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The *Michigan Tax Lawyer* is a publication of the Taxation Section of the State Bar of Michigan that is designed to be a practical and useful resource for the tax practitioner. Features include concise reports in a uniform format from the Section's committees, practitioner articles with the "how to" approach, news of events and of other Section members, and "Short Subjects" providing helpful practice information.

Input from members of the Taxation Section is most welcome. Our publication is aimed toward involving you in Section activities and assisting you in your practice. If you have suggestions or an article you wish to have considered for publication, please contact Stephen M. Feldman, Esq. at 33533 W. Twelve Mile Road, Suite 150, Farmington Hills, Michigan 48331-5645, (313) 489-8600.



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# TAXATION SECTION

STATE BAR OF MICHIGAN

December 1, 1992

Dear Taxation Section Members:

As the new Chairperson of the Tax Section, I am very much looking forward to an exciting year. With the help of the dedicated, volunteer members of the Tax Council and Committee Chairpersons, the Tax Section is planning numerous projects and activities for the coming year.

First, the Sixth Annual Summer Tax Conference will be held at the Grand Traverse Resort, in Acme, Michigan, from Thursday July 29 through Saturday July, 31, 1993. The topic for this year's Conference is "Tax Trends - What's New, What's Not and What's Next". Please reserve these dates for this Summer's Conference. If the past success of the prior programs is any indication, this Summer's Conference will prove to be educational and enjoyable for everyone.

Second, the After Hours Tax Law Series, sponsored jointly with the Institute of Continuing Legal Education, has, once again, planned a series of eight monthly programs. The sessions are from 3:00 to 6:00 p.m. and focus on current tax planning issues. For example, the September program featured Scott Carlson, a principal drafter of the Subchapter S Single Class of Stock Regulations. The programs are done each month, both at the Sheraton Oaks in Novi and at the Eberhard Center in Grand Rapids. Upcoming programs include Property Taxation: Assessments, Appeals, and Abatements by Jeffrey S. Ammon and Nanci Wold Freedman (in January); Buying and Selling Businesses by Stephen R. Kretschman and myself (in February); Corporate Restructurings and Recapitalizations by Michael Indenbaum and Robert R. Stead (in March); Like Kind Exchanges and Other Real Estate Tax Problems by Wayne P. Bryan and James A. Rocchio (in April); A Panel Discussion on Practicing Effectively Before the IRS Appeals Office by Robert E. Miller, Michael H. Obloy and Zora Hargrave, Chief of Appeals, Detroit Appeals Office (in May).

Third, we are very proud of the Tax Directory which has been provided to all members of the Tax Section. The Tax Directory contains a listing of important IRS and State of Michigan phone numbers and contact

persons, as well as a listing of members of the Tax Section and information relating to Comerica Bank personnel. We look forward to the continued participation of Comerica Bank as a sponsor of the Tax Directory.

Fourth, our committees are planning full schedules of meetings over the course of the year. The Committees consist of Corporation, Employee Benefits, Estates and Trusts, Partnership, Practice and Procedure, State and Local, and International. For further information, please feel free to contact me or our Section's Coordinator, Karen Nizol.

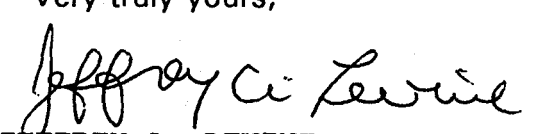
Fifth, Dennis Mitzel, our Vice Chairperson, had the opportunity to attend the annual State Bar Tax Sections' meeting in Washington, D.C., in October. Representatives of many other tax sections from around the country attended this meeting. Dennis commented that our Tax Section is really at the cutting edge in programming, as well as in our quarterly publication, the Michigan Tax Lawyer.

Sixth, the Michigan Tax Lawyer (in which you are reading this letter) is published quarterly, with Stephen Feldman as its editor and Joseph Bonventre, Reginald Nizol and Eric Weiss as the Publication Committee. The goal of the publication is to provide practitioners with information relating to the Tax Section, as well as featuring articles of practical use.

The Tax Section is your tax section. Please call me, other members of the Council, or Committee Chairs, with your comments and suggestions relating to programming, publications or any other matter. This input will be very helpful in planning future programs, and improving the quality of the Tax Section's offerings.

David Ohlgren, an active member of the Tax Section, a former committee chairperson and member of the Tax Council, has passed away. Dave's contributions will be sorely missed. I want to express condolences to Dave's family on behalf of the entire Tax Section.

Very truly yours,



JEFFREY A. LEVINE
Chairperson
Taxation Section
STATE BAR OF MICHIGAN

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## Report of the Corporation Committee

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**1. Chairperson's Message.**
As I begin my term as the Chairperson of the Corporate Committee, I would like to thank the immediate past Chairperson, Michael A. Indenbaum, for both his contributions to the Committee and his assistance in the transition. Consistent with his goals, it is my desire to increase the participation of members of the Tax Section in the activities of the Corporation Committee. Your comments, suggestions and participation are welcome, helpful and needed.

**2. Recent Activities.**
The most recent meeting of the Corporation Committee was held on Wednesday, October 28, 1992 at the offices of Kemp, Klein, Umphrey, Endelman & Beer, P.C. in Troy, Michigan. The meeting focused around a replay of the presentation of Scott Carlson, Attorney adviser at the Internal Revenue Service National office, regarding the recently published final regulations relating to the one class of stock requirement for S corporations. An advantage of the taped presentation was the ability to freeze the tape and discuss strategies and hypotheticals based on Mr. Carlson's comments. The meeting was preceded by a discussion of current utilization of personal computers in everyday practice.

**3. Future Schedule.**
The next meeting of the Corporation Committee will be held in January, 1993. Members will be informed of the date and subject matter. Please forward suggestions for topics you would like covered in the upcoming year.

**4. Important Developments.**
The National Energy Policy Act of 1992 was signed into law on October 24, 1992. The largest tax expenditure in the Act is AMT relief for non-integrated oil producers. The Act also includes a deduction for clean-fueled vehicles, a credit for the electric car, extends the business energy credit for solar and geothermal energy, and sets the maximum exclusion for employer-provided parking at $155/month. The largest sources of revenue In the Act include. (1) an increase in the tax rate on ozone-depleting chemicals, (2) the requirement that home purchasers provide taxpayer identification numbers for seller-financed mortgages, (3) an increase in the backup withholding rate on dividends and interest from 20 to 31 percent, and (4) treating property distributed to a partner within 5 years of a contribution of property to the partnership by that partner as though the partner exchanged the distributed property for the contributed property.

## Report of the Employee Benefits Committee

Janet G. Witkowski, Chairperson
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(313) 961-8380

**1. Chairperson's Message.**
Many thanks to the members who took the time to complete and return the survey I mailed out last summer. Your responses have been a tremendous help to me in planning our programs for the coming year. Of those of you who answered the survey, everyone of you indicated afternoon as a preferred meeting time; most of you specified 3:00 p.m. Accordingly, I will change next year's meeting format to reflect your prefer-

ences. The overwhelming majority responding to the survey indicated that north or northwest Detroit is the best location for them, followed by Lansing and Grand Rapids. Our September meeting next year will be in Grand Rapids in conjunction with the State Bar Annual Meeting, and I will try to schedule at least one meeting for the Lansing area, and other meetings in the Detroit area at locations convenient for those driving in from the north and west. I would especially like to thank those of you who volunteered to write articles or speak to our group during the coming year. I will be contacting you shortly.

**2. Recent Activities.**
On September 15, 1992, the Committee met at Lansing Center in conjunction with the State Bar Annual Meeting. Janice Skufca, Employee Plans Branch Chief for the Cincinnati Key District, Larry Burleson, EP Group Manager in the Detroit office and Bob Dettling, Senior EP Specialist in the Detroit office, discussed current determination letter and audit issues, good faith compliance pending issuance of final regulations, the Closing Agreement Program, Administrative Policies Regarding Sanctions, the new Voluntary Compliance Program and other current issues, and responded to members' questions on a variety of topics in a manner that was candid, helpful and informative.

The October *After Hours Tax Series* featured two of our members, David Rosenberger and Deborah Thompson, along with family law specialist James Crowley in a panel discussion on qualified domestic relations orders. The program was designed for family law practitioners who negotiate and draft QDRO's as well as employee benefits lawyers who advise plan administrators, and was extremely well attended, by family law specialists in particular, who were most enthusiastic about the presentation and encouraged us to do more in that area in the future. Thanks to the panel for an outstanding job.

**3. Future Schedule.**
Those of you who answered the survey or otherwise furnished comments to me about last year's program indicated that our Internal Revenue Service update and annual "talent show" meeting were most valuable and you would like to see these programs continue. Accordingly, I am planning to schedule both of these presentations again for the coming year. I also hope to be able to bring in a National Office representative to discuss the revised non-discrimination regulations at or near the time they are released. A session on welfare plan and cafeteria plan issues as well as a general round table discussion where we can all commiserate are also being planned. Watch your mail and future issues of the *Michigan Tax Lawyer* for specific information on meeting topics, dates and locations.

## Report of the Estates & Trusts Committee

Joseph A. Bonventre, Chairperson
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**1. Chairperson's Message.**
This is my first column as the new Chairperson. I would like to begin by thanking George Gregory (outgoing Chairperson) and his outstanding predecessors (including Dennis Mitzel and Reg Nizol) for all their efforts in making sure Committee meetings and matters are handled in an outstanding manner. For your information, I am a partner at Clark, Klein & Beaumont. On a personal note, I am married to a terrific woman and have

two wonderful children (ages 8 and 9). I look forward to seeing and working with many of you during the coming months.

