coverage less affordable for the employee).

2. Treatment of Disability Income Payments. An employer must credit "hours of service" for employees receiving short-term or long-term disability, unless the payments are made from an arrangement to which the employer did not contribute directly or indirectly.

F. Proposed Regulations on Disability Claims. On November 18, 2015, the Department of Labor (the "DOL") published proposed amendments to the claims procedure regulations for ERISA plans providing disability benefits ("Proposed Rule"). 80 Fed. Reg. 72014. The DOL states that its intent is to extend the procedural rules that apply to health care claims under the ACA (which were also finalized on November 18, 2015) to disability claims. The disability changes would take effect 60 days after publication of the final rule. Changes of concern include:

1. Disclosure of the Basis for Disagreeing with a Third Party. Adverse benefit determinations would have to contain a discussion of the decision, including the basis for disagreeing with any disability determination by the Social Security Administration, a treating physician, or other third party disability payor presented by the claimant, to the extent the plan did not follow those determinations. It is unclear how a plan can protect itself when its doctors disagree with the treating physician, for example.

2. Strict Compliance and Possible De Novo Review. If the plan fails to strictly adhere to all the claims requirements, the reviewing court would not give special deference to the plan's decision, but would review the dispute de novo. The proposal allows for a minor errors exception, which would apply only when a violation was (1) de minimis, (2) non-prejudicial, (3) attributable to good cause or matters beyond the plan's control, (4) in the context of an on-going good faith exchange of information, and (5) not reflective of a pattern or practice of noncompliance. The strict compliance standard will encourage claimants to litigate, in the hope that a judge will ignore the plan's decision and review de novo. The DOL's stated rationale, in part, for the Proposed Rule is "the volume and constancy of litigation in this area;" it would appear that the DOL seeks to give claimants an edge in court that they do not currently enjoy.

3. Right to Review and Respond to New Information Before Final Decision. Prior to a decision on appeal, the plan would be required to provide to the claimant, free of charge, any new or additional evidence considered, relied upon, or generated by (or at the direction of) the plan in connection with the claim, as well as

any new or additional rationale for a denial. The claimant must then be given a reasonable opportunity to respond to such new or additional evidence or rationale. The Proposed Rule does not state how a plan can meet existing deadlines for a decision while adding this extra step to the appeals process.

G. **ADA Wellness**. On December 31, 2015, in *EEOC v. Flambeau, Inc.*, the US District Court for the Western District of Wisconsin held that the "bona fide benefit plan" safe harbor under the Americans with Disabilities Act (ADA) allowed an employer to design its wellness program to require a health risk assessment and a biometric screening as a condition of plan enrollment (2015 WL 9593632 (Dec. 31, 2015)). The EEOC argued that this was a prohibited medical examination under the ADA. The employer's argument was that it used the wellness program to identify health risks and for underwriting purposes and thus, the program was permitted under the bona fide benefit plan safe harbor exception, and the program fit within the ADA exception for voluntary wellness programs. The court held that the wellness program was permissible under the bona fide benefit plan safe harbor, and therefore, did not address whether the program was voluntary. Notably, the court rejected the EEOC's argument that the bona fide benefit plan safe harbor would invalidate the exception for voluntary wellness programs. This is important because in the proposed ADA wellness program rules the EEOC issued last year, it noted in a footnote that it "does not believe that the ADA's 'safe harbor' provision . . . . is the proper basis for finding wellness program incentives permissible." It will be interesting to see if the EEOC addresses this issue when it issues the final ADA wellness regulations.

H. **Health Care Reimbursement Arrangements.**

1. <u>What are the consequences to the employer if the employer does not establish a health insurance plan for its own employees, but reimburses those employees for premiums they pay for health insurance (either through a qualified health plan in the Marketplace or outside the Marketplace)?</u>

a. Under IRS Notice 2013-54, such arrangements are described as employer payment plans. An employer payment plan, as the term is used in this notice, generally does not include an arrangement under which an employee may have an after-tax amount applied toward health coverage or take that amount in cash compensation.

b. As explained in Notice 2013-54, these employer payment plans are considered to be group health plans subject to the market reforms, including the prohibition on annual limits for essential health benefits and the requirement to provide certain preventive care without cost sharing. Notice 2013-54 clarifies that such arrangements cannot be integrated with individual policies to satisfy the market reforms. Consequently, such an arrangement fails to satisfy the market reforms and may be subject to a $100/day excise tax per applicable employee (which is $36,500 per year, per employee) under section 4980D of the Internal Revenue Code.

2. Is there transition relief available from the excise tax under § 4980D for certain employers who offered their employees health coverage through arrangements that would constitute an employer payment plan as described in Notice 2013-54?

a. Yes. On February 18, 2015, the IRS issued Notice 2015-17, which provides transition relief from the excise tax under § 4980D for failure to satisfy the market reforms in certain circumstances. The transition relief applies to employer healthcare arrangements that are (i) employer payment plans, as described in Notice 2013-54, if the plan is sponsored by an employer that is not an Applicable Large Employer (ALE) under Code § 4980H(c)(2) and §§ 54.4980H-1(a)(4) and -2 of the regulations; (ii) S corporation healthcare arrangements for 2-percent shareholder-employees; (iii) Medicare premium reimbursement arrangements; or (iv) TRICARE-related health reimbursement arrangements (HRAs).

b. Notice 2015-17 provides temporary relief from the § 4980D excise tax for failure to satisfy the Affordable Care Act market reforms such as the prohibition on annual limits. Under the notice, small employers with employer payment plans get relief for 2014 and up to July 1, 2015. Small employers are employers that are not Applicable Large Employers under § 4980H (generally less than 50 full time and full time equivalent employees in prior year).

c. Notice 2015-17 also clarifies that S corporations may continue to report reimbursements of health insurance of 2 percent shareholders pursuant to Notice 2008-1. Until further guidance is issued, and in any event through the end of 2015, the excise tax under Code § 4980D will not be asserted for any failure to satisfy the market reforms by a 2-percent shareholder-employee healthcare arrangement.

3. More information.

a. On Sept. 13, 2013, the IRS issued Notice 2013-54, which explains how the Affordable Care Act's market reforms apply to certain types of group health plans, including health reimbursement arrangements (HRAs), health flexible spending arrangements (health FSAs) and certain other employer healthcare arrangements, including arrangements under which an employer reimburses an employee for some or all of the premium expenses incurred for an individual health insurance policy.

b. On February 18, 2015, the IRS issued Notice 2015-17, which reiterates the conclusion in previous guidance addressing employer payment plans, including Notice 2013-54, that employer payment plans are group health plans that will fail to comply with the market reforms that apply to group health plans under the Affordable Care Act. Notice 2015-17 also provides transition relief from the assessment of the excise tax under § 4980D for failure to satisfy market reforms in certain circumstances.

c. DOL has issued a notice in substantially identical form to Notice 2013-54, DOL Technical Release 2013-03. On Jan. 24, 2013, DOL and HHS issued FAQs that address the application of the Affordable Care Act to HRAs. On Nov. 6, 2014, DOL issued additional FAQs that address the application of the Affordable Care Act to HRAs and other payment arrangements.

I. **Individual Policy Arrangements.** The IRS has released four information letters on individual policy arrangements and related issues. These letters are provided by the IRS Office of Chief Counsel. One of them responds directly to a governmental employer, and the others respond to inquiries from members of Congress on behalf of constituents.

1. Opt-Out Arrangements Permissible. Information Letter 2016-0023 describes a plan design in which a governmental employer pays additional taxable compensation to employees with other health coverage who forgo coverage under the employer's group health plan (often referred to as "opt-out payments"). Opt-out payments do not result in a health plan subject to health care reform so long as the additional taxable compensation is unrelated to the cost of the employee's other coverage. The letter notes that such an arrangement may have implications when calculating employee contributions for employer-sponsored coverage, based on the guidance in IRS Notice 2015-87 (when required employee contributions are not "affordable," employees are potentially eligible for premium tax credits and applicable large employers have potential liability under Code § 4980H(b)).

2. Small Plans Exception Allows Reimbursement of Individual Policy Premiums. Information Letter 2016-0005 reiterates that an employer's arrangement to reimburse the individual health insurance premiums of its only employee does not violate health care reform because the applicable requirements do not apply to a plan that has fewer than two participants who are active employees (sometimes referred to as the "small plans exception")

3. Relief for Certain S Corporation Arrangements Continues to Apply. Information Letter 2016-0021 acknowledges continued reliance on IRS Notice 2015-17, which states that an S corporation will not be subject to Code § 4980D excise taxes solely as a result of having a "2% shareholder-employee health care arrangement". Under such an arrangement, the S corporation pays for or reimburses premiums for individual health insurance coverage for a "2% shareholder," the payment or reimbursement is included in income, and the premiums are deductible by the 2% shareholder-employee under Code § 162(l). The letter also notes that an S corporation plan covering only a single employee (whether or not a 2% shareholder) would generally not be a group health plan subject to health care requirements since it would qualify for the small plans exception.

4. Reimbursement of Individual Policy Premiums Impermissible Unless Combined With Compliant Employer Plan. Information Letter 2016-0019 reiterates the IRS's now well-established position first articulated in IRS Notice 2013-54 that, subject to narrow exceptions, an employer violates health care reform requirements (most notably, the prohibition against an annual dollar limit on essential health benefits) by reimbursing or paying employee premiums for individual health insurance. This is because an employer's reimbursement of medical expenses up to a fixed amount is a group health plan that is deemed to have an annual limit on essential health benefits. An employer may, however, combine such an arrangement with a compliant employer group health plan (i.e., one that does not impose annual limits on essential health benefits) to determine whether the combined arrangement satisfies the annual limit (and other applicable rules). In addition, the letter notes that an employer that does not want to offer group health plan coverage may provide additional taxable compensation to its employees that the employees can use for any purpose, including the purchase of an individual health policy.

J. Proposed Form 5500 Changes & the new Schedule J: Big Changes for Small Group Health Plans.

1. The US Department of Labor (DOL) has proposed changes to the Form 5500 and schedules that will affect ERISA Title I group health plans of all sizes, but small group health plans should be especially aware of the changes. Certain small group health plans (fewer than 100 participants) are currently exempt from filing the Form 5500 Annual Return if they are fully insured, unfunded, or a combination of these. Under the proposed Form 5500 changes, these plans would no longer be exempt and all group health plans covered by Title I would be required to file a Form 5500 including a new Schedule J, Group Health Plan Information. This new schedule would drastically expand the group health plans information gathered. Changes to the form would generally be effective for plan years beginning on or after January 1, 2019.

2. According to estimates provided by the DOL, approximately 6,200 small group health plans currently file a Form 5500, at an aggregate cost of $4.1 million, but under the proposed changes that number would increase to an estimated 2,158,000 small group health plans at an estimated aggregate cost of $227.9 million. Schedule J alone is estimated to affect an estimated 2,205,900 group health plans of all sizes and will increase Form 5500 filing costs by $202.6 million, while the total increased burden from all proposed Form 5500 changes for group health plans is estimated to be a 2.2 million hours and $241.6 million.

3. Fully insured group health plans with fewer than 100 participants would complete a limited portion of Schedule J covering information on participation, coverage, insurance company, and basic benefits. The complete schedule would also require reporting of:

a. How many individuals are receiving COBRA coverage through the plan.

b. Who may be covered under the plan (employees, spouses, dependents, and/or retirees).

c. Whether the plan has a high deductible.

d. Whether the plan is an FSA or HRA (or has either as a component).

e. Whether the plan is claiming grandfathered status under the ACA.

f. Information about any rebates or reimbursements from a service provider, such as a medical loss ratio rebate under the ACA.

g. Total premium payment and other details regarding stop loss coverage.

h. Information about employer and participant contributions (for plans not completing Schedule H), and whether any contribution forwarding was untimely.

i. Claims payment information, including:

i. Counts of claims approved and denied, with a dollar amount of claims paid;

ii. Counts of benefit claim appeals (and results of appeals);

iii. Counts of benefit claims adjudicated late;

iv. Counts of pre-service claims appealed (and results of appeals); and

v. Whether the plan was unable to pay claims at any time during the year.

j. For plans with insurance policies, whether premiums were paid timely and whether any delinquent payments resulted in coverage lapse.

k. Self-reporting of compliance with various federal laws (including HIPAA, GINA, MHPAEA, and ACA).

l. Whether the plan is subject to, and if so, has complied with the Form M-1 filing requirements, a question that would be moved from the current Form 5500.

V. ESTATE PLANNING

A. 2016 Inflation Adjustments.

1. Estates of decedents who die during 2016 have a basic exclusion amount of $5,450,000 (up from a total of $5,430,000 in 2015).

2. For 2016, the exclusion from tax on a gift to a spouse who is not a U.S. citizen is $148,000 (up from $147,000 for 2015).

3. The annual exclusion for gifts remains at $14,000 for 2016.

4. For an estate of a decedent dying in calendar year 2016, if the executor elects to use the special use valuation method under Code Sec. 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use Code Sec. 2032A for purposes of the estate tax cannot exceed $1,110,000.

5. Code Sec. 6039F authorizes the Treasury Department and the IRS to require recipients of gifts from certain foreign persons to report the gifts when the aggregate value of gifts received in the tax year exceeds $15,671.

B. Extension Granted to Make Portability Election. In LTR 201548004, the IRS granted an estate an extension of time to make a portability election under section 2010(c)(5) to allow a surviving spouse to take into account the decedent's unused spousal exclusion amount.

C. Basis Reporting Forms.

1. Background. Last summer, the Highway Trust Fund received a short-term cash infusion from legislation that also imposed new basis reporting requirements on estate executors. These requirements, which are found in new Code Section 6035, apply to estate tax returns filed on or after August 1, 2015, and mandate that within 30 days of filing an estate tax return, an executor file a statement, with both the IRS and estate beneficiaries, detailing estate property and its value.

2. Delayed Effectiveness. Because the first statements would have been due at the end of August 2015 (generally relating to people who died in the fall of 2014), the IRS issued a reprieve on August 21, 2015. Notice 2015-57 instructed executors to wait until February 29, 2016 to file anything that might otherwise be due, so as to give the IRS time to develop forms and guidance. Notice 2016-19 was subsequently released extending the date to March 31, 2016 for Form 8971 to be filed if otherwise due before March 31, 2016. Thereafter, the IRS has issued temporary regulations (T.D. 9757) providing transition rules under which executors and other persons required to file or furnish a statement under Section 6035 before March 31, 2016, need not do so until that date. The IRS extended the

deadline again in Notice 2016-27 from March 31, 2016, to June 30, 2016. Notice 2016-27 is effective March 23, 2016, and applies to executors of the estates of decedents and to other persons required under Section 6018 to file a return if that return is filed after July 31, 2015.