Our Committee meets at least four times each year. The meetings are held at different locations in Michigan. Each meeting includes a presentation on one or more tax topics in the Estates and Trusts area by an individual or group of people with substantial experience in the chosen topic. I urge Committee members and non-members alike to make every effort to attend these meetings. Please feel free to give me a call (313-965-8293) if you have an interesting topic, would like to present a topic or know the name of someone who could present a topic that would be interesting and informative to our members.

Our Committee also prepares two articles each year for the *Michigan Tax Lawyer*. The articles are on a tax topic in the estates and trusts area and usually are 6-15 pages double-spaced in length. Our Committee also usually writes an article for the Tax Issue of the *Michigan Bar Journal*. Please let me know if you are interested in writing an article for either publication. Writing an article is an excellent opportunity to show other Michigan attorneys your knowledge and expertise on a topic. It is also a good practice development technique.

**2. What's New in the Estates and Trusts Area?**

The new Michigan Inheritance Tax Form Booklet is now available. If you want a copy please call the Michigan Department of Treasury at 1-800-FORM-2-ME. Please note that the Extension Form is also available but is not in the Form Booklet.

An interesting case was decided on September 16 by the 6th Circuit Court of Appeals. In *Gallenstein* v. *Commr.*, _____ F2d _____ (6th Cir.) (1992). The 6th Circuit Court of Appeals held that joint tenancies between spouses that were created before 1977 are not subject to the Economic Recovery Tax Act of 1981 rule that taxes one-half of the value of the property in the estate of the first spouse to die regardless of who furnished the consideration. Instead, the full value of the property is included if the survivor made no contribution toward its purchase. The income tax effect is that a surviving joint tenant who made no contributions ends up with a stepped-up basis in 100% of the property rather than a step-up in only 50% of the property. Each of us should review our client list to determine if any clients are eligible for a refund as a result of this decision.

**3. Recent Activities.**

At this year's State Bar Convention, on September 16, 1992, Robert B. Joslyn of Joslyn, Keydel, Wallace and Carney, Detroit, Michigan; Steven W. Jones of Beir - Howlett, Bloomfield Hills, Michigan; Dennis Mitzel of Berry, Moorman, King & Hudson, P.C., Detroit, Michigan; and William Tetrick, Estate and Gift Tax Attorney, Internal Revenue Service, Detroit District, Detroit, Michigan; presented the topic "A Planner's Nightmare, Generation Skipping Tax: Where Are We Now? The panel did an excellent job answering the dozen or so hypotheticals prepared by George Gregory. The 28 attendees learned a lot and had a good time at the offices of Foster, Swift, Collins & Smith. After the meeting, Alan Claypool invited the attendees to tour the host law firm's new offices.

On October 22, 1992, Austin Kanter, CLU, ChFC, of American Benefits Group presented the topic "Non-Estate Tax Aspects (Including Income Tax) of Life Insurance for Estate Planners" to the Committee in Southfield. Austin discussed life

insurance in general, including how to analyze projections, identifying the need for insurance, the tax consequences of using modified endowment contracts, a review of the transfer for value rules and a brief discussion of charitable remainder trusts. Several good questions were asked during the presentation and everyone left with new and interesting information about life insurance.

**4. Future Schedule.**
On Thursday, January 28, 1993, from 3:00 to 5:30 p.m. at the Radisson Plaza Hotel in Southfield two topics will be covered. First, David Horvath (Michigan Inheritance Tax Examiner for Oakland County and former Acting Manager of Michigan Inheritance Taxes) will walk through the New Michigan Inheritance Tax Forms and tell us how he thinks they should be completed. Second, Michael Obloy (First Vice President & Senior Trust Officer, Estate and Tax Administration, Comerica Bank) will present the topic What's New in the Fiduciary Income Tax Area. Mike's presentation will include a review of the 1992 U.S. and Michigan Fiduciary Income Tax Return forms and a review of some other areas of fiduciary income taxation. Please feel free to call me for additional information.

## Report of International Tax Law Committee

Richard S. Soble, Chairperson
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2290 First National Bldg.
Detroit, MI 48226
(313) 256-7520

**1. Chairperson's Message.**
On September 16, 1992, the International Committee held its inaugural meeting in Lansing. I am pleased to report that the meeting was well attended and the program was a success. Frank Miller from Chrysler Corporation spoke about audit issues regarding Mexican subsidiaries. Murray Schlussel from Ford Motor Company talked about developments in Europe. Tim Gibbs from Coopers & Lybrand summarized the foreign tax provisions of a bill pending in Congress. Finally, Denton Wolf from Deloitte & Touche discussed a recent case involving withholding of tax on an Australian group's winnings from the Virginia lottery.

The Committee also met on December 7, 1992. The scheduled speaker was unable to attend but in his place Jim Sams came from the office of IRS Chief Counsel. Jim talked about a number of issues of current interest with emphasis on the trend of thinking on international matters in Washington.

**2. Future Schedule.**
In April of 1993, the Committee will meet with the Estates and Trust Committee to listen to Howard Young discuss the use of foreign trusts to protect assets from catastrophic loss. Howard will discuss the tax, as well as other legal issues bearing on this subject. The exact date of the meeting, and of one or more other meetings that are likely to be scheduled in the interim, have not (as of this writing) been determined. Please call my secretary, Evelyn Hughes, for updates and further information.

**3. Important Developments.**
The area of international taxation continues to develop with rapidity. Recently, the IRS issued Rev. Proc. 92-66 to revise the rules regarding withholding on a foreign partner's share of income effectively connected with the conduct of a U.S. trade or business. The Rev. Proc. raises the rate of withholding for publicly traded partnerships from 28% to 31% for distributions on or after November 16, 1992. Also, a foreign partnership subject to FIRPTA with-holding on the disposition of an interest in U.S.

real estate under Section 1445(a) may credit the amount so withheld, but only to the extent such amount is allocable to foreign partners, against its obligation to withhold on distributions to foreign partners under Section 1446.

The IRS has issued final regulations in a number of areas. Final regulations regarding the definition of "nonresident alien" have been issued under Section 7701. Final regulations regarding the branch profits tax have been issued under Section 884. Finally, final regulations concerning dual consolidated losses have been issued under Section 1503(d).

## Report of the Partnership Committee

Gary Schwarcz, Chairperson
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Fifteenth Floor
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**1. Chairperson's Message.**
On October 28, 1992, the Partnership Committee, the Real Estate Section's Committee on Federal Income Tax Aspects of Real Estate Transactions and the Corporation Committee held a joint meeting to view a video tape of the recent I.C.L.E. seminar given by Scott Carlson of the Internal Revenue Service regarding recently issued S Corporation Treasury Regulations.

**2. Future Schedule.**
The next Partnership Committee meeting will take place after New Years. Notices will be mailed regarding future meetings.

**3. Important Developments.**
Revenue Ruling 92-97 held that an allocation to a partner of a share of a partnership's cancellation of indebtedness income that differs from the partner's share of the cancelled debt under Section 752(b) of the Internal Revenue Code will be found to have substantial economic effect under Code Section 704(b) if:

1. The deficit restoration obligations covering any negative capital account balances resulting from the cancellation of indebtedness, income allocations can be invoked to satisfy other partners' positive capital account balances,
2. The requirements of the economic effect test are otherwise met, and
3. Substantiality is independently established.

The Internal Revenue Service published final regulations under Code Section 707(a)(2) (the disguised sale rules) on September 30, 1992. In corrected notice 92-46 the Internal Revenue Service clarified that a partnership and partners may apply the proposed regulations to any transaction to which all transfers considered part of a sale occur after April 24, 1991, if at least one of the transfers considered part of a sale occurs before November 30, 1992.

## Report of the Practice and Procedure Committee

Thomas G. Mies, Chairperson
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Livonia, MI 48154
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**1. Chairperson's Message.**
The Committee is currently in the process of discussions with the Internal Revenue Service - Detroit District's Office of Director, and the Office of District Counsel, concerning the initiation of a liaison meeting between these officials and the Taxation Section. The purpose of the meeting, which hopefully will develop into an annual program, would be to discuss and resolve items of concern

by any parties which are adversely affecting the services we provide to our clients and the taxpayers. At the time this report is submitted for publication, the specifics as to the location of the first annual liaison meeting has not been established, but it is anticipated that it will be held in the downtown Detroit area at 3:00 p.m. on January 19, 1993. A specific announcement will be sent to members of the Practice and Procedure Committee, along with members of such other committees that have, through their chairperson, expressed an interest in this program.

**2. Recent Activities.**
At the annual State Bar Meeting on September 16, 1992, William Bigby, Chief, Collection Division of the Internal Revenue Service, Detroit District, gave a presentation on current developments within the Collection Division. He spoke on modifications in the Offer and Compromise Program and attempts by the Internal Revenue Service to make the program more accessible and efficient. He also spoke on the Internal Revenue Service's Project 2000, which is a program being implemented by the Internal Revenue Service to assist in bringing within the voluntary compliance system taxpayers who have been non-compliant. The program is focused on making the Service more "customer satisfaction oriented" and providing greater assistance to taxpayers in complying with the requirements imposed by the Internal Revenue Code.

**3. Future Schedule.**
At the time of publication of this notice, the scheduling of the first quarter 1993 meeting, which will be the liaison meeting referred to above, has not been finalized. Additional meetings for the upcoming year are scheduled on April 22, 1993 and June 24, 1993. The time for the meetings is 3:00-5:00 p.m. at 33533 W. Twelve Mile Road, Suite 150, Farmington Hills, Michigan. In addition, the Practice and Procedure annual meeting will be held in conjunction with the annual State Bar meeting at 2:00 p.m. on either September 29 or September 30, 1993 in Grand Rapids.

## Report of the State and Local Tax Committee

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Detroit, MI 48226
(313) 256-7940

**1. Chairperson's Message.**
As the newly-appointed Chairperson of the State and Local Tax Committee, I would like to take this opportunity to thank Tom Hammerschmidt, the outgoing Chairperson, for his outstanding service at the helm of this Committee. I am also looking forward to working with all of you and hope that together we can continue to be an active committee that provides meaningful contributions to our practice areas.