3. New Form. On December 18, 2015, the IRS issued draft Form 8971, "Information Regarding Beneficiaries Acquiring Property from a Decedent." On January 6, 2016, draft instructions for the form were sent to the Office of Management and Budget for review. The Form 8971 includes a Schedule A, which is to be submitted to each beneficiary receiving property from the decedent's estate.

4. Uncertainty How Residuary Estate will be Divided. The executor must complete a Schedule A for each beneficiary "that acquired (or is expected to acquire) property from the estate." And if, by the deadline for Form 8971, the executor hasn't yet determined who gets what, the executor must list on that beneficiary's Schedule A "all items of property that could be used, in whole or in part, to fund the beneficiary's distribution."

5. Unresolved Issues. The instructions do not address a number of questions that have been raised, including:

a. *Portability*. If the decedent's estate is under the current $5.45 million filing threshold for estate tax returns, but the executor files one anyway so that deceased spouse's unused exclusion amount carries over to the surviving spouse (a "portability" return), must the executor still file the Form 8971?

b. *Assets with No Basis Adjustment*. If beneficiaries receive cash (it has no basis) or assets that do not receive a basis adjustment (such as annuities or retirement accounts), is basis reporting required?

6. Penalties. The instructions detail the potential penalties for failing to file a correct Form 8971 by the due date.

a. If it is filed within 30 days after the due date, the penalty is $50 per Form 8971, with a maximum penalty of $500,000 per year, or $175,000 if the taxpayer qualifies for lower penalties.

b. If it is filed more than 30 after the due date, the penalty is $250, with a maximum penalty of $3 million, or $1 million if the taxpayer qualifies for lower penalties.

D. Proposed and Temporary Regulations on Basis Reporting. Proposed and temporary regulations issued by the IRS on Wednesday govern the newly enacted provision that requires consistency between a recipient's basis in certain property acquired from a decedent and the value of the property as finally determined for federal estate tax purposes (REG-127923-15; T.D. 9757). The regulations provide rules regarding the consistent basis reporting requirement and the required statement that must be furnished to the IRS and beneficiaries.

1. Portability and GST Elections. The proposed regulations exclude from the reporting requirements any estate tax return filed solely to claim a Section 2010(c)(5) portability election or a generation-skipping transfer tax election or allocation because these returns are not required to be filed under Section 6018.

2. Must Increases Estate Tax Liability. The consistent basis requirement of Section 1014(f)(1) applies only to property where the inclusion of that property in the decedent's gross estate for federal estate tax purposes increases the estate tax liability. The proposed regulations define this property as property includible in the gross estate under Section 2031 and property subject to tax under Section 2106 that generates a federal estate tax liability in excess of allowable credits. The regulations specifically exclude all property reported on a required estate tax return if no estate tax is imposed on the estate due to allowable credits (other than the credit for tax prepayment).

3. Marital or Charitable Deduction. If federal estate tax is due, the proposed regulations exclude property that qualifies for the marital or charitable deduction because this property does not increase federal estate tax liability.

4. Final Value Defined. The final value of property is defined in the proposed rules as either (i) the value reported on a federal estate tax return filed with the IRS that the IRS does not contest before the period of limitation on assessment expires; (ii) the value the IRS specifies if it is not timely contested by the estate's executor of the estate; or (iii) the value as determined by a court or under a settlement agreement with the IRS.

5. Executor Defined. An executor is defined in the proposed regulations as having the same meaning as in Section 2203, which includes appointed administrators and executors, and, if there is no administrator or executor, any person who is in actual or constructive possession of any of the decedent's property, but also includes any beneficiary required to file an estate tax return under Section 6018(b).

6. Subsequent Transfers. The proposed regulations require additional information reporting by certain subsequent transferors in some circumstances. Prop. Treas. Reg. 1.6035-1(f) provides that, for property that was previously reported or is required to be reported under Section 6035, if the recipient distributes or transfers all or any portion of the property to a related transferee (directly or indirectly) in a transaction in which the transferee's basis for federal income tax purposes is determined in whole or in part by reference to the transferor's basis, the transferor must file with the IRS and furnish the transferee with a supplemental statement, documenting the new ownership of the property. Related transferees, for these purposes, include family members, controlled entities, and trusts of which the transferor is deemed the owner.

E. Estate Includes Assets Decedent Transferred to Limited Partnership.

1. Overview. In *Estate of Sarah D. Holliday et al. v. Commissioner*, T.C. Memo. 2016-51; No. 8143-13 (16 Mar 2016), the Tax Court held that assets in a limited partnership were taxable at full value in the estate.

2. Background.

a. Decedent Sarah D. Holliday created Oak Capital Partners, LP (Oak Capital) on November 30, 2006. OVL Capital Management, LLC (OVL Capital) was the general partner with a 0.1% interest and Holliday owned limited partnership shares with a 99.9% interest.

b. On December 6, 2006, Holliday sold the OVL Capital shares to her sons Joseph and Douglas for two payments of $2,959.84. She also transferred 10% of her limited partnership shares to Holliday Irrevocable Trust.

c. Oak Capital was funded with $5,919,683 of public securities. It was maintained thereafter in various liquid public securities. The decedent passed away on January 7, 2009 owning 88.9% of the limited partnership shares. The estate discounted the $4,064,759 asset value to $2,428,200.

3. Arguments.

a. The IRS audited the estate and assessed a deficiency of $785,019. At trial, the IRS maintained that Holliday had retained the enjoyment of the assets and there was inclusion in the estate under Sec. 2036(a)(1).

b. Section 5 of the partnership agreement indicated that if "the partnership has sufficient funds in excess of its current operating needs to make distributions to the partners, periodic distributions of Distributable Cash shall be made to the partners on a regular basis according to their respective partnership interest." The IRS maintained that there was a right to receive distributions and the family had indicated that she would receive distributions if needed. Even though Holliday had retained substantial assets outside the limited partnership, the Tax Court determined that she had indeed a retained right under Section 2036(a)(1).

c. The estate also claimed that there was a "bona fide sale" and therefore the discount should be honored. The estate observed that she was concerned there would be risk of trial attorney extortion, that a caregiver could subject her to undue influence and that there was a family goal to preserve assets.

4. Tax Court. The Tax Court noted that there were public securities, she had ample other assets and there was no unusual liability risk. There was no demonstrated reason for a caregiver risk and the decedent had been on both sides of the transaction. There was no arms-length negotiation involved. Therefore, there were no "legitimate and nontax reasons for the transfer of assets." Because the trust also failed to follow appropriate and normal business procedures

in its administration, the assets were included at fair market value under Sec. 2036(a)(1).

F. Required Minimum Distributions. In PLR 201628006, the IRS required the minimum distribution rules apply to a designated beneficiary despite state court's post-mortem reformation of the decedent's trusts. After the decedent's death, the trustees of the trusts petitioned the Court for a declaratory judgment to modify the beneficiary designation for the decedent's IRA to carry out the intent of the decedent's original estate plan. Based on its finding of the decedent's intent, the Court ordered that the beneficiaries of the IRA are Trust #1 as a 50% beneficiary, and Trusts #2 and #3 each as 25% beneficiaries, consistent with Decedent's prior beneficiary designation. The order was retroactively effective as if such designation were made on the date Decedent signed the beneficiary designation form for the IRA. Although the Court order changed the beneficiary of the IRA under State law, the IRS determined that the order could not create a 'designated beneficiary' for purposes of Section 401(a)(9).

G. Restrictions on Valuation Discount. Proposed regulations under Section 2704 of the Internal Revenue Code, released on August 2, 2016, would make significant changes to the valuation of interests in many family-controlled entities for estate, gift, and generation-skipping transfer tax purposes.

1. <u>Background</u>.

a. In 1990, Congress enacted Section 2704 of the Internal Revenue Code, titled "Treatment of Certain Lapsing Rights and Restrictions," in an effort to limit the valuation discounts for gift and estate tax purposes applicable in the case of intra-family transfers of interests in family-owned, or "closely held," corporations and partnerships.

b. If an individual and the individual's family hold voting or liquidation control over a corporation or partnership, section 2704(a) provides that the lapse of a voting or liquidation right shall be taxed as a transfer subject to gift or estate tax.

c. Section 2704(b) provides that when an interest in a family-owned corporation or partnership is transferred within the family, if a restriction limits the ability of the corporation or partnership to liquidate and that restriction can be removed by the family, that restriction is disregarded in valuing the transferred interest for gift or estate tax purposes.

2. <u>The Proposed Regulations</u>. The IRS released the section 2704 proposed regulations on August 2, 2016, and they were published in the Federal Register on August 4, 2016. 81 Fed. Reg. 51413-51425 (Aug. 4, 2016). The proposed regulations would:

a. Treat as an additional transfer the lapse of voting and liquidation rights for transfers made within three years of death of interests in a family-controlled entity, thereby eliminating or substantially limiting the lack of control and minority discounts for these transfers;

b. Eliminate any discount based on the transferee's status as a mere assignee and not a full owner and participant in the entity;

c. Disregard the ability of most nonfamily member owners to block the removal of covered restrictions unless the nonfamily member has held the interest for more than three years, owns a substantial interest in the entity, and has the right, upon six months' notice, to be redeemed or bought out for cash or property, not including a promissory note issued by the entity, its owners, or anyone related to the entity or its owners;

d. Disregard restrictions on liquidation that are not mandated by federal or state law in determining the fair market value of the transferred interest; and

e. Clarify the description of entities covered to include limited liability companies and other entities and business arrangements, as well as corporations and partnerships.

3. Effective Date. The provisions of the proposed regulations applicable to voting and liquidation rights are proposed to apply to rights and restrictions created after October 8, 1990, but only to transfers occurring after the date the regulations are published as final regulations.

H. Relief for Unnecessary DSUE QTIP Elections. On Sept. 27, 2016, the Internal Revenue Service released Rev. Proc. 2016-49, providing new procedures for treating as null and void a qualified terminable interest property (QTIP) election to qualify property for the estate tax marital deduction. The new procedure resolves an issue that has persisted since the 2010 enactment of Internal Revenue Code Section 2011(c) involving whether the QTIP election could be made, not to avoid federal estate, but to increase the amount of deceased spousal unused exemption (DSUE) being ported to the surviving spouse.

VI. MERGERS & ACQUISITIONS

A. New Proposed Regulations on Fee Waivers. The Treasury Department issued proposed regulations (REG-115452-14), addressing when a fee waiver will be treated as a disguised payment for services. They will affect many common private equity fund arrangements in which a profits interest is granted in exchange for a fee waiver.

1. Background. Private equity funds are generally managed by separate management companies related to the general partner. The general partner typically owns a 1 percent capital interest in the fund and a profits interest entitling the manager to a 20 percent share of the fund's profits. The manager has the right to a fixed fee, usually 2 percent of invested capital, but no profits interest.

Fee waivers are used to defer fee income and convert it to capital gain when private equity funds sell companies. In the typical management fee waiver, the manager waives its right to the fixed fee in exchange for a profits interest in the fund and a special distribution on that interest. However, in some cases managers have waived their fees when they were already due and made sure that they had the broad discretion to define profits in such a way that they could allocate the fees to their profits interest even when the fund was not profitable.

2. Proposed Regulations. The proposed regulations apply to arrangements that are treated as a "disguised payment for services." Six non-exclusive factors are used in determining whether a disguised payment for services exists. The most important of these factors is whether the arrangement has "significant entrepreneurial risk." The following facts create a presumption that an arrangement lacks significant entrepreneurial risk:

- Capped allocations of income if the cap is reasonably expected to apply in most years;
- An allocation for one or more years under which the manager's share of income is reasonably certain;
- An allocation of gross income;
- An allocation (under a formula or otherwise) that is predominately fixed in amount, is reasonably determinable, or is designed to assure that sufficient net profits are highly likely to be available; and
- An arrangement in which a manager waives its rights to receive payment for the future performance of services in a manner that is non-binding or fails to timely notify the private equity fund and its partners of the waiver and its terms.

The other five factors are (i) the manager holds, or is expected to hold, a transitory partnership interest or a partnership interest for only a short duration, (ii) the manager receives an allocation and distribution in a time frame comparable to the time frame that a non-partner service provider would typically receive payment, (iii) the manager became a partner primarily to obtain tax benefits that would not have been available if the services were rendered to the private equity fund in a third-party capacity, (iv) the value of the manager's interest in the private equity fund's profits is small in relation to the allocations and distributions, and (v) the arrangement provides for different allocations or distributions with respect to different services received when the services are provided by a related party.

3. Examples. The proposed regulations provide a number of examples which illustrate that the most important factor in determining whether an arrangement is a disguised payment for services is the presence or absence of significant entrepreneurial risk.

a. In Example 3, the manager is entitled to a priority distribution of profits. The related general partner has the power to sell or revalue assets to find net gain in any 12-month accounting period to make that distribution.

The IRS concludes that there is no entrepreneurial risk to the manager because the allocation is reasonably determinable and designed to ensure sufficient profits.

b. In contrast, Examples 5 and 6 describe arrangements that do not produce income for services rendered. In Example 5, when the partnership is formed the general partner receives a profits interest intended to replicate a 1 percent fee on capital committed by the limited partners. It is subject to a clawback obligation and the profits allocable to it cannot be predicted. In Example 6, the manager in an investment fund is permitted to irrevocably waive its fixed fee in exchange for a profits interest 60 days before the beginning of the year in which the fee would be payable. The profits allocable to this interest are not readily determinable. The allocation is also subject to a clawback obligation. The IRS found there to be significant entrepreneurial risk in both of these situations.

4. Changes to Profits Interest Safe Harbor.

a. Rev. Proc. 93-27 provides a safe harbor which states that if a person receives a profits interest for past or anticipated services, then the transfer of the profits interest will be nontaxable to the extent that (i) the profits interest does not relate to a substantially certain and predictable stream of income from partnership assets, (ii) the partner does not dispose of the profits interest within two years of receipt, or (iii) the profits interest is not a limited partnership interest in a publicly traded partnership.

b. The proposed regulations indicate that Rev. Proc. 93-27 does not apply to transactions in which one party provides services and another party receives a seemingly associated allocation and distribution of income or gain, e.g., where a manager that provides services waives its fee and a party related to the manager receives an interest in future profits that approximates the amount of the fee. The proposed regulations also indicate that the IRS plans to issue a new exception to Rev. Proc. 93-27 once they are finalized that will apply to a profits interest issued in conjunction with a partner forgoing payment of an amount that is substantially fixed (including a substantially fixed amount determined by formula, such as a fee based on a percentage of partner capital commitments) for the performance of services.

5. Effective Date. The proposed regulations are effective on the date the final regulations are published in the Federal Register, and would apply to any arrangement entered into or modified on or after that date. They will apply to an arrangement entered into before the publication of final regulations if a service provider waives its fee after publication of the final regulations.

B. No-Disposition Rule Problem.

1. Background. Rev. Proc. 93-27, 1993-2 C.B. 343 states that "if a person receives a profits interest for the provision of services to or for the benefit of a partnership in a partner capacity or in anticipation of being a partner, the

Internal Revenue Service will not treat the receipt of such an interest as a taxable event for the partner or the partnership." However, the safe harbor isn't available if the partner disposes of the profits interest within two years of receipt -- the no-disposition rule.

2. Waiver Results in Disposition. The special counsel to the IRS associate chief counsel (passthroughs and special industries), said at the New York State Bar Association Tax Section annual meeting in New York January 26, 2016, that a potential problem arises when an entity that manages a fund and has a right to a fee waives it in exchange for a separate or increased profits interest in the fund itself that is held by an affiliate of the fee entity. The concern is that if the fee is waived by one entity and the interest is issued to another, it could be viewed as a disposition within two years.

VII. REAL ESTATE

A. Bad Boy Guarantee. A recently released IRS legal memorandum (ILM 201606027) suggests that the use of a so-called bad boy guarantee could cause a nonrecourse real estate loan to be treated as recourse.

1. Definition. When a borrower takes out a nonrecourse loan to purchase real estate, the lender can't go after him personally if he defaults on the loan (no personal economic risk of loss). The lender can only foreclose on the real estate. Because such a loan is riskier for the lender, it will often contain a bad boy guarantee, which is essentially a promise by the guarantor not to violate stated conditions -- such as a promise not to commit an act of gross negligence (like burning down the property). If violated, the loan becomes recourse and the lender can go after the guarantor to recoup the debt.

2. Regulations. Treas. Reg. Section 1.752-2 is used to determine which partners should be allocated deductions from a partnership loss stemming from a recourse loan. Essentially, the test says that if everything goes wrong and all of the partnership's assets turn out to be worthless, then whoever is on the hook to pay back the debt (i.e., whoever has personal economic risk of loss) gets the deductions.

3. Exception. However, there's an exception. Treas. Reg. Section 1.752-2(b)(4) states that a partner's payment obligation "is disregarded if, taking into account all the facts and circumstances, the obligation is subject to contingencies that make it unlikely that the obligation will ever be discharged. If a payment obligation would arise at a future time after the occurrence of an event that is not determinable with reasonable certainty, the obligation is ignored until the event occurs."

4. IRS Legal Memorandum. The real estate industry has always said yes, because bad boy guarantees are almost never violated. In the memo, the IRS said no, finding that the guarantor bore economic risk of loss for the debt, which should be treated as recourse.

5. IRS Reverses Position. Following pressure by real estate tax practitioners, the IRS issued a generic legal advice memo (GLAM) AM2016-001 on April 15, 2016, essentially reversing the position taken in ILM 201606027. The GLAM characterized the same seven nonrecourse carveouts as "fairly common" and as conditions that the borrower not only has control over but is "very unlikely to voluntarily" violate. The GLAM concluded that if a partner's guarantee of a partnership's nonrecourse debt is conditioned on one or more of the seven listed carveouts, the guarantee will not cause the debt to fail to qualify as a nonrecourse debt under Section 752 and as qualified nonrecourse financing for purposes of section 465(b)(6). In its analysis, the IRS wrote that "because it is not in the economic interest of the borrower or the guarantor to commit the bad acts described in the typical 'nonrecourse carve-out' provisions, it is unlikely that the contingency will occur and the contingent payment obligation should be disregarded under Treas. Reg. 1.752-2(b)(4)."

B. Final Regulations Reflect PATH Act Changes to FIRPTA Withholding. The IRS has issued final and temporary regulations (T.D. 9751) on the taxation of, and withholding on, foreign persons on some dispositions of, and distributions related to, U.S. real property interests (USRPIs) to reflect changes made by the Protecting Americans From Tax Hikes (PATH) Act of 2015. The PATH Act increased the withholding rate under the applicable provisions of section 1445 from 10 percent to 15 percent. The act retained the 10 percent withholding rate for a disposition of property that is acquired by the transferee for his or her use as a residence for which the amount realized is between $300,000 and $1 million. Section 897 generally provides that an interest in a corporation isn't a USRPI if the corporation doesn't hold USRPIs as of the date its stock is sold and the corporation disposed of all the USRPIs that it held during the applicable testing period in transactions in which the full amount of gain, if any, was recognized (the cleansing exception). The PATH Act provides that the cleansing exception won't apply to dispositions after December 17, 2015, if the corporation or its predecessor was a real estate investment trust or a regulated investment company during specified periods. The act also added section 897(l), which provides the circumstances to which section 897 doesn't apply, and amended the definition of foreign person in section 1445(f)(3). Comments are requested on what regulations, if any, should be issued regarding section 897(l). Effective February 19, 2016, the final and temporary regulations update the applicable rules under sections 897 and 1445 to reflect changes made by the PATH Act. The regulations also update some mailing addresses listed in the rules under sections 897 and 1445. Consistent with the PATH Act, the changes to incorporate the exemption under section 1445(f)(3) for entities described in section 897(l) apply to dispositions and distributions after December 18, 2015, and the revisions regarding the cleansing exception apply to dispositions after December 17, 2015. The new withholding rates apply to dispositions of, and distributions related to, USRPIs that occur after February 16, 2016. Taxpayers must use the revised mailing address beginning February 20, but the IRS won't assert penalties against taxpayers that use the previously specified mailing address before June 21.

TAX CONTROVERSY: AUDITS, APPEALS AND LITIGATION

By: Evan H. Kaploe, Esq.

I. TAX EXAMINATIONS AND AUDITS

A. Introduction and Goals

1. Goals in handling the examination

2. How are returns selected for examination

B. Types of Examinations

1. Three Types of Exams

a. Correspondence Exam

b. Field Examination

c. Office Audits

C. Preparing for the Examination

1. Prepare Document and Transaction Summaries

2. Research the Law

3. Anticipate the Service's Position

4. Evaluate your Client's Position

D. The Examination

1. Jurisdiction

a. You may want to transfer the examination from a service center to a field audit. Skill levels of the IRS employees are different depending on the type of examination.

2. Time and Place

3. Communication with the Service

   a. Oral communication with the Service

   b. Written Communication

   c. Taxpayer participation

   d. Retaining expert witnesses

4. Obtaining a Legal Opinion from IRS Counsel

   If you think the law is on your side, you may want to seek legal advice from the Office of Chief Counsel. This is especially true where the revenue Agent and his supervisor begin to drift from proper interpretation of the law.

   a. *Advice from Local Counsel*

   b. *National Office Advide* (TAM or GLAM)

5. Problems with the Examination

   a. Lack of Evidence

   b. Bad Facts

   c. Indications of Fraud or other Criminal Activity

6. Problems with Examiners

   If the examiners conduct is egregious, consider whether the conduct rises to the level of the "ten deadly sins" contained in section 1203 of the 1998 Reform Act, such as:

a. § 1203(b)(1) – failure to obtain required approval relative to seizures of certain assets.

b. § 1203(b)(2) – providing false statements with respect to a material matter involving a taxpayer or his representative.

c. § 1203(b)(3)(A) – violating constitutional rights of taxpayers.

d. § 1203(b)(4) – falsifying or destroying documents to conceal mistakes by employee relative to taxpayers.

e. § 1203(b)(6) – violating the laws or policies of the IRS to retaliate or harass a taxpayer or his representative

f. § 1203(b)(10) – threatening an audit for personal gain.

E. Settlement and Concluding the Examination

1. Conclusion Types

a. "No-Change"

b. Fully Agreed

c. Partially Unagreed

d. Fully Unagreed

2. Finality of Settlement

Once a taxpayer's return has been examined and it has been closed by agreement or otherwise, it will unlikely be reopened unless: (1) evidence of fraud, (2) clearly defined substantial error based on an established Service position, or (3) when failure to reopen would be a serious administrative omission.

3. Audit Reconsideration

II. OFFICE OF APPEALS AND TAX APPEALS

A. Types of Determinations from which Appeal is Possible

1. Deficiency Appeals

a. Docketed vs. Non-Docketed

2. Collection Matters

a. Collection Appeals Procedure (CAP)

b. Collection Due Process (CDP)

c. Offers in Compromise (OIC)

3. Refund Disallowance

4. Assessable Taxes and Penalties

5. When is an Appeals Conference not Available?

B. Strategy for Appeals Conference

1. How to Get More Time

2. Requesting Information

a. Available by Written Request, Oral Request, or FOIA

b. Form 5402

c. The RA's Workpapers and Notes

d. Examiner's Rebuttal

e. Informant's Reports

f. Information from Other taxpayer's returns

g. Agent's Interview Memoranda

3. Burden of Proof

4. Hazards of Litigation – The Key to Appeals

C. Seek Appeals or Bypass Administrative Review by Appeals

1. Advantages

2. Disadvantages

D. Preparing a Protest Letter

1. Objective of the Protest Letter

2. Contents of a Written Protest

E. Appeals Conference

1. Timing for Appeals

2. Preparing for the Conference

3. Who Should Attend the Appeals Conference

F. Settlement of the Case in Appeals

1. Offers and Counter-Offers

2. Qualified Offers and IRC § 7430

3. Basis for Settlement

a. Mutual-Concession Settlements

b. Split-Issue Settlements

c. Nuisance Value Offers

4. Documenting Settlement

a. Forms 870, 890, 1902-B and 4549

b. Forms 870-AD and 890-AD

c. Closing Agreements (Form 866 and Form 906)

III. LITIGATION OF TAX ISSUES AND PROCEDURES

A. Choice of forum and Jurisdiction

1. Three choices of where to litigate a tax case

a. Federal District Court or Court of Claims. In all situations, the taxpayer can pay the taxes owed, claim a refund with the IRS and, if disallowed, file a complaint in either the Federal District Court or the Court of Federal Claims.

b. United States Tax Court. If a deficiency in income, estate, or gift tax is involved, or other enumerated scenarios occur (CDP, Innocent Spouse, Interest Abatements, Worker Classification), then the taxpayer can petition the Tax Court without the requirement to pay the amount asserted.

c. Bankruptcy Court. If a debtor has sought protection under the bankruptcy provisions, the Bankruptcy Court can determine the extent of debt due to the IRS when a debtor has petitioned for relief under Title 11, USC.

2. Factors to Consider

    a. Jurisdiction over the matter

    b. Can the taxpayer make full payment?

    c. Which court has decided the issue more favorably in the past?

    d. Judge or jury/are there equitable concerns?

    e. Are you concerned about the IRS raising a new issue now or in the future?

    f. Is interest accruing?

    g. Are costs of litigation a concern?

    h. Are there opposing counsel issues?

    i. Which Settlement procedures do you prefer?

    j. Publicity, favorable state law matters, docket size of federal courts, and processing subpoenas

B. Overview of a Tax Court Case

1. Pleadings and Additional Documentary Requirements

    a. Do you want to file as an "S" case?

    b. Mailing in your Petition – make sure it is timely IRC § 7502

2. Settlement and Discovery

Branerton Corp. v. Commissioner, 61 TC 691 (1974)

Characteristics	S Case	Regular Case
Amount in Controversy	Up to $50,000	
Procedural rules, including pleadings	Relaxed	Formal
Right to appeal	No	Yes
Post-trial briefing	No – Unless ordered	Yes
Time period to decision	Less than 1 year	Over 2 years
Judge	Special trial judge	Tax Court Judge
Number of cities cases heard	74	59
Opinions	Summary	Regular or Memo

3. Stipulation of Facts

4. Notice of Calendared Case and Pretrial Orders

5. Calendar Call, Trial, and Briefs

6. Decision and Appeal

C. Pretrial Procedures and Settlement Negotiations

1. Factors to Consider in Deciding Whether to Settle

2. Appeals Office Consideration Jurisdiction

3. Area Counsel Settlement Jurisdiction

4. Documenting the Settlement

5. Stipulations

D. Trial Procedures

1. Setting the Case for Trial

a. Trial Status Reports

b. Calendars

c. Motion Calendars

d. Continuances

e. Calendar Call

f. Trial

g. Decision

E. Post-trial Procedures

1. Computation of Tax Deficiency

2. Rule 155 Agreed Computation

3. Unagreed Computation

4. Entry of Decision

   a. Motion for Entry of Decision

   b. Motion for Reconsideration

5. Appellate Review

ETHICS AND THE USE OF THE INTERNET: TWO CASE STUDIES

By: Charles M. Lax

I. ACCOUNTANTS AND THE USE OF SOCIAL MEDIA

A. What is Social Media?

1. Generally websites or other electronic technologies that allow people and organizations to create, share or exchange information, interests, ideas and pictures/videos in virtual communities and networks.

2. Common features include: interactivity, user generated content, profiles of users and the development of social networks to facilitate relationships.

3. The most common social media sites used in the work place: Facebook, LinkedIn, Twitter and YouTube.

4. The most common social media sites that are primarily personal networks: Instagram, Snapchat and WhatsApp.

B. Common situations where ethical dilemmas may be encountered by the use of social media:

1. Recruiting and hiring.

2. Misuse of the Internet by employees.

3. Employee advancement and disciplinary actions.

4. Employee productivity.

5. Relationships with clients.

6. Firm promotion.

7. Personal promotion.

C. Legal considerations/issues encountered through the use of social media in the workplace:

1. National Labor Relations Act protects employees' right to use the Internet to unionize and to work together to bargain for better wages and working conditions.

2. Can't use information about personal attributes of the Internet poster that are protected by anti-discrimination laws such as age, disability, marital status, race, religion, ethnic background and sexual orientation.

3. Many states have passed privacy protections laws.

   a. Prohibits the request or requirement of applicants or employees to provide access to their personal internet accounts.

   b. Prohibits penalizing, disciplinary action or discharging of an employee, or the failure to hire an applicant if access to their personal account is denied.