**2. Recent Activities and Developments.**
The committee held its most recent meeting on September 16, 1992 in conjunction with the State Bar Annual Meeting. We appreciate the efforts of our guest speaker, Mr. Howard Heideman, Manager of Tax Policy with the Michigan Department of Treasury ("Department"). Mr. Heideman (i) provided handouts and an insightful discussion of the property tax ballot proposals (Proposals A and C both of which were defeated), (ii) distributed and discussed House Taxation Committee Memoranda analyzing SB 843 (H-2) (which has been enacted as 1992 PA 225 to change the collection point of the diesel fuel tax from the retailer to the

supplier) and HB 5774 (H-1) and 5786 (H-1) (which are proposed taxpayer rights provisions addressing procedural improvements in the administration of the revenue taxes), and (iii) distributed copies of the proposed Single Business Tax ("SBT") Rules which were scheduled for a hearing before Joint Committee on Administrative Rules on October 1, 1992.

The SBT rules were removed from the Joint Committee's October 1, 1992 docket at the last minute and have not been rescheduled for hearing. Please contact me if you need a copy of the proposed rules and/or have any comments regarding the same.

During Mr. Heideman's presentation, we also discussed the recent amendments to the Michigan Inheritance Tax (1992 PA 65). In addition, many of our attending members commented, in response to an inquiry by Mr. Heideman, regarding Michigan's proposed "Limited Liability Company" legislation (HB 4902 Substitute H-2), and the effect of enacting such legislation on Michigan businesses. Mr. Heideman remarked that the input from tax practitioners was very helpful in evaluating the proposed legislation and in developing tax policy.

Other recent developments, some of which were addressed at the meeting, include:

A. *Caterpillar, Inc.* v. *MDT* - A Petition for Writ of Certiorari was filed in the U.S. Supreme Court by Caterpillar on October 13, 1992. Certiorari was denied on November 30, 1992.

B. Proposed Repeal of CAD - On September 22, 1992, Senator Nick Smith introduced SB 1171 which repeals the SBT capital acquisition deduction effective for years ending on or after January 1, 1993. The repeal is tie-barred to the enactment of SB's 1143 and 1144 which reduce the Industrial Facilities Tax and Commercial Facilities Tax by 50 percent.

C. Proposed School Finance Reform - On November 10, 1992 the House Committee on Taxation held a hearing on a package of school finance reform bills including HB 4967 and 4970 which raise the SBT and Income Tax rates to 5.80 percent and 7.25 percent, respectively.

D. Draft Sales/Use Tax RAB - The Department has unofficially circulated to various industry groups a draft RAB titled "Service vs Tangible Property." The "real object" test of *Shelby Graphics, Inc.* v. *MDT,* MTT Docket No. 83611 (1986) is strictly applied generally on an all-or-nothing basis. Please contact me if you would like to have a copy of the draft RAB.

E. SBT ERISA Preemption - The decision of the U.S. District Court in *Thiokol, Inc.* v. *MDT* (ruling that Michigan Courts have jurisdiction over an SBT ERISA preemption claim) has been appealed to the Sixth Circuit. Other ERISA preemption claims have been filed in both the Michigan Court of Claims and Federal District Court pending the Thiokol appeal.

F. S Corporation Refund Potential - In *Anthony E. Wisne* v. *MDT,* and *Herbert D. and Audre Mendel* v. *MDT,* Michigan Court of Claims Docket Nos. 91-13364CM and 91-13583CM, respectively, the Court interpreted the language of MCL 206.110 (prior to an amendment effective December 14, 1990), as excluding from the Michigan income tax base of a nonresident shareholder the distributive share of an S corporation with Michigan source income. Nonresident shareholders of S corporations have a potential refund opportunity for pre-amendment years. However, the Michigan Tax Tribunal has issued, without reference to the Court of Claims cases, a

contrary ruling in *John C. Bachman* v. *MDT,* MTT Docket No. 155009. The *Mendel* and *Bachman* cases have been appealed.

G. Small Business Credit - Greg Nowak reported at the meeting that the Department has indicated it will acquiesce in the ruling of *Alameda Gage Corp.* v. *MDT,* 159 Mich App 693 (1987). The Court of Appeals ruled in *Alameda* that the gross receipts of consolidated group members are considered in the threshold test for the SBT small business credit (MCL 208.36) only if such members have business activity in Michigan.

**3. Future Schedule.**

The next meeting of the State and Local Tax Committee is scheduled for January 7, 1993 at 3:00 p.m. in the Detroit office of Honigman Miller Schwartz and Cohn. A notice will be mailed soon with further details. I encourage everyone to attend and will be happy to conference in members located outside of the Detroit area.

The Practice and Procedures Committee has invited our members to participate in a liaison meeting to be scheduled in the later part of January, 1993 with local IRS officials including members from the offices of District Counsel, District Director and District Appeals. We were also asked to submit written questions for these IRS officials whether or not we can attend the meeting.

# Generation Skipping Transfer Tax – Here to Stay Implications for Estate Planners

By Lauren M. Underwood

The Generation Skipping Transfer Tax (GST Tax) was enacted as part of the Tax Reform Act of 1986,[1] and is designed to tax transfers that skip generations in essentially the same manner as estate and gift taxes tax transfers from one generation to the next. It is an extremely complex mechanism that can have unexpected consequences. Essentially, the GST taxes three types of transfers: taxable terminations, taxable distributions and direct skips. While this may sound straightforward, it is easy to overlook situations that may become taxable terminations or transfers, or even direct skips, and the impact is a significant amount of tax that might have been avoided if the transferor's GST exemption had been properly allocated or the amounts were subject to estate taxes instead of the GST Tax. The effect of the GST Tax is an issue that should be addressed in all medium to large-sized estates, even estates that are near the million dollar range. Asset appreciation, an aging society, changing family needs and order of death problems are all factors that contribute to create estates where the GST Tax will have an impact.

***It is easy to overlook situations that may become taxable terminations or transfers, or even direct skips, and the impact is a significant amount of tax that might have been avoided...***

## The Basics

Essentially, the GST Tax applies to a transfer of an interest in property to a skip person, a generation skipping transfer (GST). To determine whether a transfer has been made to a skip person, there are two questions that must be answered "yes." 1. Has there been a transfer of an interest in property and 2. whether the transfer was made to a skip person.

## Skip Persons

A skip person is a natural person who is two or more generations below the generation assignment of the transferor.[2] For example, a grandchild is a skip person unless a special rule (discussed below) applies. The definition of skip person also includes a trust where either all of the interests are held by skip persons or distributions can only be made to skip persons.[3] A trust established for the benefit of one grandchild or a trust established for all of Settlor's grandchildren is a skip person.

## Determining the Generation Assignment

The generation assignment of a beneficiary determines whether a person is a skip person. There are two methods of generation assignment.

## Relationship to the Transferor's Grandparent

The first method is a blood or marriage relationship test to a grandparent of the transferor or the transferor's spouse. This test traces the relationship to the grandparent of the transferor or the grandparent of the transferor's spouse. The generation assignment is made by comparing the number of generations between the grandparent and the transferee to the number of generations between the grandparent and the transferor (or the transferor's spouse).[4] This is the most common method of generation assignment. As a general rule, if an individual is two or more generations below the transferor, he or she is a skip person. For example, a grandchild is a skip person, because a grandchild is two generations below the transferor, except under §2612(c) when the parent of the grandchild has predeceased the transferor. Relationships by adoption are treated as relationships by blood and relationships by half-blood are treated as

relationships by whole blood.[5] Spouses are assigned to the same generation.[6] These rules are important to remember when dealing with second marriages and blended families.

Under certain circumstances, it is possible to assign the same individual to different generations under the two different methods. If this is possible, the generation assignment made by relationship to the transferor's grandparent as a lineal descendant controls.[7] The estate plan may inadvertently result in a transfer to a skip person where none was intended. The importance of gathering complete family information to avoid inadvertent transfers to skip persons cannot be overlooked.

**Ages of the Transferor and Transferee**

The second method only applies when the transferee cannot be assigned a generation level by blood or marriage. This method is based on the ages of the transferor and transferee.[8] If the beneficiary is not more than 12½ years younger than the transferor, they are considered to be in the same generation. A person 12½ to 37½ years younger is considered to be in the first generation below the transferor. This is comparable to a child of the transferor or the transferor's spouse. A new generation follows every 25 years after that, for example at 67½ years and 87½ years younger than the transferor. Again, it is important to be very specific when making generation assignments. An example would be when a Settlor is establishing educational trusts for the children of friends. This may be a direct skip based on the age calculations. If the Settlor is 50 and the beneficiaries are 8 and 9, they are skip persons even though we would generally consider them to be one generation below the Settlor.

**Non-Skip Persons**

Non-skip persons are any natural persons or trusts that are not skip persons.[9] These include persons at higher generational levels than the transferor, at the same generational level as the transferor and one generation below the transferor. Non-skip persons would include the transferor's parents, spouse or children.

**Does the Skip Person have an Interest in Property**

A person has an interest in property held in trust if that person has a right to receive income or principal from the trust, other than a future interest or if the person is a permissible current recipient of income or principal.[10] Nominal interests used primarily to avoid the imposition of the GST Tax are disregarded in determining if the person has an interest in the trust.[11] If discretionary distributions of income or principal may be used to satisfy support obligations, they will be disregarded, as will uses pursuant to a state's equivalent of the Uniform Gifts to Minors Act.[12]

The beneficiary of a trust who has a right of withdrawal, such as a Crummey power in an irrevocable instrument, has an interest as defined in §2652(c). If a skip person such as a grandchild is the holder of such a power, both the exercise of the power and the lapse or non-exercise of the power are direct skips which are subject to the GST Tax.