4. The privacy limitations do not prohibit an employer from:

   a. Accessing, viewing or using information about an applicant or employee that is either in the public domain or obtained without required access information.

   b. Requiring an employee to disclose access information to allow an employer access to a device paid for by the employer.

c. Accessing or monitoring electronic data or information stored on a device paid for by the employer or traveling through an employer's network.

d. Discharging or disciplining an employee for transferring, without authorization, any of their employer's confidential or proprietary information to an employee's personal device.

e. Prohibiting or restricting an employee's access to certain websites using a device or network paid for by the employer.

D. Best practice today is to adopt a social media policy statement. It should address the employer's expectations with regard to:

1. An employee's use of social media for personal, business or marketing purposes.

2. The employer's intention to monitor the employee's activities on social media.

3. The disciplinary action that will be taken for breach of the policy.

II. <u>RELEVANT SECTIONS OF CIRCULAR 230</u>

A. Who does Circular 230 cover?

1. Certified Public Accounts, 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. Sections of Circular 230 to consider.

1. Section 10.30 - Solicitation.

a. A practitioner may not with respect to any IRS matter use any form of public communication containing a false, fraudulent or coercive statement or claim; or a misleading or deceptive statement or claim.

b. Enrolled Agents may not utilize the term "certified" or imply an employer/employee relationship with the IRS. An acceptable description of an Enrolled Agent is "enrolled to practice before the IRS."

2. Section 10.35 - Competence.

a. A practitioner must possess the requisite competence to practice before the IRS.

b. Competence requires knowledge, skill, thoroughness and preparation necessary for the matter.

3. 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.

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.

III. RELEVANT SECTIONS OF THE AICPA CODE OF PROFESSIONAL CONDUCT.

A. Professional Conduct (0.300.020). In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all of their activities.

B. Supervision (1.300.070). In order to assure compliance with the Code, members should practice in firms that have internal quality control procedures to ensure that services are competently delivered and adequately supervised.

C. Confidentiality (1.700.0001.01) A member shall not disclose any confidential client information without the specific consent of the client. Confidential client information includes any information obtained from the client that is not available to the public.

D. False Advertising (1.400.090) A member may not promote or market the member's abilities to provide professional services or make claims about the member's experience or qualifications in a manner that is false, misleading, or deceptive. Promotional efforts would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived.

IV. CASE STUDIES

A. **Big Brother Is Watching**

Your firm has a social media policy prepared by its attorney advising employees that when they use social media, whether for business or personal use, they must comply with the terms of the policy. The policy, in part, provides that employees must at all times observe a "high standard of professional conduct."

One day you get a call from the owner of your firm's biggest and best client. He informs you he is personally offended and concerned about the competency of one of your young CPAs, Harvey Brown, who works on his Company's financial statements because of a series of photos that appeared on Harvey's Facebook page and Instagram account. The photos show that Harvey attended a party last weekend where he and others were clearly smoking marijuana. (Your firm is not located in Colorado or any other state that may have legalized the use of marijuana, nor do you believe Harvey has a health issue that permits the use of medical marijuana.)

You know your client's political views are conservative in nature. He demands that you immediately terminate Harvey as an employee or at least replace him on the file because of his "illegal activity." What should/can you do? Should you terminate Harvey (he is an at-will employee)? Can you tell him to stop posting pictures on his Facebook page?

Analysis:

1. Should you actively monitor your employees' personal activities?

2. Should your social media policy cover the personal use of social media?

3. Section 0.300.200 of the Code requires members to exercise sensitive professional and moral judgments in all of their activities. Does this conduct violate the Code?

4. Section 1.300.070 of the Code requires procedures to be in place to assure compliance with the Code by adequate supervision. As Harvey's supervisor can you ignore this?

Would your answer be any different if instead of posting pictures on his Facebook page, Harvey posted a link to an article advocating the decriminalization of all drugs?

Analysis:

1. The issues are the same as the first scenario.

2. The big difference is that in this case, Harvey is exercising a First Amendment right.

B. **Facebook Is the Answer**

Your firm hires a new marketing consultant, Frank Zuckerberg, who believes you must raise your profile through the use of social media. You're skeptical about how it could help your CPA firm, but you authorize Frank to develop a program for you. Frank recommends a program that will be based upon the development of a firm Facebook page and individual LinkedIn pages for your accountants. You spend some time with Frank and give him a great deal of background on your firm, what you do, and the type of clients you are targeting. Your accounting staff also spends time with Frank and gives him their personal and professional information.

Within a short time, Frank and his staff present to you a proposed Facebook page, representing that:

1. Your accounting staff includes accountants who are Certified Valuation Analysts (CVA) and Accredited in Business Valuations (ABV) who are capable of providing business valuation services for such purposes on transaction based, tax

based and litigation based needs. In fact you have a friend who is a CVA and an ABV and although he works for a "big four" firm, he has agreed to "eyeball" your Business Valuation Reports and will be available to answer a few questions.

2. Your firm is "highly creative, responsive and cost effective." The statement is attributed to Frank's wife in the form of a testimonial. In fact, Frank's wife is not a client and you've never met her.

3. Your firm represents clients of all sizes from sole proprietorships to publicly traded companies. In fact, five years ago you lost a client which had initiated an IPO and determined they needed a "major event" firm.

4. Your clients include the "largest John Deere Dealership in the State of Michigan." While this is true, you have not secured authorization from your client to disclose that they are a client of your firm.

Are any of these statements problematic or troubling? Do any of them violate your obligations under the Code or Circular 230?

Analysis:

1. Do any of these statements constitute false advertising?

2. Do any of these statements violate the confidentiality obligation under Section 1.700.001.01 of the Code?

3. Does the arrangement with the "outside" valuation expert meet the requirement under Section 10.35 of Circular 230 that members and firms possess requisite competence to practice before the IRS?

A few months later in reviewing the LinkedIn pages that were created for your staff you notice that one of your staff accountants, Betty Jones, has now included on her LinkedIn page the following:

1. She is a CPA. In fact, she sat for the exam and is waiting for results.

2. She worked for the IRS. In fact, she was an unpaid summer intern at the IRS while in college.

3. She possesses extensive knowledge and experience in tax administration and compliance. In fact, she has worked as an accountant for only two years.

Since these statements appear on Betty's "personal" LinkedIn page, should you take any action? Are any of these statements problematic or troubling under the Code or Circular 230?

Analysis:

1. Clearly, the statements may violate Section 10.30 of Circular 230 and Section 1.400.090 of the Code. The Code provides that a member may not promote or market their abilities to render professional services or make claims about their experience or qualifications if false, misleading or deceptive.

2. Can/Should you take some action against Betty since under Section 10.36 of Circular 230 and Section 1.300.070 of the Code you have an obligation to establish procedures and take the requisite action to make certain that members comply with Circular 230 and the Code?

HEALTH CARE COMPLIANCE TESTING

By: Marc S. Wise

I. INTRODUCTION

As employers and their advisors have been spending an inordinate amount of time attempting to decipher the compliance aspects of the Affordable Care Act ("ACA"), they should not forget about the various health care compliance testing requirements under the Internal Revenue Code ("Code").

This presentation reviews the common health care benefits made available to the employees, the IRS testing required for such plans and the applicable penalties for non-compliance.

II. TYPES OF BENEFITS

A. Health Savings Accounts. HSAs were created to help individuals save for future qualified medical and retiree health expenses on a tax-free basis.

1. Eligible individuals may, subject to statutory limits, make deductible contributions to a health savings account. Under IRC Section 223(c), an "eligible individual" means an individual who is covered under a high deductible health plan (HDHP) (see below) and who is not covered under any other health plan which is not a HDHP, unless the other coverage is permitted insurance or coverage for accidents, disability, dental care, vision care or long-term care. HSA contributions for an individual are not deductible if the individual can be claimed as a dependent by another taxpayer for the year.

2. High Deductible Health Plans (HDHP). For 2017, a HDHP is a health plan with an annual deductible of at least $1,300 for

individual coverage ($3,400 for family coverage) and a limit on the maximum out-of-pocket expenses (deductibles, co-payments, and other amounts, but not premiums) of $6,550 for individual coverage ($13,100 for family coverage).

3. Other coverage. Health Flexible Spending Accounts and Health Reimbursement Arrangements are "other coverage" that will generally preclude HSA eligibility. Exceptions to this rule apply for limited purpose FSAs and HRAs (those providing only certain benefits such as dental and vision), suspended HRAs (where the employee forgoes reimbursements) and HRAs providing benefits only after retirement.

4. Limits on contributions. For calendar year 2017, the limitation on deductions for an individual with self-only coverage under a high deductible plan is $3,400 and $6,750 for family coverage. These limits are unchanged from 2016, except for self-only which increase by $50.

   a. Additional contributions for individuals 55 or older. For individuals who attain age 55 before the close of the taxable year, a catch-up contribution of an additional $1,000.

   b. Tax treatment of distributions from a HAS.

      i. Amounts used for qualified medical expenses. Any amount paid or distributed out of an HSA which is used exclusively to pay qualified medical expenses of any account beneficiary will not be included in gross income. A "qualified medical expense" means, amounts paid by such beneficiary for medical care (as defined in Section

213(d)) for such individual, the spouse of such individual and any dependent of such individual, but only to the extent such amounts are not compensated for or by insurance or otherwise.

ii. Health insurance may not be purchased from the account, except for:

(A) COBRA continuation coverage;

(B) A qualified long-term care insurance contract;

(C) A health plan during the period in which the individual is receiving unemployment compensation under any federal or state law; or

(D) In the case of an account beneficiary who has attained social security retirement age, any health insurance other than a Medicare supplemental policy.

5. HSA contribution through a cafeteria plan. An employer's contribution (including an employee's contributions through a Section 125 cafeteria plan) to an employee's HSA is not subject to federal income tax withholding or Social Security, Medicare or FUTA if it is reasonable to believe at the time of the payment that the contribution will be excludable from the employee's income.

B. Health Reimbursement Arrangements (HRA) and Self-Insured Health Plans. An HRA is an employer-established arrangement to reimburse employees for medical and dental expenses not covered by insurance or otherwise reimbursable. Benefits from an HRA are paid solely by the employer, employee contributions are not permitted. These arrangements were previously referred to as medical expense reimbursement plan.

1. Internal Revenue Code provisions. HRAs and self-insured health plans are governed by Section 105 of the Internal Revenue Code, which allows health plan benefits used for medical care to be exempt from taxes, and Section 106 of the Code, which allows employer contributions to those plans to be tax-exempt. Such plans need not be funded and may be paid from the general assets of the employer.

2. Reimbursements. An HRA can reimburse an eligible employee for "medically necessary" expenses such as co-pays, deductibles, office visits, vision care expenses, prescriptions, and most dental expenses. Expenses related to cosmetic services are not eligible for reimbursement.

3. Plan documentation. An employer establishes an HRA by adopting a formal plan and distributing a Summary Plan Description (SPD) to all eligible employees. The SPD describes among other things, the amount of money available to each employee's personal health account for the coverage. As eligible expenses are submitted, the employee's account is reduced and paid to them on a non-taxable basis. At the end of the HRA plan year, the employee's account is increased to the level of reimbursement applicable to the new year. Any funds left over from the prior year can either be forfeited or credited to the participant's bookkeeping account for the subsequent year, as determined by the employer in the initial design of the plan. Stand-alone HRAs are not permitted for health care expenses

other than dental and vision unless the employer also maintains an ACA compliant group health plan.

4. ERISA application. An HRA is an ERISA health plan and is subject to the ERISA disclosure and reporting requirements for health plans.

5. ACA issues. In order to avoid ACA issues and $100 per day penalties, the HRA should only cover employees that also participate in the employer's group health plan.

C. Flexible Spending Account. A Flexible Spending Account is a feature contained in a cafeteria plan under Section 125 of the Internal Revenue Code.

1. Summary description of cafeteria plan.

a. Employee choice. The main feature of a cafeteria plan is that it permits each participating employee to choose among two or more benefits. Under such a plan, the employee may "purchase" non-taxable benefits by foregoing taxable cash compensation.

b. Benefits offered. A cafeteria plan may offer a number of different types of benefits. In general, in order for a benefit to be a qualified benefit for purposes of Section 125, a benefit must be excludable from the employee's gross income under specific provisions of the Code and must not defer compensation, except as specifically allowed under Section 125. The examples of qualified benefits include the following:

i. Group-Term Life Insurance on the life of an employee (Section 79);

ii. Employer-provided accident and health plans (Sections 105 and 106);

iii. Health flexible spending arrangement (Sections 105 and 106);

iv. Accidental death and dismemberment policies (Sections 105 and 106);

v. Dependant care assistance program (Section 129);

vi. Adoption assistance program (Section 137);

vii. Contributions to health savings accounts;

viii. Long-term and short-term disability coverage (Section 106).

c. Non-qualified benefits. Non-qualified benefits may not be offered in a cafeteria plan regardless of whether any such benefit is purchased with after-tax employee contributions or on any other basis. A plan that offers a non-qualified benefit is not a cafeteria plan. Employee elections between taxable and non-taxable benefits through such a plan will result in gross income to the participants for any benefit elected. (Prop. Reg. 1.125-1(q)(2)).

The following benefits are non-qualified benefits that are not permitted to be offered in a cafeteria plan:

i. Scholarships described in Section 117;

ii. Employer-provided meals and lodging described in Section 119;

iii. Educational assistance described in Section 127;

iv. Fringe benefits described in Section 132;

v. Long-term care insurance, or any product which is advertised, marketed or offered as long-term care insurance;

vi. Long-term care services;

vii. Group-term life insurance on the life of any individual other than an employee (whether includable or excludable from the employee's gross income);

viii. Health reimbursement arrangements (HRAs);

ix. Elective deferrals to a Section 403(b) plan.

2. Flexible Spending Arrangements (FSA) defined. An FSA is a benefit program that provides employees with coverage which reimburses specified, incurred expenses (subject to reimbursement maximums and any other reasonable conditions). An expense for qualified benefits must not be reimbursed from the FSA unless it is incurred during a period of coverage. After an expense for a qualified benefit has been incurred, the expense must first be substantiated before the expense is reimbursed.

3. Maximum amount of reimbursement. The maximum amount of reimbursement that is reasonably available to an employee for a period of coverage must not be substantially in excess of the

total salary reduction and employer flex credit for such participant's coverage. The employer may set limits on the maximum amount that may be deferred to the plan.

4. Flex-credits allowed. An FSA in a cafeteria plan must include an election between cash or taxable benefits (including salary reduction) and one or more qualified benefits, and may include employer flex-credits. Flex-credits are non-elective employer contributions that the employer makes available for every eligible employee to participate in the employer's cafeteria plan. These credits can be used at the employee's election only for one or more qualified benefits (but not as cash or taxable benefits).

5. Use or lose rule. An FSA may not defer compensation. No contribution or benefit from an FSA may be carried over to any subsequent plan year or period of coverage. Unused benefits or contributions remaining at the end of the plan year (or grace period, if applicable) are forfeited.

6. Reimbursement available at all times. Reimbursement from the FSA is deemed to be available at all times if it is paid at least monthly or when the total amount of the claims to be submitted is at least a specified, reasonable minimum amount (for example, $50.00).

7. Conditions for limited FSA COBRA coverage.

   a. COBRA elections for health FSAs. If a health FSA satisfies the two conditions found below, the obligations of the health FSA to make COBRA continuation coverage available to a qualified beneficiary who experiences a qualifying event in that plan year is limited to such benefits that may be received during the remainder of the plan year. This limitation applies (1) if the benefit exceeds the maximum amount that the health FSA is permitted to require to be paid for COBRA continuation coverage for the remainder of the plan year and (2) the health FSA is not obligated to make such COBRA continuation available for any subsequent plan year. Whether an employer must offer COBRA to a terminated employee during the year of termination and the subsequent year depends on certain factors:

b. Year of termination. COBRA may not be offered to a qualified beneficiary who has overspent their Flexible Spending Account as of the date of the qualifying event. COBRA must be offered to those who have under spent their Flexible Spending Account.

c. COBRA requirements for the year subsequent to the plan year of termination.

   i. The health FSA is exempt from HIPAA. The health FSA is exempt from HIPAA if those eligible to participate in the health FSA are also eligible to participate in the employer's major medical plan and the maximum benefit payable to the employee under the FSA exceeds two times the employee's salary reduction amount (or, if greater, the amount of the employee's salary reduction under the health spending account for the year, plus $500), the employer must comply with HIPAA.

ii. If the employer contributes more than $500 to a health spending account either as a discretionary contribution or as a match, the employer may have to comply with HIPAA. For credit based Section 125 Plans, if the employee can receive the unused portions as taxable income, then the employer need not comply with HIPAA. If the employee does not have the option to receive the unused portions as taxable income, the plan will have to comply with HIPAA only if the plan designed prohibits employees from directing more than $500 of the employer credits to the health spending account.

d. The maximum COBRA premium the employer may charge for the health FSA coverage equals or exceeds the maximum annual health FSA coverage amount.

e. As of the date of the qualifying event, the qualified beneficiary has overspent their health FSA account.

f. COBRA coverage can be cut off at the end of the plan year in which the qualifying event occurred if the health FSA is exempt from HIPAA and the maximum COBRA premium equals or exceeds the annual coverage amount. In such case, the employer would not have offer COBRA continuation for the health FSA at the next open enrollment.

8. ACA changes to Flexible Spending Accounts. FSAs are limited to $2,550 per year per employer for 2016. A small increase may be announced for 2017. If married, the spouse may also contribute up to $2,550 in an FSA with their employer.

Unless the FSA can only be used for dental and vision or other HIPAA excepted benefits, the employee must be eligible to participate in the employer's group health plan in order to use the FSA. Failure to comply can lead to $100 per day/per participant penalties.

9. HSA and Flexible Spending Accounts. Participants with HSA cannot participate in a general purpose FSA. Such employees must use, and the FSA plan must provide an option for a limited purpose FSA. A limited purpose FSA can only be used for dental and vision expenses.

D. High Deductible Health Care Plans (HDHP). An HDHP is generally a traditional health care plan that has reduced premiums in exchange for high deductibles. Many plans offer different levels of deductibles, typically starting at or just above the health savings account minimum and going higher. HDHPs are generally combined with a health reimbursement arrangement (HRA) or with a health savings account (HSA) that enrollees can use to pay for a portion of their heath expenses.

The higher deductible associated with the HDHPs typically result in lower health insurance premiums because the enrollee is responsible for a greater share of the initial cost of care.

III. IRS TESTING REQUIREMENTS

As with the employee benefit area, the Internal Revenue Service has imposed various discrimination tests on the various benefits discussed in this outline.

A. Health Savings Accounts. A Health Savings Account is generally treated as an account outside the purview of an employer-sponsored benefit. Thus, to the extent the contributions to an HSA are solely salary deferrals by the employees, non-discrimination rules under the Internal Revenue Code are inapplicable.

1. Employer contributions to HSAs. An employer that chooses to contribute to the HSAs of its employees must make comparable contributions to the HSAs of all "comparable participating employees". This is defined as those eligible employees who have the same category of high deductible health plan coverage. Categories of coverage generally are (a) self-only coverage, (b) couples, (c) family plus extras for each additional child. Employer contributions are "comparable" if they are either the (1) same amount or (2) same percentage of the deductible for employees with self-only HDHP coverage are tested separately from employees with family HDHP.

2. Excise tax on failure of employer to make comparable HSA contributions. For an employer who makes a contribution to any employee's HSA during a calendar year, a 35% excise tax is imposed under IRC 4980G on the employer's failure to make comparable contributions to the HSA's of all "comparable participating employees for the calendar year". Highly compensated employees as defined under IRC 414(q) are excluded from this definition. Thus, an employer may provide smaller HSA contributions to the highly compensated employees than to the non-highly compensated employees. The 35% excise tax is on the total amount of contributions made by the employer to the HSAs of the employees for that year. Part or all of the IRC 4980G excise tax for non-compliance may be waived by the IRS for such failures due to reasonable cause and not due to willful neglect if the payment of the tax would be excessive relative to the failure involved.

B. Section 125 cafeteria plans. As defined in the proposed regulations, cafeteria plans allow employers to offer one or more benefits on a tax-favored basis. To qualify, the cafeteria plan must offer at least one taxable benefit (such as cash) and at least one benefit that is excludable from income (such as health insurance coverage) with employee contributions made typically on a salary reduction basis. Under its most simplest form, it is a premium only plan (POP). Under a POP, the employee may elect salary at the regular level (cash) or pay their share of the health insurance premium on a pre-tax basis.

1. Choice of cash or excludable benefit. The essence of the cafeteria plan is an individual's choice between cash and accruable benefits. Thus, as provided in the new proposed regulations, mandating employee participation in a POP, for example, disqualifies the POP as a cafeteria plan. Although the individual may be able to get the health coverage and reimbursements on a tax-favored basis under Code Sections 105 and 106, other possible ramifications exist for the plan. For example, the DOL trust and reporting rules exempt cafeteria plans from their requirements. Loss of cafeteria plan status, therefore, could also trigger those requirements to have the funds placed in a trust and comply with Form 5500 filing requirements.

2. Written plan requirement. A cafeteria plan must be in writing. Lack of a written plan results in the loss of tax benefits offered and the inclusion in the participant's gross income of the highest valued benefits that the employees could have received. Under the rules, the plan must be adopted and effective on or before the first day of the cafeteria plan year to which it relates (Treas. Reg. 1.125-1(c)).

The plan terms must apply uniformly to all participants, and must include the following specific information:

a. A specific description of each benefit available through the plan;

b. The plan's participation rules, specifically limiting plan participation to employees only;

c. The procedures governing employees' elections under the plan, including the period when the elections may be made, the period in which elections are effective, and the irrevocability of elections, except to the extent allowed under the optional change in status rules;

d. How employer contributions may be made under the plan (for example, through an employee's salary reduction election or by non-elective employer contributions, or both);

e. The maximum amount of employer contributions available to any employee; and

f. The plan year of the cafeteria plan.

The plan sponsor may amend the cafeteria plan at any time, but the amendment can only be effective for periods after the later of the adoption date or effective date of the amendment. Thus, the plan can only reimburse expenses under the new benefit that are incurred after the later of the adoption date or effective date (Treas. Reg. 1.125-1(c)(5)).

3. Non-discrimination rules. Cafeteria plans cannot favor highly compensated individuals (HCIs) as to eligibility, or favor HCIs as to contributions and benefits.

a. Applicable definitions. Under the new proposed rules, an HCI means an individual who has:

   i. An officer;

   ii. A 5% shareholder; or

   iii. Highly compensated.

Spouses and dependents of HCIs are also HCIs. For purposes of the cafeteria plan rules, the definition of highly compensated employee will follow the rules of IRC 414(q) that are applicable to qualified retirement plans.

4. Eligibility test. Cafeteria plans cannot discriminate as to eligibility in favor of HCIs. The proposed cafeteria plan rules incorporate the retirement plan safe-harbor percentage test for eligibility under IRC 410(b). Under this test, a certain minimum percentage of non-highly compensated individuals must be benefiting under the plan relative to a certain percentage of HCIs. If enough non-highly compensated employees benefit relative to the number of HCIs benefiting, the plan falls within a safe harbor and is automatically deemed not to discriminate as to eligibility (Treas. Reg. 1.125-7(b)). If the ratio of non-highly compensated employees benefiting relative to the HCIs is too low, then the plan is deemed discriminatory. A plan that fails the ratio test may yet satisfy the requirements under the facts-and-circumstances test.

5. Contributions and benefits test. A cafeteria plan cannot discriminate in favor of highly compensated participants (HCPs) regarding contributions and benefits. A plan must give each similarly situated participant a uniform chance to elect qualified

benefits, and the HCPs must not in disproportionate numbers actually elect those benefits.

Under the benefits test, this proportionate election exists if the aggregate qualified benefits that HCPs elect, measured as a percentage of their aggregate compensation, exceeds the aggregate qualified benefits that non-highly compensated participants elect, measured as a percentage of their aggregate compensation (Treas. Reg. 1.125-7(c)(2)).

6. Key employee test. If the non-taxable benefits provided to key employees exceeds 25% of the aggregate non-taxable benefits provided for all employees for the cafeteria plan, each key employee includes in gross income an amount equaling the maximum taxable benefit that he or she could have elected for the plan year (Treas. Reg. 1.125-7(d)(1)).

For example, the employer has two key employees who are non-highly compensated employees. The key employees each elect $2,000 of qualified benefits. Each non-highly compensated employee also elects $2,000 of qualified benefits. The qualified benefits are statutory non-taxable benefits.

Results: The key employees receive $4,000 of statutory non-taxable benefits and the non-highly compensated employees will receive $8,000 of statutory non-taxable benefits for a total of $12,000. The key employees receive 33% of the statutory non-taxable benefits (4,000 divided by 12,000). Because the cafeteria plan provides more than 25% of the aggregate of statutory non-taxable benefits to key employees, the plan fails to key employee concentration test.

7. Safe harbor test for Premium Only Plans. A POP is deemed to satisfy the non-discrimination rules for a plan year if, for that plan year, the plan satisfies the safe harbor percentage test for eligibility.

For example - Premium Only Plan. Employer's cafeteria plan is a premium only plan. The written cafeteria plan offers one employer-provided accident and health plan and offers all employees the election to salary reduce the same percentage of the premium for self-only or family coverage. All key employees and all highly compensated employees elect salary reduction for the accident and health plan, but only 20% of the non-highly compensated employees elect the accident and health plan.

Results: this premium only plan satisfies the non-discrimination rules in IRC 125(b) and (c).

Note: for purposes of the safe harbor, only benefits from major medical coverage are included and dental coverage and health FSAs are excluded from benefiting under this test.

8. Health plan and safe harbor. There is also an additional safe harbor for contributions and benefits for group health plans only. This safe harbor excludes dental and health FSAs. The safe harbor applies if the employer contributions on behalf of each participant equals 100% of the cost of health coverage of the majority of similarly situated highly compensated participants, or at least equal 75% of the cost of health coverage of similarly situated participants with the highest cost health coverage under the plan.

9. Employee elections. Employees must have a choice between permitted taxable benefits (cash) and qualified benefits (health, dental, etc.). The regulations require that elections must be made before the earlier of the date benefits are available or before the plan year begins. Employers may design their plans to have a "negative election" which are automatic elections for health coverage for new and current employees. Procedures for such negative elections must be described in the plan's written materials.

10. Time to perform non-discrimination testing. The regulations provide that the non-discrimination testing must be performed as of the last day of the plan year, taking into account all non-excludable employees (or former employees) who were employees on any day during the plan year. Thus, employees who terminated during the plan year and who otherwise met the eligibility requirements for the cafeteria plan must be included in the discrimination testing. If the plan is found to be discriminatory, highly compensated employees and key employees participating must include in gross income the value of the taxable benefit with the greatest value that the employee could have elected to receive, even if the employee elects to receive only the non-taxable benefits offered.

11. Employer contributions to employees' health savings accounts. If employer contributions to an employee's health savings account are made through a cafeteria plan, those contributions are subject to the non-discrimination rules in Section 125 and are not subject to the comparability rules in IRC 4980G.

12. Form 5500 filing reminder. A plan that only provides for pre-tax payment of premiums is not subject to the Form 5500 filing

rules even if the plan exceeds 100 participants. If the plan also includes a health flexible spending account with 100 or more participants a Form 5500 is required for purposes of ERISA in that such benefit is considered to be an employer sponsored group health plan.

IV. COMMON HEALTH PLAN PROBLEMS

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

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

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

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

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

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

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

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

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

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

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

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

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

V. <u>IRS FORM 8928-RETURN OF EXCISE TAXES UNDER CHAPTER 43 OF INTERNAL REVENUE CODE</u>

A. Tax on failure to satisfy the COBRA health care continuation requirements.

1. Examples of failures that would trigger excise taxes are COBRA notice failures (missing, late, or incomplete initial or qualifying event notices); COBRA premium violations

(overcharging, or not complying with grace period rules); and procedural failures such as not allowing COBRA recipients to make changes at open enrollment, or on special enrollment events.

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

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

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

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

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

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

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

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

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

d. Failure to comply with the parity in mental health and substance abuse disorder requirements;

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

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

2. Applicable excise taxes. The amount of the tax imposed on any failure shall be $100 for each day in the noncompliance period with respect to each individual to whom such failure relates. Employers with 50 or fewer employees with fully insured health plans are exempt from this penalty if the failure is due solely because of the health insurer.

C. Tax on failure to make comparable HSA contributions under Code §4980G:

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

   Example One. An employer makes a $1,400 contribution to the HSA of each non-highly compensated employee without making contributions to the HSA of each highly compensated employee. No excise tax will be applicable since discrimination against highly compensated employees is permitted.