**Definitions of Taxable Terminations, Taxable Distributions & Direct Skips**

The GST Tax is imposed on taxable terminations, taxable distributions and direct skips.

**Taxable Terminations**

Taxable terminations are the termination of an interest held in trust unless a non-skip person has an

***Under certain circumstances, it is possible to assign the same individual to different generations under the two different methods.***

interest in the property immediately after the transfer, or unless no distributions may be made to a skip person after the termination.[13] A common example is a trust where the transferor's child has a life interest and the child's issue have a remainder interest. The taxable termination occurs when the child dies because no non-skip person has an interest in the property, and no more distributions may be made to non-skip persons.

If property remains in trust after a generation skipping transfer has occurred, it remains subject to GST Tax. This is known as the "transferor move down rule".[14] This is another mechanism to ensure taxation similar to estate and gift taxes. When a GST occurs, the rule moves the transferor down to the first generation above the trust beneficiary in the highest generation after the transfer. For example, if the trust property had been held for the benefit of a child and then transferred to a grandchild, the original transferor was obviously the Settlor of the trust. A taxable termination occurs at the child's death, if the property interest is transferred to a grandchild in trust. At that time, the child becomes the transferor for GST purposes, and another taxable termination may occur at the death of the grandchild.

**Taxable Distributions**

Taxable distributions are defined in the negative. They are distributions from a trust to a skip person, other than taxable terminations or direct skips.[15] A taxable distribution, unlike a taxable transfer, is subject to the GST Tax only once, when the distribution is made. An example would be a trust that permits the sprinkling of income among the Settlor's spouse and issue, and a distribution is made to a grandchild for educational expenses. This distribution would be taxable distribution for GST purposes.

**Direct Skips**

Direct skips are transfers to a skip person that are subject to estate or gift tax at the time of the transfer made to the skip person.[16] A simple example is a gift to a grandchild, or a trust for the benefit of a grandchild. A direct skip which is an outright transfer to a skip person is taxed only once, when the transfer occurs. This is true even if more than one generation is skipped, as in a trust for a great-grandchild. However, it is possible to have a transfer to a trust that is subject to the GST Tax going into the trust, and subject to the GST Tax again coming out of the trust. For example, Settlor establishes a trust for a grandchild to age 60. This is a direct skip and subject to the GST Tax. The trust provides that if the grandchild dies before reaching age 60, trust property is distributed to the grandchild's issue. This could result in a GST to the grandchild's issue, and be subject to the GST Tax. If a trust is not carefully drafted so that trust property is includible in the trust beneficiary's estate, property could be subject to the GST Tax going into and coming out of the trust.

The "deceased parent" rule noted above applies only to direct skips. It does not apply to a GST which is a taxable termination or a taxable distribution. In the case of a direct skip, the rule provides that if the transferee is a grandchild whose parent has predeceased the transferor, the grandchild is treated as a child of the transferor for GST purposes. Therefore, the property is not subject to the GST Tax.[17] This is also true regardless of how many generations are skipped. Therefore, if the transferee is a great-grandchild and the child and grandchild have predeceased the transferor, the transfer is not subject to GST Tax.

**What is the Inclusion Ratio?**

The GST Tax is determined by a

multiple step calculation. The first step is to determine the taxable amount or value of the property being transferred. This amount is the value of the property received by the transferee for direct skips. It is the value of the property less certain expenses for taxable distributions and taxable terminations.[18] Second is to determine the inclusion ratio.[19] To determine the inclusion ratio, the applicable fraction must be determined. The numerator of the fraction is the amount of the transferor's GST exemption allocated to the trust or allocated to the property transferred in a direct skip. The denominator of the fraction is the value of the property transferred less estate or death taxes actually recovered from the trust attributable to such property and any charitable deduction.[20] The inclusion ratio is the applicable fraction subtracted from 1. Third, multiply the inclusion ratio by the maximum Federal estate tax. The result is the applicable rate.[21] Finally, multiply the taxable amount by the applicable rate to determine the amount of GST Tax.[22]

Every transferor has a GST exemption of $1,000,000.[23] The exemption amount can be allocated at any time during the transferor's life, or after death as long as the allocation is made prior to the date an estate tax return would have to be filed.[24]

The taxable amount for taxable terminations and distributions includes the GST. In other words, it is made on a tax inclusive basis.[25] Again, this effectuates the intent that the GST Tax be imposed in a manner that is similar to estate and gift taxes. However, the tax on direct skips is not tax inclusive. The tax is imposed only on the amount received by the transferee. The GST Tax is not included as part of the tax base.[26] For example, if the amount of a taxable termination or distribution is $1,000,000, the inclusion ratio is 1 and the tax rate is 55%, the GST Tax would be $550,000. Assuming the same facts for a direct skip, the GST Tax would be $354,839. If the tax on a taxable distribution is paid from a trust, it becomes a further taxable distribution, and is itself subject to tax.[27]

**Impact On Estate Planning**

The impact of the GST Tax must be considered in any estate that nears $1 million or could be expected to appreciate to that amount during the actuarial life expectancy of the property owner. Imposition of the GST Tax is harsh because it is a flat tax at the maximum estate or gift tax rate in effect at the time of the transfer. At the signing of this article, that rate is 55%. Careful drafting could avoid imposition of a GST Tax or maximize the protection from the GST Tax afforded by the GST exemption. Even where the transferor's plan is to skip a generation and a GST cannot be avoided, the amount of GST Tax can be minimized by planning for a tax exclusive transfer instead of a tax inclusive transfer.

***Imposition of the GST Tax is harsh because it is a flat tax at the maximum estate or gift tax rate in effect at the time of the transfer.***

There are circumstances where the tax may apply unexpectedly. Transfers of property that were never intended to skip a generation may do so because of an unexpected order of death. This unanticipated generation-skipping transfer can occur with insurance policy proceeds. If the transferor outlives the primary beneficiary, the contingent beneficiaries may be skip persons. If the insured outlives the primary beneficiary and there is no contingent beneficiary chosen, the proceeds may be paid to an estate and ultimately distributed to skip persons.

Another example can be found in generally used trust provisions. Many trusts will provide that assets otherwise distributed outright to a minor beneficiary will be held in trust until the beneficiary attains a

specified age. If the transfer to the trust is made to lineal descendants of the Settlor or the Settlor's spouse, the GST to the trust for the minor beneficiary will be protected from GST Tax by application of the predeceased parent rule under §2612(c). If the minor dies before termination of the trust and the minor does not hold a general power of appointment which would include the assets in the minor's estate, and the assets are distributed to a grandchild of the minor, the transfer will be subject to the GST Tax at the minor's death at a flat rate of 55%. This result is unintended. A GST Tax may be imposed where it could have been avoided with proper drafting. Given changes in our society, including increased life span and blended families, it is more likely that unintended results will occur. Consideration should be given to including a general power of appointment that makes the trust property includible in the life beneficiary's estate that would protect against this possibility.

***If a husband creates a QTIP trust for his wife with a remainder interest in the husband's issue without making proper provision for allocation of his GST exemption, the resulting taxes could be significant.***

**Use of the Reverse QTIP Election**

Use of the QTIP trust has become quite common, and is an effective estate planning tool. The typical trust may create a taxable termination or taxable distribution to a skip person. Proper allocation of Settlor's and Settlor's spouse's GST exemption can avoid or reduce the GST Tax consequences. As we will see, planning for this allocation must be done in advance, in the estate planning documents. Planning for the allocation here can limit or even avoid altogether payment of GST Tax. Failure to plan can create significant tax liability.

A "reverse QTIP election" may be made that allows the creator to remain the transferor of the property for GST purposes. This election to have the decedent be the transferor of property can only be made if the property is QTIP property. It cannot be used with an outright transfer to a spouse or a marital bequest that qualifies as power of appointment property. If a transfer qualifies for the marital deduction, the property is subject to estate tax in the spouse's estate. The spouse becomes the transferor of QTIP property for GST purposes when a reverse QTIP election is made. An election may be made to treat the property as if no QTIP election had been made for purposes of the GST Tax. If the election is made, the decedent remains the transferor of QTIP property for GST Tax purposes. The reverse QTIP election allows the trustee to fully allocate the GST exemption of the decedent to the property, thereby protecting the maximum amount from GST Tax.

A reverse QTIP election is irrevocable, and must be made as to all or none of the property in a QTIP trust. No partial QTIP elections may be made.[28] If the QTIP election is made as to all of the trust, the reverse QTIP election must be made as to all of the trust. For this reason, advance planning allowing the trustee to establish a separate reverse QTIP trust is critical to making or obtaining the maximum benefit of the GST exemption of the first spouse to die.

If a separate QTIP trust is established, it should be in the exact amount of the Settlor's available GST exemption. Allocation of the GST exemption is critical in estates with values over $1,000,000, because any resulting GST Tax could be reduced or even eliminated. If a husband creates a QTIP trust for his wife with a remainder interest in the husband's issue without making proper provision for allocation of his GST exemption, the resulting taxes could be significant. The trust can direct or authorize the trustee to establish a QTIP trust and a separate reverse QTIP trust. This allows the trustee to effectively allocate the GST exemption with significant tax

savings. This method of allocation of trust assets allows the trustee to manage assets in the reverse QTIP or GST exempt trust for maximum appreciation. Since the inclusion ratio will be zero, this allows for the maximum amounts to be passed to skip persons tax free.

These results are most significant in estates over $600,000. We will look at two examples, one QTIP trust valued at $1,500,000 and another valued at $4,000,000. For simplicity, we will assume that the Settlor exhausted his or her unified credit during life, that Settlor used none of his or her GST exemption and that all applicable federal estate taxes, Michigan Inheritance Taxes and administration expenses have been paid. We will further assume a maximum tax rate of 55%, appreciation of 25% by the time of the death of the surviving spouse and that the first spouse to die is the husband.

**EXAMPLE: $1,500,000**
**QTIP TRUST**

**1. No Reverse QTIP Election Made:** If no reverse QTIP election is made, none of the husband's GST exemption is allocated to the trust. At the time of the wife's death, the value of trust property is $1,875,000. If the wife directs or authorizes allocation of all her GST exemption, the inclusion ratio is .466, and the applicable rate is 25.63%. The GST Tax on the death of the last child to die will be $480,563.

**2. Reverse QTIP Election Made:** If a reverse QTIP election is made, the trustee allocates all of the husband's $1,000,000 exemption to the trust property. The inclusion ratio is .333 and the applicable rate is 18.32%. The GST Tax on $1,875,000 is $343,500. This is an improvement over the first scenario. However, watch what happens when the trustee has the ability to divide trust property into separate trusts, allocates all of the husband's GST exemption and the wife then allocates all of her GST exemption.

**3. QTIP and Reverse QTIP Trusts Established:** The value of trust property allocated to the Reverse QTIP/GST exempt trust is $1,000,000, the husband's GST exemption. The inclusion ratio is 0 and the GST Tax on the death of the last child to die will be 0, regardless of appreciation. The remaining $500,000 is allocated to the QTIP trust, which appreciates to $625,000. If the wife allocates $625,000 of her GST exemption to that property, the inclusion ratio is 0. GST Tax on the death of the last child to die is 0.

**EXAMPLE: $4,000,000**
**QTIP TRUST**

**1. No Reverse QTIP Election Made:** None of Settlor's GST exemption is allocated to the trust. At the time of the wife's death, the value of the trust property with appreciation is $5,000,000. If the wife allocates all of her GST exemption, the inclusion ratio is .80 and the applicable rate is 44%. The tax on the death of the last child to die is $2,200,000.

**2. Reverse QTIP Election Made:** The trustee allocates all of the husband's GST exemption, the inclusion ratio is .75, the effective tax rate is 41.25% and the tax is $2,062,500.

**3. QTIP and Reverse QTIP Trusts Established:** The value of the trust property allocated to the GST exempt/reverse QTIP Trust is $1,000,000, the amount of the husband's GST exemption, and the inclusion ratio is 0. Tax on the death of the last child to die is 0. The remaining $3,000,000 is allocated to the QTIP Trust, which appreciates to $3,750,000. The wife allocates her GST exemption to that

property. The inclusion ratio is .73 and the applicable rate is 40.15%. The tax on the death of the last child to die is $1,505,625. This results in a total tax savings of $694,375.

Clearly, effective allocation of the GST exemption can have a significant impact in estates over $600,000. Unfortunately, it is often overlooked in drafting as something that is too confusing for the client, something the client does not want, or unnecessarily complex drafting for estates near $1,000,000. In the $1,500,000 trust example discussed above, maximum allocation of the GST exemption resulted in tax savings of $480,563, almost 1/3 of the appreciated value of the trust. Careful drafting can ensure the best possible results for clients.

***The GST Tax raises many extremely complex issues that require complete family information and awareness of the client's assets and planning goals.***

Use of the QTIP and Reverse QTIP trusts can also have its downside. A primary disadvantage is that taxable terminations are taxed in a tax inclusive manner but direct skips are not. Using direct skips could result in further tax savings. However, there are many family issues that may be explored when considering planning for direct skips. If the Settlor's children are well established, trusts for grandchildren may be advantageous and appropriate for the family. However, there are many issues surrounding placing assets in the hands of grandchildren and taking them out of the control of children. The family needs and the dynamics of the family relationships must be carefully considered. As always, the client's goals in caring for spouse and family must drive the estate planning process, not merely tax savings.

## CONCLUSION

The GST Tax can apply to many transfers not intended to be reached by the GST Tax and can place a significant tax burden on many estates and trusts. Careful drafting can minimize these effects and provide the maximum tax savings for clients. The GST Tax raises many extremely complex issues that require complete family information and awareness of the client's assets and planning goals. This article is extremely general in its treatment of the GST Tax and the definitions applicable to it. This overview should raise issues and questions for the estate planner, and give a sense of how intricate the GST Tax is.

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FOOTNOTES

1. P.L. 99-514 (1986).
2. I.R.C. § 2613(a)(1).
3. I.R.C. § 2613(a)(2).
4. I.R.C. § 2651(b).
5. I.R.C. § 2651(b)(3).
6. I.R.C. § 2651(c).
7. I.R.C. § 2651(d).
8. I.R.C. § 2651(d).
9. I.R.C. § 2613(b).
10. I.R.C. § 2652(c). If the permissible recipient is described in I.R.C. § 2055(a), then the transferee is not considered to have an interest in the trust unless the transferee is described in § 2055(a) is a charitable remainder annuity trust, and charitable remainder unitrust or a pooled income fund. In general, §2055(a) includes the United States or a political subdivision thereof, a charitable organization or a veteran's organization.
11. I.R.C. § 2652(c)(2).
12. I.R.C. § 2652 (c) (3).
13. I.R.C. § 2612(a).
14. I.R.C. § 2653(a).
15. I.R.C. § 2612(b).
16. I.R.C. § 2612(c).
17. I.R.C. § 2612(c)(2).
18. I.R.C. § 2621, I.R.C. § 2622, I.R.C. § 2623.
19. I.R.C. § 2642.
20. I.R.C. § 2642(a).
21. I.R.C. § 2641(a).
22. I.R.C. § 2602.
23. I.R.C. § 2631(a).
24. I.R.C. § 2632(a). This is true regardless of whether an estate tax return is required to be filed.
25. I.R.C. § 2622.
26. I.R.C. § 2623.
27. I.R.C. § 2621(b).
28. I.R.C. § 2652(a)(3).

# The Michigan Limited Liability Company: House Bill 4902 for Michigan Businesses

By: Gary Schwarcz
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## I. Generally: What, Why and When.

### A. Why an LLC?

A variety of legal entities provide the financial protection of limited liability. However, practitioners have become accustomed to choosing between, and planning to deal with, their various tax shortcomings and other tradeoffs. For example, a "C" Corporation[1] subjects its owners to two layers of taxation on its earnings, once at the entity level and once at the shareholder level. In addition, a corporation is subject to well known but nonetheless fairly detailed laws regarding state filings, the regulation of its structure, and the governance of its affairs.

Unlike a "C" Corporation, a limited liability company (an "LLC") qualifying for taxation as a partnership, a limited partnership so qualifying, or an "S" corporation[2] will not generally be taxed on its earnings at the entity level. However, an LLC and a limited partnership are not subject to the restrictions applicable to "S" corporations, such as limitations on the type and number of shareholders. In addition, LLCs and limited partnerships provide more flexibility as to capital structure,[3] internal governance and the distribution of entity earnings, plus also afford owners a tax basis in their interest which includes a share of entity debt.

In contrast to a limited partnership, an LLC provides for broader, more flexible participation by owners in the management of the entity. An LLC does not require that at least one owner be personally liable for entity debt, such as is the case with the general partner of a limited partnership.

A timely example illustrates the versatility of the LLC. Where an entity laden with debt seeks to implement a workout or to effectuate a leveraged buy-out, it may be reorganized as, or converted to, an LLC to make its creditors owning members. An LLC permits flexible ownership arrangements which may be designed to give members participation in management differing from their participation in earnings. To the extent that debt persists after the restructuring, or in the event the restructuring permits the deferral of debt to creditors, an LLC's non-taxability at the entity level may lessen concern that entity debt would be reclassified as equity. This may be a significant advantage if as part of a workout restructuring strategy creditors seek a managerial role in the event that they do not receive full debt payment. An LLC may also be advantageous as part of a debt restructuring because it may, by written agreement, be allowed to pay interest in excess of the legal rate up to the criminal usury rate.[4]

The adaptability and advantages of LLCs make them attractive in many business start ups where limited liability and avoidance of double level taxation are desired. Indeed, an LLC may in many instances be preferable to alternative entities, because an LLC generally combines the best features of partnerships and corporations.

LLCs may, however, at least initially, have some disadvantages which should be considered. The transferability of LLC ownership

*The adaptability and advantages of LLCs make them attractive in many business start ups where limited liability and avoidance of double level taxation are desired.*

interests may be significantly restricted and thus many LLCs will be closely held. LLCs may not offer as much protection to minority interest owners due to lack of transfer restrictions, buy-out provisions and limited dissolution rights.

As a result of the relative dearth of judicial nontax experience, the treatment of LLCs may be less certain than that of partnerships or corporations. In addition, the treatment of an LLC under the Bankruptcy code is subject to a number of unsettled questions.

Partnership taxation under the Internal Revenue Code of 1986, as amended, is quite beneficial but surprisingly complex. Because no member is liable for entity obligations, the debt will be treated as nonrecourse, thus bringing into play detailed Treasury Regulations concerning allocations of nonrecourse liabilities and of nonrecourse deductions. An LLC may also require compliance under the detailed Treasury Regulations concerning partnership allocations. Thus, LLCs may require legal and accounting analysis which may be less familiar to some practitioners than would be the case with a corporation. However, substantial partnership tax guidance is available, and for those prepared to chart a course through challenging but navigable waters, a LLC may be very beneficial, and indeed, may be preferable.

**B. Proposed Legislation.**

The Michigan legislature is considering House Bill 4902 (the "Bill") which passed the House on June 25, 1992. Currently eighteen (18) states permit business activity to be conducted as LLCs.[5] Many other states, such as Michigan, are considering LLC legislation.