   Example Two. During 2016, the employer has 8 non-highly compensated employees who are eligible individuals with self-only coverage under a high deductible health plan provided by the employer. The deductible for the high deductible health plan is $2,000. For the 2016 calendar year, the employer contributes $2,000 to the HSAs of two employees and $1,000 each to the HSAs of the other six employees, for total HSA contributions of $10,000. The employer's contribution does not satisfy the comparability rules. The employer is subject to an excise tax of $3,500 (35% multiplied by $10,000) for its failure to make comparable contributions to its employees' HSAs.

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

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

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

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

5. File a Form 7004, application for automatic extension of time to file certain business income tax, information, and other returns, to request an automatic extension of time to file the Form 8928.

The timely filing of the Form 7004 will provide for an automatic six-month extension for filing.

D. Failure to file penalties. As with most tax reporting obligations under the Code, there are consequences for failing to timely file the Form 8928 and pay the requisite excise tax. Under Code Section 6651, the penalty for a late return is generally 5% of the amount due for each month or part of a month the return is late, up to a maximum of 25%, and the penalty for failure to timely pay an excise tax is ½% of the unpaid tax for each month or part of a month the tax remains unpaid, up to a maximum of 25%. Plan sponsors also may be subject to interest on the unpaid taxes and penalties at the rate provided under Code section 6621 (generally, the federal short-term rate plus three percentage points).

THE ABCs OF RESPONDING TO A SUBPOENA

By: Lindsey R. Johnson

I. ANALYSIS OF A SUBPOENA

A. Basics of a subpoena.

1. Was service of the subpoena proper?

    a. Subpoenas often are hand delivered by private process servers or government agents. An accountant who is handed a subpoena should accept it politely, without discussing the substance of any client matter with the process server or agent.

    b. An accountant also might receive a subpoena by mail.

2. Is the subpoena valid?

    a. A subpoena can be issued for any of a wide variety of legal proceedings: a civil case in federal or state court; a federal or state criminal case; an IRS civil or criminal investigation; a proceeding before an administrative agency — again, federal or state; or even an arbitration.

    b. In particular, the validity of certain subpoenas is subject to various geographical limitations (*i.e.* a state-court subpoena is valid only in the state in which it was issued).

3. What is the scope of the subpoena?

    a. Reach out to the party that issued the subpoena to learn about the substance and scope of the underlying matter, and if the timeline for responding is set in stone.

b. If subpoena requires document production, costs for reimbursement.

4. Compliance with the subpoena.

a. Document Production.

i. Is the *information* requested privileged? Do you have client consent to produce documentation? If not, you will need to produce a privilege log.

ii. Document all objections.

iii. Is a motion to quash necessary?

b. Testify at deposition?

c. Testify at trial?

II. <u>CPA CONFIDENTIALITY – MCLA §339.732 & IRC §7525</u>

A. MCLA §339.732 – Michigan's Statutory Accountant-Client Privilege

1. Strictly and narrowly construed because the common (non-statutory) law does not provide for an accountant-client privilege.

2. Scope of the Privilege:

a. Information must be a communication made, or information supplied to, "licensee, or person employed by licensee" or information derived from or as the result of professional service rendered by a certified public accountant **AND** that communication or information must be relative to, or in connection with, an examination, audit, or report on books, records or accounts that the licensee or the employee of the licensee was employed to make ("Protected Information").

b. Licensee or employee of licensee shall not disclose or divulge or be required to disclose or divulge the Protected Information.

3. Exceptions:

a. Disclosure can be made when licensee has "written permission from the client or the heir, successor, or personal representative of the client to whom the information pertains."

b. A certified public accountant whose professional competence has been challenged in a court of law or before an administrative agency may disclose Protected Information as part of a defense.

c. Disclosure can be made to a licensed certified public accountant as part of a practice monitoring program or an ethical investigation (but note: the privilege then applies in the hands of that investigator/monitoring licensed certified public accountant.

d. Joint clients cannot assert a privilege against each other. *Harwood v Randolph Harwood, Inc.*, 124 Mich App 137 (1983).

B. IRC 7525 – Communications Privilege for "Federally Authorized Practitioners"

1. Scope of the Privilege:

a. Communication or disclosure by taxpayer client must be made with "respect to tax advice" (which is advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice as a federally authorized tax practitioner) **AND** to a "federally authorized tax practitioner" (which is any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice is subject to Federal regulation under section 330 of title 31, United States Code).

b. If (a) is met, then communication or disclosure is afforded the same confidentiality that applies to communications and disclosures between a taxpayer and an attorney under common law to the extent that such communication or disclosure would have been privileged if made by a taxpayer to an attorney.

c. This means that the test for attorney-client privilege applies, which requires:

   i. the communication or disclosure by the taxpayer must have been made for the purpose of obtaining tax advice;

   ii. the communication must have been made between the taxpayer and the federally authorized tax practitioner and not through intermediaries; and

   iii. the communication or disclosure must have been intended to be confidential and is actually kept confidential from those persons outside the taxpayer/practitioner relationship.

2. Limitation:

a. This privilege can <u>only</u> be asserted in any non-criminal tax matter before the Internal Revenue Service and any non-criminal tax proceeding in Federal court brought by or against the United States.

III. <u>STEPS TO AVOID INADVERTANT DISCLOSURE OF PRIVILEGED INFORMATION</u>

A. Do not mix protected privileged communications and advice with other general business or other information. You want to be able to demonstrate that the communication was for the purpose of obtaining accounting or tax advice and not for other purposes. By mixing topics and purposes, you jeopardize the privilege.

B. State clearly that the communication is privileged accounting or tax advice with an appropriate warning: "Confidential and privileged advice is contained in the communication. Do not forward or distribute this information." Note: some judges are not persuaded that the boilerplate warning on all of a firm's e-mails has any weight on the issue of privilege because the same warning appears on all types of communications, including lunch orders.

C. Limit recipients of the protected communication.

D. Do not share the accounting or tax analysis with persons who truly do not need to know the analysis. If a person only needs to know what the decision is upon a particular issue, information them of the decision but not the analysis.

MC 11 (6/04) **SUBPOENA, Order to Appear and/or Produce** MCL 600.1455, 600.1701, 600.6110, 600.6119, MCR 2.506

SUBPOENA
Case No. 16-011713-NO

PROOF OF SERVICE

TO PROCESS SERVER: You must make and file your return with the court clerk. If you are unable to complete service, you must return this original and all copies to the court clerk.

CERTIFICATE / AFFIDAVIT OF SERVICE / NON-SERVICE

☐ OFFICER CERTIFICATE	OR	☒ AFFIDAVIT OF PROCESS SERVER
I certify that I am a sheriff, deputy sheriff, bailiff, Appointed court officer, or attorney for a party [MCR 2.104(A)(2)], and that: (notary not required)		Being first duly sworn, I state that I am a legally competent adult who is not a party or an officer of a corporate party, and that: (notary required)

☒ I served a copy of the subpoena, together with **Notice of Taking Records Deposition**
Attachment

☐ personal service ☒registered or certified mail & first class mail

Name(s)	Complete address(es) of service	Day, date, time

☐ I have personally attempted to serve the subpoena and required fees, if any, together with ______
Attachment
on the following person and have been unable to complete service.

Name(s)	Complete address(es) of service	Day, date, time

Service fee	Miles Traveled	Mileage fee	Total fee	Signature
$		$	$	

Title

Subscribed and sworn to before me ______________, ______________ County, Michigan.
Date

My commission expires: ______________ Signature: ______________
Date

Notary public, State of Michigan, County of ______________

ACKNOWLEDGMENT OF SERVICE

I acknowledge that I have received service of the subpoena and required fees, if any, together with: ______________
Attachment

______________ on ______________
Day, date, time

______________ on behalf of ______________
Signature

AFFIDAVIT FOR JUDGMENT DEBTOR EXAMINATION

I request that the court issue a subpoena which orders the party named on this form to be examined under oath concerning the money or property
for the following

____
Signature

Subscribed and sworn to before me ______________, ______________ County, Michigan.
Date

My commission expires: ______________ Signature: ______________
Date Deputy court clerk/Notary public

Notary public, State of Michigan, County of ______________

MCR 2.105

STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE COUNTY OF OAKLAND

JAMES SLEAZY,

Plaintiff,

Case No: 16-011713-NO
Hon. Daniel Fairman

v.

BETH ATTIC,

Defendant.

SCARY, JERKY & MEANIE, PLC **Michael Meanie (P12121)** 456 No Mercy Street Southfield, MI 48034 (248) 443-6552 *Attorneys for Plaintiff*	HOWIE & CREAMUM, PLC **Gracie Johnson (P80822)** 1900 Ford St., Ste. 100 Southfield, MI 48034 (248) 359-7564 *Attorneys for Defendant*

NOTICE OF TAKING DEPOSITION DUCES TECUM

TO: **Anita Break, CPA**
123 Jones St., Suite 111
Pontiac, MI

PLEASE TAKE NOTICE that on **Monday, November 28, 2016,** at **10:00 a.m.** at the offices of SCARY, JERKY & MEANIE, PLC, 456 No Mercy Street, Southfield, MI 48034, the counsel for Plaintiff, will take the deposition of **Anita Break, CPA.** The deposition shall be continued from time to time until completed.

The deposition is to be taken in accordance with MCR 2.306 and MCR 2.308, before a notary public duly authorized to administer oaths. Pursuant to MCR 2.310 the deponent is required to produce the documents set forth on Exhibit A attached hereto.

Dated: October 31, 2016

SCARY, JERKY & MEANIE, PLC
Michael Meanie (P12121)

DEFINITIONS

The term "Document" or “document” means each and any form in which information is kept, however produced, reproduced, or stored, in your actual or constructive possession, custody or control, or which you have knowledge of its existence, and whether prepared, published or released by you or any other person or entity, including but not limited to, letters, reports, agreements, correspondence, intra-office or interoffice correspondence or memorandum, telegrams, e-mail, minutes or records of meetings, reports or summaries of investigations, expressions or statements of policy, opinions or reports of consultants, lists, drafts, revisions, invoices, receipts, original or preliminary notes, preliminary sketches, records, ledgers, contracts, agreements, bills of lading, bills, insurance policies, inventories, applications, financial data, diagrams, maps, plans, blue prints, schematics, memoranda, accounting and financial records, operating agreements, shareholder agreements, bylaws, financial statements, tax returns, budgets, diaries, journals, calendars, statements, loans, mortgages, financing applications, appraisals, work papers, videotapes, photographs, pamphlets, brochures, media guides, advertisements, trade letters, press releases, drawings, recaps, tables, articles, summaries of conversations, computer cards, tapes, disks, and other means of electronically, digitally, or magnetically maintained information and printouts. "Document" includes, without limitation all originals and non-identical copies and all drafts and proofs thereof. "Document" includes a copy of the original if the original is not in the possession or custody or control of witness, and every non-identical copy of the original.

The term “Document” or “document” also means all information of all kinds maintained by electronic data processing systems including all non-identical copies of such information. Electronic data includes, but is not limited to, computer programs (whether private, commercial or work-in-progress), programming notes or instructions, and input and/or output used or produced by any software program or utility (including electronic mail messages and all information referencing or relating to such messages anywhere on the computer system, word processing documents and all information stored in connection with such documents, electronic spreadsheets, databases including all records and fields and structural information, charts, graphs and outlines, arrays of information and all other information used or produced by any software), operating systems, source code of all types, programming languages, linkers and compilers, peripheral drivers, PIF files, batch files, any and all ASCII files, and any and all miscellaneous files and/or file fragments, regardless of the media on which they reside and regardless of whether said electronic data consists in an active file, deleted file or file fragment. Electronic data includes any and all information stored on computer memories, hard disks, floppy disks, CD-ROM drives, Bernoulli Box drives and their equivalent, magnetic tape of all types, microfiche, punched cards, punched tape, computer chips, including, but not limited to EPROM, PROM, RAM and ROM, or on or in any other vehicle for digital data storage and/or transmittal. The term electronic data also includes the file, folder tabs and/or containers and labels appended to, or associated with, any physical storage device associated with the information described above. All electronic data is to be produced in the form in which it is ordinarily maintained, unless otherwise instructed.

The term "communication" or "communications" means any document, as defined herein, sent to or received from the identified person(s) and includes all notes and memos of conversations.

If you claim any privilege, you must maintain and provide a privilege log identifying the author, recipients, date and description of the document, communication, or tangible things not produced or disclosed. If a privilege is claimed, please identify the basis for the privilege.

Deponent is requested to produce the following records:

1. All documents in connection with services provided to any of the following:

   (a) The Lotta Money Family LLC
   (b) The Lotta Money Family Trust

2. All communications regarding any of the following:

   (a) Beth Attic
   (b) James Sleazy
   (c) Any member of the Lotta Money Family LLC.

3. All retainer letters with those listed in paragraph 1.

4. All statements for services rendered to any of the persons listed in paragraph 1.
5. All work papers prepared in connection with those listed in paragraph 1.
6. All documents relating to the Lotta Money Family LLC.
7. All documents relating to the dissolution of the Lotta Money Family LLC.
8. All opinion letters in connection with any of those listed in paragraph 1.
9. All time records in connection with services for those listed in paragraph 1.
10. All Gift Tax Returns (Form 709), work papers and supporting documents.
11. All Estate Tax Returns (Form 706), work papers and supporting documents.
12. All Valuation Statements, work papers and supporting documents.
13. All appraisals, work papers and supporting documents.
14. All research on IRS disallowance of discounts for LLCs conducted as part of services rendered for those listed in paragraph1.

STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE COUNTY OF OAKLAND

JAMES SLEAZY,

Plaintiff,

v.

BETH ATTIC,

Defendant.