**C. Characteristics of an LLC under the Bill.**

**1. Organization.**

An LLC would be formed by filing articles of organization[6] signed by at least two persons who would be members (defined as persons with an ownership interest in the LLC and having rights and obligations as specified in the proposed LLC Act). The articles of organization would contain any provisions desired by the organizers not inconsistent with the Bill, including (presumably without limitation) certain specified provisions.[7] The name of the LLC would have to contain specific words denoting its status,[8] although assumed names would be allowed subject to restrictions. The LLC would be required to have a registered office, have a registered agent, file an annual statement and keep specified information at its registered office.[9] Other provisions concerning the affairs of an LLC and the conduct of its business may be set forth in a written or oral operating agreement,[10] which does not need to be filed, but must (if written), be kept among other documents at its Michigan registered office.[11]

**2. Contributions and Distributions.**

Contributions of cash or other tangible or intangible property[12] will be permitted, including without limitation, promissory notes, services performed, binding contracts for services to be performed, or contracts to contribute cash or other property in the future. Commitments for future contribution(s) would not be enforceable unless set forth in writing and signed by the member.[13]

Distributions would be made as provided in the operating agreement, or in the absence of such a provision based on the value of

***Substantial partnership tax guidance is available, and for those prepared to chart a course through challenging but navigable waters, an LLC may be very beneficial, and indeed, may be preferable.***

recorded (and unreturned) member contributions, as is the case with Michigan limited partnerships.[14] This measure may not be equivalent to sharing based on a partner's proportionate capital account balance as determined by federal partnership income tax law.

An LLC formed under the Bill is prohibited from making distributions if the LLC's other debt could not be paid as due in the ordinary course of business, or assuming hypothetically that the LLC was in dissolution, if the preferential rights of other members that are superior to the proposed distributee could not be satisfied.[15] Such a determination could be made based on the financial statements prepared in accordance with accounting practices reasonable under the circumstances.[16] A member's rights to receive distributions would be on par with general unsecured creditors. A member or manager who voted for, failed to vote against (or dissent) or who received a distribution in violation of an operating agreement or the Bill could be personally liable.[17]

***A member's rights to receive distributions would be on par with general unsecured creditors.***

**3. Operation and Management.**

Members would manage the business of an LLC unless the articles of organization stated that it must be managed by "managers".[18] Management by members may be subject to provisions in the operating agreement that restrict or enlarge the management rights and duties of any members or groups of members. Restrictive or expansive provisions may be used to give non-managing members more control over LLC managers who, unlike general partners, are not disciplined by personal liability.

Although these restrictive provisions could be in the operating agreement, presumably, the articles of organization, which would be filed and available to the public, would have to contain such provisions to provide arguable notice to creditors so as to cause such restrictions or expansions to be effective as to non LLC members. This argument would be enhanced if the Bill was amended to clarify the effect of such a restriction. If actual notice is given, or knowledge exists, general agency law may provide a basis for such an argument. However, because managers would not be liable to creditors, the Bill only protects creditors through rules concerning disclosure, distributions and dissolution. Thus, a court may be reluctant to expand the effect of such restrictions.

If management was left to the members, they would be treated as "managers" for all purposes under the Bill (unless clearly required otherwise) and would be subject to all duties and liabilities, and enjoy all limitations on liability and indemnification rights of managers.

The articles of organization could provide that management would be by one or more "managers," who could be, but would not be required to be, members.[19] Unless the operating agreement provides otherwise, selection of managers is to be by majority vote of members voting in proportion to their shares of the LLC's distributions.[20] Managers could be removed with or without cause by a similar majority vote, unless specified otherwise in the operating agreement.[21] Managers would be held to a good faith "prudent person" standard re-

garding discharge of duties.[22] Presumably, if a fiduciary duty, as applies in the partnership setting, is desired, it should be imposed in the operating agreement.

The Bill provides various safeguards allowing the manager to rely on information from various sources or on information provided by a committee of managers under provisions similar to rules with like purpose under the Michigan Business Corporation Act.[23] The manager would be held to account in the manner of a trustee for any profit or benefit derived without members' informed consent from any transaction involving LLC activities or from personal use by the manager of the LLC's property.[24] The manager would not be personally liable for any act in compliance with the Bill.[25] The manager would be subject to the provisions of the operating agreement and the articles of organization. Managers would decide by majority vote unless otherwise provided in the operating agreement.[26]

An LLC could limit a manager's liability[27] and provide for indemnification to hold the manager harmless from and against all losses, expenses, claims and demands sustained by reason of alleged acts or omissions as a manager. However, a manager may not be indemnified for conduct prohibited by the Bill or as otherwise provided by law.[28] The LLC is authorized to maintain insurance on behalf of the manager against liability and expense asserted against the manager arising as a result of his or her status as manager, whether or not the LLC would indemnify the manager against liability [29].

**4. Rights of Members and Managers.**

A person would become a member by making a contribution which is accepted by the LLC.[30] An assignee may become a member by unanimous consent of the LLC's other members or, under limited circumstances, as otherwise allowed under the operating agreement.[31] A member would not be liable to the LLC or its creditors for the LLC's acts, debts or obligations, unless due to the member's own conduct.[32]

*A member would not be liable to the LLC or its creditors for the LLC's acts, debts or obligations, unless due to the member's own conduct.*

Generally, members of an LLC would vote in the proportion their shares represent of the LLC's distributions. This may encourage disagreements as to the value of a member's contribution(s) because this value, in turn, determines a member's share of LLC distributions. The Michigan Uniform Partnership Act and Michigan Revised Uniform Limited Partnership Act avoid this potential difficulty by providing for voting in equal or per capita proportions respectively, unless otherwise provided in the partnership agreement.[33] By requiring a member's voting power to be determined by the relative value of the members contributions, the Bill places a premium on valuation agreements for contributions (perhaps periodic valuation or valuation at the time of significant voting), and will encourage greater attention to contribution (or capital) accounts during the life of the LLC.

A member would be entitled to vote on the LLC's dissolution or merger, on another LLC transaction involving actual or potential conflict of interest between a manager and the LLC or on amendments to the LLC's

articles of organization.[34]

Other voting rights such as those pertaining to selling, exchanging, leasing or transferring all or substantially all of the LLC's assets, other than in the ordinary course of business, could be provided for by the articles of organization.[35] Generally, any member would be entitled to receive, upon request, the LLC's most recent annual financial statement and Federal, State and local income tax returns and reports. In addition, a member may receive upon reasonable request, true and full information regarding the current state of business and financial condition of the LLC.[36] Other provisions of the Bill permit a member to obtain, upon reasonable request, other information concerning the affairs of the LLC, including without limitation, a formal accounting.

A members' interest would be deemed to be personal property, similar to the character of a partner's interest in a partnership. Likewise, LLC members have no interest in specific LLC property.[37]

Generally, a member's interest would be assignable but, similar to the partnership scheme, such an assignment does not entitle the assignee to participate in the management and affairs of the LLC, or to exercise any rights of a member. The assignment of an LLC member's interest would only entitle the assignee to receive, to the extent assigned, distributions to which the assignor would be entitled. Correspondingly, unless otherwise provided in the operating agreement or otherwise assumed by the assignee, the assignee would have no liability as a member solely as a result of the assignment.[38]

Unless members manage the LLC, and the operating agreement does not provide for continuation of the business without the unanimous consent of the members (in which case the operating agreement may provide the manner in which an assignee becomes a member), the assignee of an LLC interest may become a member only if other member(s) unanimously consent.[39] Once a member, the assignee's only obligations would be for any obligations of the assignor member, to make contributions provided as described above and/or to return distributions if so required by the Bill.

Members may withdraw on 90 days notice, unless in contravention of the operating agreement which may restrict distributions to a withdrawing member. An LLC may also recoup damages in such a case.[40]

Special provisions are made for suits concerning members' rights (providing for charging orders) and obligations, suits by the LLC and suits in the nature of derivative proceedings.[41]

**5. Amendments to Articles.**
An LLC would be subject to requirements to amend its articles of organization in certain specified circumstances, reminiscent of partnership rules.[42]

**6. Mergers of LLC.**
Mergers would be permitted pursuant to a written plan of merger (setting forth, among other things, the terms and conditions of proposed merger, including the manner and basis of converting members' interest into those of the surviving LLC, or into cash or other property) under the provisions that are similar to those familiar to corporate practitioners.[43] A merger of LLCs would require approval by unanimous consent of the members of

each LLC, unless otherwise provided in the operating agreement.[44]

**7. Dissolution.**
Dissolution of an LLC would occur on the first to occur of the following:

**a.** the time specified in the articles of organization, or in an operating agreement,
**b.** the occurrence of certain events as stated in the articles of organization or operating agreement, or
**c.** consent of all members, and
**d.** upon death, withdrawal, expulsion, bankruptcy or dissolution of a member, or the occurrence of any other event that ended the members continual membership in the LLC, unless the LLC is continued (see below discussion concerning tax classification of the LLC and determination of whether the LLC has "continuity of life").[45]

Provision is also made for a Circuit Court to decree dissolution.[46] Detailed provisions are made in the Bill for dealing with dissolution.[47] These rules require distributions of liquidation proceeds in excess of liabilities of the LLC (owed to creditors and/or members) to members in proportion with their shares of distributions.

**8. Professional Services.**
The Bill contains a section patterned after the Professional Service Corporation Act to permit LLCs to be used for professional service organizations.[48] Indeed, due to an LLC's potential to provide limited liability, eliminate double taxation and avoid many tax difficulties encountered by professional service corporations, LLC's may be particularly attractive to professional organizations.

**9. Foreign Limited Liability.**
Subject to Michigan's constitution, the laws of a foreign jurisdiction in which a foreign LLC was formed would govern its internal organizational affairs. Any difference between the laws of that jurisdiction and of Michigan concerning LLCs would not be grounds for denying a certificate of authority to operate the foreign LLC in Michigan.[49] Detailed provisions reminiscent of corporate statutes are provided requiring a foreign LLC to obtain a certificate of authority, consent to such authority and withdrawal of such authority. Also, provisions familiar to the corporate practitioner are provided with respect to the operation of a foreign LLC in Michigan without a certificate of authority. Particularly commendable is the Bill's significant detail in providing a test to determine whether a foreign LLC would be considered to be transacting business in Michigan.

**D. When?**
Although the Bill has been passed by the Michigan House of Representatives, it will not be the subject of action by the Senate, which is anticipated to be receptive, until the beginning of 1993. Once the Bill is finalized, it is likely that it will be submitted to the IRS to seek approval that an LLC formed pursuant to the Bill will be taxed as a partnership for federal income tax purposes.

***The Bill contains a section patterned after the Professional Service Corporation Act to permit LLCs to be used for professional service organizations.***

## II. Classification as a Partnership.

As discussed above, if an LLC is classified as a partnership rather than an association for tax purposes, the LLC's tax attributes will pass through to its members. In a partner-

ship, each partner takes into account his distributive share of the partnership's income, gain, loss, deduction or credit.[50] Thus, the income of the entity is taxed only once, at the partner level. In comparison, corporate income (other than the income of an S corporation) is generally subject to taxation at both the corporate level and at the shareholder level. If a practitioner establishes an LLC on behalf of a client, only to find the Internal Revenue Service later treats the entity as an association (which is taxable as a corporation), the LLC will be burdened with significant unanticipated taxes. As a result, it is extremely important for practitioners to understand the criteria used in the determination of whether an LLC will be treated, for tax purposes, as a partnership or as an association.

***It is crucial for practitioners to assure that a newly created LLC has at least as many or more non-corporate characteristics than corporate characteristics.***

**A. Historical Background.** Although an entity may be treated as a partnership for state law purposes, it may still be classified as an association for federal tax purposes. In finding a trust to be taxable as an association, the Supreme Court in *Morrissey* v *Commissioner*[51] held that an unincorporated entity may resemble an association, taxable as a corporation, more so than it resembles a partnership.

Applicable Treasury Regulations have adopted the six corporate characteristics set forth and analyzed in *Morrissey:* (1) associates; (2) an objective to carry on a business and divide the gains therefrom; (3) continuity of life; (4) centralization of management; (5) liability for corporate debts limited to corporate property; and (6) free transferability of interest.[52]

Both partnerships and associations contain the first two corporate characteristics. As a result, in determining whether an entity is to be taxable as a partnership for federal tax purposes, the Treasury Regulations analyze criteria (3) through (6).

**B. The Treasury Regulations.** The Treasury Regulations set forth a purely numerical test. If an entity has more corporate characteristics than non-corporate characteristics, it will be classified as an association and taxable as a corporation.[53] The corporate characteristics of continuity of life, centralization of management, unlimited liability, and free transferability of interest appear to be weighted equally under the Treasury Regulations.[54]

If an LLC formed under the Bill, if enacted, possesses no more than two of the four corporate characteristics, it will be taxable as a partnership for federal tax purposes. Thus, it is crucial for practitioners to assure that a newly created LLC has at least as many or more non-corporate characteristics than corporate characteristics. Practitioners may hesitate giving an opinion that an LLC established for the client is taxable as a partnership until the IRS has ruled that an LLC formed under and in compliance with the Bill will be treated as a partnership for tax purposes or until obtaining a private letter ruling that the specific LLC formed for the client will be treated as a partnership for tax purposes.

The corporate characteristics of continuity of life, centralization of management, limited liability, and free transferability of interest are discussed below with examples of how the Florida and Wyoming LLC statutes and the Michigan Bill have addressed each corporate characteristic. Since there have been numerous IRS rulings with respect to the Florida and Wyoming LLC statutes, the analysis of the corporate characteristics focuses on these two statutes.

**1. Continuity of Life.**
"An organization has continuity of life if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution of the organization."[55] If any of the above events result in the dissolution of an organization, the organization will be found to lack continuity of life. Even if the governing agreement provides that the organization will continue upon the death or withdrawal of any member but local law provides that death or withdrawal causes a dissolution of the organization, the entity will lack continuity of life.[56] As the Treasury Regulations have implied and the Tax Court has confirmed, continuity of life may be avoided if the happening of any one of the described events results in dissolution.[57]

An LLC is dissolved under the Wyoming statute, for example, upon the occurrence of (1) the expiration of the period fixed for the duration of the LLC, (2) the unanimous written consent of all the members, or (3) the death, retirement, resignation, expulsion, bankruptcy, dissolution of a member or the occurrence of any other event that terminates the continued membership of a member, unless the business of the LLC is continued by the consent of all the remaining members under a right to do so stated in the articles of organization of the LLC.[58] The IRS has ruled that an entity formed under the Wyoming statute lacks the corporate characteristic of continuity of life.[59]

In contrast, the Florida statute provides that if an LLC is dissolved because of the death retirement, resignation, expulsion, bankruptcy or dissolution of a member or upon the occurrence of any other event which terminates a member's continued membership in the LLC, the LLC will be continued by either the consent of all the members or under a right to continue stated in the articles of organization.[60] The IRS has ruled that a specific LLC formed under the Florida statute lacked continuity of life.[61] However, the articles of the LLCs discussed in the private rulings did not provide for automatic continuation as permitted under the Florida statute. Had it done so, it is likely that continuity of life would have been found.[62]

As mentioned above, Section 801 of the Michigan Bill provides that an LLC is dissolved upon the occurrence of:

> **(1)** the time or happening of events specified in the articles of organization or in the operating agreement,
> **(2)** the unanimous written consent of all the members, or
> **(3)** the death, withdrawal, expulsion, bankruptcy, or dissolution of a member, or the occurrence of any other event that terminates the continued membership of a member, unless one of the following applies:
>
> > **(a)** Within 90 days following the termination of membership, all remaining members consent to continue the business of the LLC and to the admission of one or more members as necessary, or
> > **(b)** Management of the LLC has not been delegated to managers, an operating agreement does not allow an assignee to become a member other than by unanimous consent of the other members pursuant to Section 506 of

the Bill, and the business of the LLC is continued as provided for in the operating agreement.

The Bill is structured to provide that the LLC will not possess at least two of the corporate characteristics. Thus, if both centralized management and free transferability are absent, the LLC's operating agreement may provide for continuity of life. However, if either centralized management or free transferability exist, continuity of life requires the consent of all remaining members. In this way, the Bill is designed to prevent a practitioner from inadvertently causing the LLC to be found to be an association. In all events, at least two of the corporate characteristics should be absent.

***The Bill is designed to prevent a practitioner from inadvertently causing the LLC to be found to be an association.***

In certain circumstances, however, the IRS's position as to the existence of continuity of life and possibly centralization of management may be unclear if all members are under common control.

In such cases practitioners may desire to obtain a private letter ruling before relying on the Bill's attempt to provide fail safe protection.

Additionally, the IRS has proposed an amendment to the partnership association classification regulations discussed above. This proposal is the subject of hearings occurring at the time this article is being written. The proposal would clarify that continuity of life may be avoided by a partnership even if dissolution (upon retirement, death, insanity, bankruptcy, resignation, or expulsion of a general partner) may be avoided by an agreement to continue the partnership by all of the remaining partners, or at least a majority in interest of the remaining general and limited partners combined. How this would be applied to LLC's is uncertain, however, it may signal the IRS's willingness to consider a continuation provision requiring a vote of a majority of members rather than requiring unanimous consent.[63]

**2. Centralized Management.**

The Treasury Regulations provide that "an organization has centralized management if any person (or any group of persons which does not include all of the members) has continuing exclusive authority to make the management decisions necessary to the conduct of the business for which the organization was formed."[64] The Treasury Regulations go on to provide that centralized management exists when independent business decisions may be made on behalf of the organization without the ratification of such decisions by members of such organization.[65]

Both the Florida and Wyoming statutes provide that all the members will manage their LLC in proportion to their contributed capital.[66] The members may, however, designate one or more persons to act as managers. If the members elect to designate managers, centralized management will be found to exist.[67] If, however, the articles provide that all of the members of the LLC will retain management rights and power, centralized management will not be found to exist.[68]

Article 4 of the Bill permits the LLC to be managed by managers, if so provided in the articles of organization. Thus, an LLC formed under the Bill may possess the corporate characteristic of centralized management.

**3. Limited Liability.**

An organization will be deemed to have limited liability if under

local law no member of such organization is personally liable for the debts of such organization. For these purposes, personal liability means that a creditor may seek satisfaction of an organization's liabilities from the members of such organization in the event that the assets of the organization are insufficient to satisfy the creditor's claim.[69]

By definition, no member of an LLC is personally liable for the LLC's debt. Thus, unless the members agree to be liable for the LLC's debt, an LLC will have the corporate characteristic of limited liability.

**4. Free Transferability of Interest.**

Free transferability of interest will be found if each member of an organization, or those members owning substantially all of the interests in the organization, may substitute for themselves, without the consent of other members, a person who is not a member of the organization. Free transferability exists only if a member may freely transfer all the attributes of his interest in the organization. For example, free transferability does not exist if, absent the consent of all other members, a member may only transfer his or her interest in the LLC's profits.[70]

Both the Florida and Wyoming statutes provide that absent the unanimous written consent of all members, a member may transfer his interest in profits but he may not transfer the right to participate in management or the right to be a member.[71] The IRS has ruled that entities formed under either statute lack the corporate characteristic of free transferability.[72]

Section 505 of the Michigan Bill provides that a member's right to LLC distributions is assignable in whole or in part. However, Section 506 provides that an assignee of a membership interest in an LLC may become a member only if the other members unanimously consent unless the operating agreement provides otherwise and both of the following conditions are met:

(1) Management of the LLC has not been delegated to managers, and

(2) The operating agreement does not provide for continuation of the business other than by unanimous consent.

Again, the Bill attempts to assure that at least two of the four corporate characteristics are absent. It is not clear that an LLC will lack free transferability if the consent was provided in advance, or if consent is required from less than all other members.