Case No: 16-011713-NO
Hon. Daniel Fairman

SCARY, JERKY & MEANIE, PLC
Michael Meanie (P12121)
456 No Mercy Street
Southfield, MI 48034
(248) 443-6552
Attorneys for Plaintiff

HOWIE & CREAMUM, PLC
Gracie Johnson (P80822)
1900 Ford St., Ste. 100
Southfield, MI 48034
(248) 359-7564
Attorneys for Defendant

ANITA BREAK CPA'S PRIVILEGE LOG

Doc.	Author	Recipient	Date	Bates Nos.	Privilege Asserted
Email	Lotta Money	Anita Break	5/14/15	N/A	Accountant-Client (tax advice)
Email	Anita Break	Lotta Money	5/15/14	N/A	Accountant-Client (tax advice)
Email	Anita Break	Beth Attic	5/14/15	N/A	Accountant-Client (tax advice)
Email	Beth Attic	Anita Break	1/16/15	N/A	Accountant-Client (tax advice)
Report Checklist	Lotta Money Family, LLC	N/A	6/00/15	N/A	Accountant-Client (hypos)

TAX AND NON-TAX CONSIDERATIONS OF OFFERING MINORITY INTERESTS IN A CLOSELY HELD BUSINESS TO KEY EMPLOYEES

By: Stuart M. Bordman

I. METHODS TO ACHIEVE EMPLOYEE RETENTION

A. Additional Compensation.

B. Longevity Bonus - $1,000 on the anniversary of each full year of employment.

C. Attendance Bonus - $100 for each week the employee works each scheduled shift.

D. Additional Paid Time Off – an additional week of paid vacation after each 5 years of employment.

E. Gift cards, etc. - $100 gift card for each week the employee works all scheduled shifts.

F. Giving/Selling the employee an equity interest (stock or membership interest) in the business entity. Employee wants:

1. Status of being a shareholder, officer and director (or member).

2. Share in management decisions.

3. Additional income.

4. Chance to cash out if the business is sold.

II. CONTROL TECHNIQUES TO PROTECT THE MAJORITY SHAREHOLDER OR MEMBER

A. Shareholder/operating agreement which addresses with respect to **all** shareholders/members.

1. Compensation and fringe benefits.

2. Duties and responsibilities.

3. Distribution of cash.

4. Power to terminate employment of minority shareholder/member which will be retained by the majority shareholder/member.

5. Consequences upon death, disability, termination of employment, etc.

B. Use of a second class of stock or membership interest.

III. TAX CONSEQUENCES OF TRANSFERRING STOCK TO AN EMPLOYEE

A. Section 83 applies if:

1. Property.

2. Is transferred (the transferor must acquire a beneficial interest in the property.

3. In connection with the performance of services.

B. A taxpayer who performs services in return for property (stock of the employer) has gross income equal to the FMV of the property or if the taxpayer pays something for the property the excess of its FMV over the amount paid.

Example: P.C. X issues Dr. No (an employee of X) 100 shares of X stock. Dr. No has gross income equal to the FMV of the stock received.

C. If an employee realizes income under Section 83 as a result of a compensating transfer of property, the employer has an equal deduction under Section 162.

D. Section 83 determines the income tax consequences to both the employee and the employer. Under Section 83(a), property transferred to an employee as compensation for services is taxable to the employee on the earlier of (1) the date the property is not subject to a substantial risk of forfeiture by the employee; or (2) the date it is transferable by the employee.

E. A transfer of property occurs when a person acquires a beneficial interest in such property. No transfer is deemed to have occurred where the property is transferred under conditions that require its return upon the happening of an event that is certain to occur such as the termination of employment. Whether a transfer has occurred depends upon all of the facts and circumstances.

F. Example 1: On January 3, 2016, X corporation purports to transfer to A, an employee, 100 shares of stock in X corporation. The X stock is subject to the sole restriction that A must sell the stock to X on termination of employment for any reason for an amount which is equal to the excess (if any) of the book value of the X stock at termination of employment over book value on January 3, 2016. The stock is not transferable by A and the restrictions on transfer are stamped on the certificate. Under these facts and circumstances, there is no transfer of the X stock within the meeting of Section 83.

G. Example 2: On January 3, 2016, X corporation purports to transfer to G, an employee, 100 shares of X stock. The stock is subject to the sole restriction that termination of employment G must sell the stock to X for the greater of its fair market value at such time or $100, the amount G paid for the stock. On January 3, 2016 the X stock has a fair market value of $100. Therefore, G does not incur the risk of a beneficial owner that the value of the stock at the time of transfer ($100) will decline substantially. Under these facts and circumstances, no transfer has occurred.

IV. <u>TYPICAL FACT PATTERN FOR A PROFESSIONAL CORPORATION</u>

A. Sale of stock: Professional Corporation X sells shares to physician Y (who will be a minority shareholder) pursuant to a formula that establishes the fair market value of the stock: net book value plus collectible accounts receivable less tax liability on collection of accounts receivable. Y must sell his stock to corporation X on termination of employment for any reason on the same formula. Y pays for his stock by issuing a promissory note. Since Y is paying FMV for the stock. Y has no income.

B. Compensation and fringe benefits of all employees is based upon production or some other formula.

C. Income from designated health services is divided equally or in some other manner not based on the value or volume of referrals.

D. Dividends and a liquidating dividend upon sale of the practice will be based on stock ownership.

E. Compensation/Fringe Benefits/Perks of majority shareholder must be established in advance and fixed.

F. Payments to entities under control of majority shareholder (rent, management fees, etc.) which affect the profitability of the P.C., must be established in advance and fixed.

Note: The minority shareholder will want to know that if the majority shareholder sells the practice, the minority shareholder will share in the proceeds. While the majority shareholder will retain the power to terminate the employment of a minority shareholder and cause the redemption of his shares, the minority shareholder must be protected so the majority shareholder cannot terminate employment of the minority shareholder immediately before a sale and deprive the minority shareholder of a share of the sale proceeds.

V. <u>PROFESSIONAL LIMITED LIABILITY COMPANY</u>

A. A profits interest is an LLC membership interest that gives the member the right to share in profits of the practice or business that arises after the holder acquires the interest (see Rev. Proc. 93-27).

B. There is no taxable income to the recipient upon receipt of a profits interest.

C. IRC 721 makes it clear that no gain or loss is recognized to a partner or a partnership for a contribution of property to the partnership in exchange for an interest in the partnership. The statute does not discuss the treatment when an individual receives a membership interest without contributing property.

D. A profits interest is defined as a partnership interest other than a capital interest.

E. A capital interest is defined as a partnership interest that at the time of receipt gives the holder a share of the proceeds if the partnership's assets are sold at FMV and the proceeds are then distributed in complete liquidation of the partnership.

F. See Rev. Proc. 2001-43 for further information regarding a profits interest.

BIOGRAPHIES

VANESSA L. BAILEY is an associate and member of the firm's Consumer Finance Regulatory Compliance and Real Property Litigation Practice Group. Ms. Bailey earned her Bachelor of Business Administration from the University of Hawaii at Manoa with dual majors in Finance and International Business.

Prior to Ms. Bailey's undergraduate education, she was recruited by the University of Hawaii's Women's Soccer Team during her junior-year of high school and received a full, four year athletic scholarship.

In 2014, Ms. Bailey received her Juris Doctor degree from Wayne State University Law School. While in law school, Ms. Bailey was a legal intern to the Honorable Judge Colleen O'Brien, who was appointed to the Michigan Court of Appeals Second District in October 2015.

STUART M. BORDMAN is a shareholder and a certified public accountant. 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.

Mr. Bordman has handled a wide variety of business transactions including the purchase and sale of businesses, the resolution of business disputes and formation, liquidation and dissolution of business entities. He recently became general counsel for a large non-profit organization and together with other attorneys in the Maddin Hauser firm, handles substantially all of its tax, governance, employment and general business matters.

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 the franchisor 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-franchisor dispute, a mediator, and 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.

KAITLIN A. BROWN is an associate attorney in the firm's Corporate and Employment practice groups. Specializing in employment law, Ms. Brown represents employers to prevent and respond to employees' concerns involving wrongful termination, discrimination, harassment, and wage and hour claims. She also reviews contracts, prepares compliant handbooks, and negotiates severance agreements. Ms. Brown has worked with clients in myriad industries, including automotive, corporate, medical, educational, and financial fields. She is committed to fully understanding her clients' business with a results-driven approach to provide high-quality legal advice.

Ms. Brown's experiences range from administrative agencies to large firm litigation. At the Michigan Department of Civil Rights, Ms. Brown worked in the Reconsideration Unit, evaluating and deciding appeals of administrative decisions. At Kitch, Drutchas, Valitutti, & Sherbrook, PC, she litigated complex insurance, contract, and constitutional cases. The success of Ms. Brown's practice is driven by her hard-work, active listening, investigative research, and organized analysis. She values professional relationships based on trust, authenticity, and respect.

Ms. Brown has been recognized as a Michigan *Super Lawyers®* Rising Star from 2014 to 2016. This recognition, given to select attorneys age 40 or younger or in practice for ten years or less, is granted to only 2.5 percent of lawyers in Michigan. The United States District Court for the Eastern District of Michigan also recognized Ms. Brown with a Pro Bono Accomplishment Award. She has provided numerous pro bono services, including handling a prisoner's rights case, volunteering at Homeless Experience Legal Protection and Common Ground's Legal Clinic, and coordinating pro bono activities for the Women's Bar Association. Additionally, Ms. Brown has been included in Michigan Lawyers' Weekly's 2016 list of Up and Coming Lawyers.

Ms. Brown is admitted to practice law in the State of Michigan, United States District Court for the Eastern District of Michigan, and in the State of Indiana.

Prior to becoming an attorney, she worked in New York City making documentaries for networks such as National Geographic International, The History Channel, and Discovery Health.

SARAH J. BRUTMAN is an associate and member of the firm's Defense and Insurance Coverage Practice Group who concentrates her practice on commercial insurance coverage and liability defense. She has extensive experience handling complex litigation matters in both state and federal courts across the country, including construction and insurance matters.

Graduating from Wayne State University Law School *cum laude* in 2004, Ms. Brutman earned her Bachelor of Arts in Political Science *summa cum laude* from the University of Detroit Mercy in 1999. She was named as a Super Lawyer – Rising Star for four consecutive years and was recognized by Hour Magazine as a Top

Woman Lawyer in 2013-14. Ms. Brutman is a member of Claims & Litigation Management Alliance.

Ms. Brutman is admitted to practice in the United States District Court for the Eastern District of Michigan and the State of Michigan.

JONATHAN B. FRANK is Of Counsel and a member of the firm's Complex Litigation and Risk Advisory Practice Group. He focuses his practice in the areas of civil litigation, employment, real estate, and business litigation. He also provides arbitration and mediation services in business and real estate cases.

Mr. Frank is admitted to the bar in Michigan and California. He received his undergraduate degree, with distinction, from Stanford University in 1982, and his law degree, cum laude, from the University of Michigan in 1985. At the University of Michigan, he was a finalist in the Campbell Moot Court Competition and received the Gussin Award for Trial Work. Mr. Frank has completed mediator training courses sponsored by the Michigan Supreme Court Administrator's Office and is a Neutral Arbitrator for the American Arbitration Association. He has also been selected by his peers for inclusion in the Michigan edition of *Super Lawyers®* from 2013-2016.

Mr. Frank is a member of the Oakland County Circuit Court Committee and Oakland County ADR Committee. He also serves on the board of directors of several charitable organizations, including the Detroit Police Athletic League, Detroit Urban Debate League and American Jewish Committee.

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.

Graduating 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. Since 1997, he has been with Maddin Hauser, 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.

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, he has also 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.

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. He was listed as a Leading Lawyer for 2016 and 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.

MICHELLE C. HARRELL is an experienced litigator, shareholder and Chair of the firm's Complex Litigation and Risk Advisory 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 is an approved ADR provider for Macomb County (Family Matters, Probate) and

Oakland County (Civil/Commercial, Probate, District Court) and has also been approved as a Commercial Arbitrator for the American Arbitration Association.

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 appointed to the Board of Directors of Living Arts. 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 2007-2016. 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. Mr. Hauser 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 a senior 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 2007-2016, 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 Jewish Federations of North America.

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 2006-2016 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 and other commercial transactions, including the purchase and sale of companies, residential mortgage banking, and finance. Throughout his career, Mr. Jacobs has, among other things, represented mortgage companies in the purchase, sale, origination and servicing of residential mortgage loans. Mr. Jacobs also 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 and named as a Top Lawyer by *DBusiness Magazine*.

ERIN A. JOHNSON is an associate in the firm's Real Estate and Corporate and Employment Practice groups, where she advises clients regarding a variety of corporate, employment, and real estate matters. Johnson earned a Bachelor of Fine Arts in Musical Theatre from the University of Michigan, where she graduated *magna cum laude*. After college, she moved to New York City, performing in Broadway musicals such as "42nd Street," "Thoroughly Modern Millie" and "West Side Story."

In 2011, Johnson earned her juris doctor *magna cum laude* from the University of Illinois College of Law, where she served as the Managing Editor of the Elder Law Journal and as the research assistant for Professor Peter B. Maggs. Johnson also competed on the College of Law's trial team and clerked for Judge Holly F. Clemons of the Champaign County Superior Court.

Following law school, Johnson practiced law in Indianapolis, Indiana, for four years as an associate at Ice Miller LLP, where she advised corporate and healthcare clients on a variety of litigation, regulatory, and corporate matters. Throughout her time in Indianapolis, Johnson regularly volunteered with School on Wheels, a non-profit organization that provides educational advocacy and one-on-one tutoring to school-aged children impacted by homelessness, serving as a tutor and the chair of the SPOKES Speakers Bureau.

Johnson is admitted to practice law in the State of Michigan and the State of Indiana.

LINDSEY R. JOHNSON focuses her practice on commercial general liability. She has handled cases involving premises liability claims and third party auto negligence claims. She has also performed examinations under oath for various insurance companies. In addition, 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, 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.

Earning her Juris Doctor *cum laude*, from Thomas M. Cooley Law School, Ms. Johnson served as a subcite editor of the Thomas M. Cooley Law Review and a teaching assistant for the scholarly writing course. She also received the Eugene Krasicky Award for writing excellence.

Ms. Johnson is licensed to practice in Michigan as well as the federal courts for the Eastern and Western Districts of Michigan. Her professional affiliations include the

State Bar of Michigan, and Oakland County Bar Association – Real Estate and ADR Sections.

EVAN H. KAPLOE is a shareholder in the firm's Tax Practice Group who works with businesses and their owners to solve difficult tax issues that range from tax compliance to tax planning and litigation. Mr. Kaploe's goal is to work with the business or potential business to identify strategic areas of Federal and State tax to achieve a cost savings. He also works with corporations, partnerships and limited liability companies in business combinations and separations.

In situations which an entity or individual previously consummated a transaction or took a tax position on a return where the Internal Revenue Service or State taxing agency identified an issue, Mr. Kaploe works closely with the client and tax authorities to reach a settlement.

Mr. Kaploe understands that, on occasion, it is necessary to litigate a matter in the United States Tax Court or a Federal District Court to reach the most favorable and just result. He will always conduct a cost-benefit analysis to determine whether the cost of litigation outweighs the potential tax savings. Mr. Kaploe takes the same value-added approach to transactions. His goal is to give sound tax planning advice to each client, whether a large established business or a new venture.

Having spent years inside the Internal Revenue Service as an attorney, Mr. Kaploe has a unique perspective on how to tackle challenging tax problems facing business and their owners in today's economic climate. He not only understands the intricacies of the Code and Regulations, but also has personal relationships with IRS Counsel, Revenue Agents and Officers and Appeals Officers.

In addition to his other specialties, Mr. Kaploe's experience includes addressing issues relating to the taxation of mortgage backed securities, collateralized debt obligations, and REMICS. Mr. Kaploe has prepared numerous tax opinions regarding defeasances, assignments, and assumptions of securitized mortgages to ensure that the mortgage pool remained compliant with the Internal Revenue laws, specifically, Sections 860A through 860G.

ROBERT D. KAPLOW is a shareholder in the firm. His practice is concentrated in estate planning and personal and corporate income tax planning. Mr. Kaplow is a graduate of Cornell University, receiving his law degree from the University of Michigan. He received a Master's 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 (Real Property, Trust and Estate Law Section). 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, 2010-2015. 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 2013-2016, as well as *HOUR Detroit* magazine as one of Michigan's top female attorneys.

GARY A. KRAVITZ is a senior attorney in the firm's Real Estate, Corporate and Business, and Franchise practice groups where he represents clients in real estate matters including property acquisition and disposition, office, retail and industrial lease agreements, option agreements and real estate related litigation. Counseling clients on business law matters including structuring LLCs and corporations, asset and stock purchase transactions and preparing employment agreements, confidentiality and non-compete agreements and shareholder agreements, Mr. Kravitz also assists clients with financial matters in the areas of lending, foreclosures, workouts and refinancing.

Admitted to the bar in Michigan, Mr. Kravitz received his undergraduate degree from Cornell University in 1990, earning his Juris Doctor from George Washington University Law School in 1993, and his Master of Laws (LLM) in Taxation from Wayne State University Law School in 2007.

Mr. Kravitz is a member of the U.S. Green Building Council's Commercial Real Estate Committee and the State Bar of Michigan's Law Related Education and Public Outreach Committee. He also serves as vice president of the Six Rivers Land Conservancy, an organization focused on conserving, sustaining and connecting natural areas, lands and waters.

CHARLES M. LAX is a shareholder of the firm who practices 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 an Emeritus member of the IRS Great Lakes TE/GE Council. Mr. Lax has previously served as the Chairman of the State Bar of Michigan - Section of Taxation, the Chairman of the State Bar Employee Benefits Committee, the Advisory Committee for TE/GE, the IRS Regional Council Bar Advisory Group - Central Region, the ASPPA Vice Chairman for Regional Conferences, the Co-Chairman of the Great Lakes Benefits Conference for 2007 and 2008 and as Co-Chairman 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 and 2016 "Detroit Lawyer of the Year" in employee benefits law.

Mr. Lax has also been recognized by *Chambers USA*, continuously selected for inclusion in the Michigan edition of *Super Lawyers®* from 2006-2016 (one of the top 100 lawyers in the State of Michigan for 2008), and named as a Top Lawyer by *DBusiness Magazine*. 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 is a shareholder and concentrates her practice on commercial insurance coverage and liability defense for national insurers and private clients. She specializes in negotiating global resolutions in complex cases involving product liability, general contractors and subcontractors, class actions, construction defects, premises liability, torts and commercial automobile accidents. She also represents banks in trust disputes. Ms. Ludden sits as a commercial case evaluator in Oakland County and as a tort case evaluator in Wayne County. She is available to sit as a facilitator in commercial liability cases where insurance coverage is at issue.

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. Ms. Ludden 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, Federal Bar Association, and Oakland County Bar Association. Ms. Ludden is a member of the Claims & Litigation Management

Alliance and sits on the Executive Board for the Michigan Chapter of the Federalist Society.

She has been recognized among Michigan Lawyers Weekly's 2016 "Women in the Law," an awards program honoring women lawyers in Michigan who have a commitment to excellence in the practice of law, are inspiring and accomplished leaders in the legal profession, serve as mentors to other women, and who contribute significant time and effort to volunteerism and/or pro bono work.

Ms. Ludden is admitted to practice in the United States Court of Appeals for the Sixth Circuit, United States District Courts for the Eastern and Western Districts of Michigan, Bankruptcy Court for the Eastern District of Michigan, and all Michigan state courts.

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 50 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 now Of Counsel to the firm who has practiced law for more than 45 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 a 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® 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 "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.

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 Best Lawyers in America® since 2015 in the area of professional malpractice law-defendants.

STEPHANIE C. MELLIN (formerly Kamykowski) is an associate in the firm's Consumer Finance Regulatory Compliance and Real Property Litigation Practice Group. Focusing her practice in this area since 2010, Stephanie uses her expertise to provide advantageous solutions to client matters.

Receiving her Bachelor of Arts degree from Michigan State University in East Lansing, Michigan, where she majored in Political Science, Stephanie earned her Juris Doctor from Wayne State University Law School in Detroit, Michigan.

She is currently licensed to practice law in the State of Michigan, the United States District Court for the Eastern and Western Districts of Michigan and Michigan Tribal Court.

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 commercial litigation, including professional liability defense of insurance agents, real estate agents, financial professionals, attorneys and others, products liability and intellectual property. He has authored numerous publications and spoken to many industry professional groups. 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 Litigation and Risk Advisory, 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 litigation 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.

KAREN E. PLAZA is an associate and member of the firm's Consumer Finance Regulatory Compliance and Real Property Litigation Practice Group. She received her Bachelor of Arts degree from the University of Michigan in 2005, and her Juris Doctorate from the University of Detroit Mercy School of Law in 2008. She is admitted to practice law in Michigan and Washington, D.C. Ms. Plaza is also admitted to the Federal District Court for the Eastern and Western Districts of Michigan, U.S. Bankruptcy Court for the Eastern District of Michigan, and United States Court of Appeals for the Sixth Circuit.

Ms. Plaza has extensive litigation, research, and briefing experience in the areas of real property law, commercial litigation, consumer compliance regulations, creditor's rights, and bankruptcy. She has successfully represented clients in matters involving claims arising under the Truth In Lending Act, Fair Debt Collection Practices Act, Fair Credit Reporting Act, and Real Estate Settlement Procedures Act and related state law claims. Ms. Plaza's experience also involves quiet title actions, contested foreclosures and evictions. She also has intimate knowledge of the interrelationship between mortgage servicers and mortgage foreclosure firms.

Ms. Plaza has contributed articles to the National Firm, LLC's "State-By-State Update" newsletter and co-authored materials for use in the Norton Bankruptcy Institutes law seminar materials. She has also been published in the Oxford International Encyclopedia of Peace.

Ms. Plaza is a member of the Real Property, Litigation, and Young Lawyers Sections of the State Bar of Michigan.

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 was recognized as a Michigan *Super Lawyers®* Rising Star 2014-2016.

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 serves as Co-Chair of the Law Related Education subcommittee. 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 serves as Chair of the Oakland County Bar Association's Employment Law Committee and as the Resource Partner Director for the Michigan Society for Human Resources Management. Mr. Reid is a member of the State Bar of Michigan (Labor and Employment Law Section e-News Committee). He was named as a Michigan *Super Lawyers®* Rising Star in 2015 and 2016, and is admitted to practice before the federal and state courts of Michigan.

JESSE L. ROTH is an associate and member of the firm's Defense and Insurance Coverage Practice Group. In 2014, Mr. Roth earned his Juris Doctor degree, cum laude, from the University of Michigan Law School, where he was awarded a Clarence Darrow Scholarship - a three-year, full-tuition merit scholarship. While in law school, he received a Certificate of Merit in International Corporate Governance. Mr. Roth also served in the chambers of a U.S. Magistrate Judge for the District of New Jersey. Prior to law school, he worked for an educational startup company in Mexico and then for the Cleveland Indians baseball team.

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 Top Lawyer since 2010 by DBusiness and has been named in Michigan Super Lawyers® since 2007.

<u>STEVEN D. SALLEN</u> began his career at Maddin Hauser in 1983, as a law clerk. Today, he is the President and Chief Executive Officer of the firm. 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 head of Maddin Hauser's Environmental Law Practice Group, and co-chair of the Real Estate Practice Group.

Reflective of his problem-solving approach to transactional issues, Mr. Sallen's many publications include: <u>From Lemons to Lemonade; Successful Management of Lease Termination Negotiations Can Lead to New Opportunities For Commercial Property Owners</u> (*Michigan Lawyers Weekly*, April 21, 2008) and <u>New IRS Rules for Lenders May Help Troubled Commercial Borrowers</u> (*Michigan Lawyer's Weekly*, November 2, 2009).

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.

<u>DAVID M. SAPERSTEIN</u> is a shareholder of the firm who 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 joined Maddin Hauser in July, 2001, and is admitted to practice law in Michigan, Ohio and California.

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.

Mr. Saperstein's publications include: "Why There are No Common-Law Exceptions to a Municipality's Governmental Immunity: A Municipal Perspective," *Public Corporation Law Quarterly*, Spring 2001, No. 9, p.1, and "The Abominable Snowman, the Easter Bunny, and The Intentional Tort Exception to Governmental Immunity: Why Sudul v Hamtramck was Wrongly Decided," *16 Michigan Defense Quarterly*, No. 2, p. 7 (2000).

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 has served as an officer of B'nai Israel Synagogue of West Bloomfield, 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: "Avoiding Tax-Related Identity Theft," Accounting Today (September 2016), "NIIT Nits," Laches, No. 587 (April, 2016), "The Beneficiary as Trustee: Designing the Henhouse Around the Fox," *Laches*, No. 567 (April, 2014), "Equity Compensation in LLCs," *Laches*, No. 557 (April 2013), "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 who 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.

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, member of the firm's Executive Committee, co-head of the firm's Real Estate Practice Group and 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.

AARON M. SWEDLER is Of Counsel and part of our firm's Healthcare Practice Group. Mr. Swedler's practice tackles a wide range of healthcare recovery problems from including but not limited to: fully insured and self-insured employee benefit plans and commercial health insurance, medical claims coding and administrative matters, auto accidents and no-fault insurance and commercial liability insurance, government-funded programs and HMO(s), TPA(s) and stop-loss sureties, and PPO(s) and provider or network agreements.

Mr. Swedler doesn't believe the patient experience ends with his or her medical stay. As counsel for hospital systems - the commitment to provide exceptional patient care extends to him, and he takes this responsibility seriously. Problems with third-party recovery aren't easy for patients. These issues are frustrating and uncomfortable and understandably so. Representing the healthcare community exacts an extra degree of sensitivity and compassion for these concerns. For Mr. Swedler - it's a part of who he is, what he does, and how he goes about business on behalf of the healthcare community.

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.

MATTHEW B. THEUNICK is an associate in the firm's Consumer Finance Regulatory Compliance and Real Property Litigation Practice Group. Graduating from Oakland University (*magna cum laude*) in 1996 and the Valparaiso University School of Law in 2001 (Honors Scholarship Recipient), Mr. Theunick has nearly fifteen years of experience in litigation and mortgage banking, where he specializes in appellate, real estate, and financial services litigation, along with regulatory compliance and risk management. Mr. Theunick's experience includes having worked in the regulatory compliance department of a national depository institution. He is admitted to practice by the State Bars of Michigan and Illinois and is also admitted to the Federal District Courts for the Eastern and Western Districts of Michigan and the United States Court of Appeals for the Sixth Circuit. Mr. Theunick has been recognized as a Super Lawyers Rising Star (2013) for Business Litigation and a DBusiness Magazine Top Lawyer (2014) for Real Estate Law.

As an avid legal writer, Mr. Theunick has published numerous articles on trending real property law and compliance issues, including: *Kim v. JP Morgan Chase Bank, NA* - Mortgage Transfers by Operation of Law, published in the Michigan Real Property Review; HOA Talk: Michigan - Condo Association Fees Upon Acquisition of Title, published in the USFN; Facing the Fall-Out from the 10-Year Anniversary of the Commercial Lending Surge, published in the Real Estate Journal; Regulation X: Borrower Requests for Loan Servicing File, published in the USFN; and Revisiting the Mortgage Forgiveness Debt Relief Act of 2007, published in the Real Property Law Section of the State Bar of Michigan.

STEWART C.W. WEINER is a shareholder and member of the firm's Complex Litigation and Risk Advisory Practice Group. 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 Executive Committee and Board of Governors of the Jewish Federation of Metropolitan Detroit for many years.

THOMAS W. WERNER is a shareholder who joined the firm's Defense and Insurance Coverage Practice Group in November 2011. In 2004, Mr. Werner 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, Mr. Werner concentrated his practice on commercial litigation, insurance coverage, and defense of product liability actions throughout the country. He is a published author and has made several professional presentations, including seminars teaching clients how to properly communicate and draft contracts in order to avoid litigation.

Mr. Werner 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. He was named a 2011 Rising Star by *Michigan Super Lawyers.* In June, 2015, Mr. Werner was elected for a three year term to the Board of Directors for the Michigan Youth Arts, an organization that provides opportunities to youths across the state to participate in choral, instrumental, visual, film, dance and written arts.

MARC 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 as a Leader in his Field of Employee Benefits & Executive Compensation (2013-2016).

STEVEN M. WOLOCK is a shareholder in the firm who received his law degree from the University of Michigan Law School in 1985 and obtained a Bachelor's of Science in Economics from the University of California at Santa Cruz in 1977.

Mr. Wolock specializes in general commercial litigation and professional liability litigation and has extensive experience in labor and employment law.

Mr. Wolock 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 continuously selected by his peers for inclusion in the Michigan edition of *Super Lawyers®* since 2007 in the area of professional liability defense and selected for inclusion in the *Top Lawyers* edition of *DBusiness Magazine* since 2010 in the area of legal malpractice. Mr. Wolock has been named a "Leading Lawyer" for the year 2016 by *Leading Lawyers Magazine*.

Mr. Wolock has served on the Michigan State Court Administrative Office Dispute Resolution Rules Committee and on the Michigan State Court Administrative Office Mediation Confidentiality and Standards of Conduct Committee. In 2009, Mr. Wolock was appointed by Michigan's Governor to serve as the attorney member of the Michigan State Board of Accountancy and served a four year term. Mr. Wolock serves as a hearing panelist for the State Bar of Michigan Attorney Discipline Board.

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).

Notes

Notes