***Free transferability exists only if a member may freely transfer all the attributes of his interest in the organization.***

**C. Partnership Status.**

Since an LLC is deemed to have limited liability, a practitioner who creates an LLC pursuant to the Bill will have to ensure that the LLC lacks at least two of the remaining three corporate characteristics (free transferability, centralized management and continuity of life) for partnership status to be established.

In considering LLC legislation, Michigan legislators have attempted to ensure partnership status for federal tax purposes by providing that (i) upon dissolution, an LLC may not be continued absent the unanimous consent of all members unless centralized management <u>and</u> free transferability are absent and (ii) an interest in an LLC is not transferable absent the unanimous consent of all members unless centralized management and continuity of life are absent. Such legislation would

guaranty that an LLC formed in Michigan lacked at least two of the corporate characteristics and, thus, should be treated as a partnership.

Until such time as a published ruling is issued by the IRS, if ever, practitioners will have to obtain a private letter ruling when they create an LLC in order to ensure partnership tax treatment. Private letter rulings are time consuming and can be costly. If the future Michigan LLC legislation eliminates the ability of LLCs to possess more than two corporate characteristics, as the Bill appears to do, the IRS may issue a published ruling stating that any entity formed under the Michigan LLC statute is a partnership.

***When dealing with unincorporated foreign organizations, the IRS has found continuity of life and free transferability, even where local law requires the consent of all members.***

**D. Other Questions Concerning Partnership Classification.**

A troubling aspect of recent IRS Rulings concerning LLCs is the requirement that LLCs comply with Rev. Proc. 89-12 for advance ruling purposes.[73] Rev. Proc. 89-12 requires, among other things, that 1% of each material item of income, gain, loss, deduction or credit be allocated to a general partner, and that a corporate general partner maintain a minimum capital account balance. However, for purposes of Rev. Proc. 89-12, who is the general partner in an LLC context? The IRS has also stated that Section 4 of Rev. Proc. 89-12 need not be complied with if all the members share management equally.[74] If the IRS continues requiring the application of Rev. Proc. 89-12 for partnership status, it is difficult to see how an LLC with centralized management will be able to obtain an advance ruling.

When dealing with unincorporated foreign organizations, the IRS has found continuity of life and free transferability, even where local law requires the consent of all members. This has been found under a "no separate interest" theory where all the members are under common control.[75] The underlying theory is that the common management will always approve the continuation of the enterprise or the transfer of an interest in the LLC. It is not certain if and to what extent the IRS will apply the "no separate interest" theory to domestic LLCs. If the IRS applies the "no separate interest" theory to domestic LLCs, care will have to be taken to assure the membership interests in the LLC are not under common ownership.

**E. Other Tax Issues.**

An issue which must be addressed by an LLC is whether it must use the accrual method of accounting. Temporary Treasury Regulation Section 1.448-1T(a)(2) prohibits the use of the cash method of accounting by tax shelters. A tax shelter is defined to include any syndicate.[76] A syndicate is defined to include a partnership or other entity (other than a C corporation) if more than 35 percent of the losses of such entity during the taxable year are allocated to limited entrepreneurs[77] A limited entrepreneur would appear to include a member of an LLC. However, an LLC should be permitted to use the cash method of accounting so long as the LLC does not actually allocate losses to members in any given year. [78]

**F. State Taxation of LLC's.**

If an LLC is treated as a partnership for state income tax purposes, then the LLC should not be subject to state tax. Also, the Michigan Intangibles Tax would not apply to distributions if the LLC is treated for such purposes as a partnership. Clarification of Michigan tax law treatment would be helpful. Reportedly, Florida LLC's have not been popular because they are subject to state tax as corporations.

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## FOOTNOTES

1. Taxable under Subchapter C of the Internal Revenue Code of 1986, as amended ("Code").
2. An "S" corporation must comply with strict requirements under Subchapter S of the Code posing limitations on the character and number of shareholders, and other restrictions on its owners and procedures for qualification.
3. See Treas. Reg. Section 1.1361-1(l).
4. Bill No. 4902, Section 212.
5. A.R.S. Sec. 29-601 (1992); Colo. Rev. Stat. Sec. 7-80-101, (1990); 1992 Del. ALS 434; Fla. Stat. Sec. 608.401, (1987); 1992 Ill. ALS 1062; 1992 Ia. HF 2369; Kan. Stat. Ann. Sec. 17.7601, (Supp. 1990); 1992 La. ALS 780; 1992 Md. ALS 536; 1992 Minn. ALS 517; Nev. Rev. Stat. Ann. Sec. 86.011 (1991); 1992 Ok. ALS 148; 1992 R.I. ALS 280; Tex. Sess. Law Serv. Ch. 901 (H.B. 278, Sec. 46, Art. 2.01) (Vernon); Utah Code Ann. Sec. 48-2b-101, (1991); Va. Code Ann. Sec. 13.1-1000, (1991); W. Va. Code Sec. 31-1A-1 (1992); and Wyo. Stat. Sec. 17-15-101, (1977);
6. Bill No. 4902, Section 202.
7. Bill No. 4902, Section 203. Generally: name, purpose, address of registered office, name of initial registered agent, a statement that the company would be managed by "managers," if this is case, the maximum duration of the LLC, any other provision required or permitted to be in the operating agreement by the Bill.
8. Bill No. 4902, Section 204.
9. Bill No. 4902, Section 206.
10. Bill No. 4902, Section 102(n).
11. Bill No. 4902, Section 213.
12. Bill No. 4902, Section 301(1).
13. Bill No. 4902, Section 302. Any binding obligation to perform services not fulfilled because of death, disability or other reason, would have to be made up by cash at the option of the LLC.
14. MCL Section 449.1504.
15. Bill No. 4902, Section 307.
16. Id.
17. Bill No. 4902, Section 308.
18. Bill No. 4902, Section 401.
19. Bill No. 4902, Section 402.
20. Bill No. 4902, Section 403(1).
21. Bill No. 4902, Section 403(2).
22. Bill No. 4902, Section 404(1).
23. Bill No. 4902, Section 404.
24. Bill No. 4902, Section 404(5).
25. Bill No. 4902, Section 404(4).
26. Bill No. 4902, Section 405.
27. Bill No. 4902, Section 407.
28. Bill No. 4902, Section 408.
29. Bill No. 4902, Section 408(2).

**FOOTNOTES (continued)**

30. Bill No. 4902, Section 501(1).
31. See discussion at Section II.B.3. of this article.
32. Bill No. 4902, Section 501.
33. MCL Section 449.18 and MCL Sections 449.1302 and 449.1405.
34. Bill No. 4902, Section 502.
35. Bill No. 4902, Section 502.
36. Bill No. 4902, Section 503.
37. Bill No. 4902, Section 504.
38. Bill No. 4902, Section 505.
39. Bill No. 4902, Section 506.
40. Bill No. 4902, Section 509.
41. Bill No. 4902, Sections 507 and 510-514.
42. Bill No. 4902, Article 6.
43. Bill No. 4902, Section 701.
44. Bill No. 4902, Section 702.
45 Bill No. 4902, Section 801.
46. Bill No. 4902, Section 802.
47. Bill No. 4902, Sections 803-807.
48. Bill No. 4902, Article 9.
49. Bill No. 4902, Article 10.
50. Code Section 702(a).
51. 296 U.S. 344 (1935).
52. Treas. Reg. Section 301.7701-2(a)(1).
53. Treas. Reg. Section 301.7701-2(a)(3).
54. See Larson v Commissioner, 66 TC 159, 172 (1976); Rev. Rul. 88-76, 1988-2 C.B. 360.
55. Treas. Reg. Section 301.7701-2(b)(1).
56. Treas. Reg. Section 301.7701-2(b)(2).
57. Larson at 175.
58. Wyo. Stat. Section 17-15-123(a).
59. Rev. Rul. 88-76, 1988-2 C.B. 360.
60. Fla. Stat. Ann. Section 608.441.
61. PLR 8937010 and PLR 9030013.
62. See also PLR 9029019 where under a similar set of facts, continuity of life was not found to exist. See also PLR 9147017.
63. Prop. Treas. Reg. Section 301.7701-2(b)(1).
64. Treas. Reg. Section 301.7701-2(c)(1).
65. Treas. Reg. Section 301.7701-2(c)(3).
66. Fla. Stat. Ann. Section 608.422; Wyo. Stat. Section 17-15-116.
67. See Rev. Rul. 88-76.
68. See PLR 9010027.
69. Treas. Reg. Section 301.7701-2(d)(1).
70. Treas. Reg. Section 301.7701-2(e)(1).
71. Fla. Stat. Ann. Section 608.432; Wyo. Stat. Section 17-15-122.
72. Rev. Rul. 88-76, PLR 9030013, PLR 8937010.
73. Rev. Proc. 89-12, 1989-I.C.B. 798; See also Rev. Proc. 92-88, 1992-42 I.R.B. 39, PLR 9029019, and PLR 9030013.
74. PLR 9030013.
75. Rev. Rul. 77-214, 1977-1 C.B. 408; PLR 8401001; and Rev. Proc. 92-9, 1992-1 I.R.B. 152, Sec. 3.
76. Temporary Treasury Regulation Section 1.448-1T(b)(1)(ii).
77. Temporary Treasury Regulation Section 1.448-1T(b)(3).
78. See PLR 8911011 and PLR 8753032.

Recent Cases

## Drainage District User Charge – Unlawful Retroactive Effect of Municipal Resolution

*Downriver Plaza Group* v *Southgate*, unpublished opinion per curiam of the Court of Appeals, Docket No. 129708; 7/21/92

Alleging that user charges imposed by the City of Southgate and included on city tax bills for operation and maintenance of a drainage system were invalid, Plaintiffs brought suit in the circuit court. The trial court ruled that two early resolutions of the city council were unenforceable because they violated a provision of city charter in not stating a rate for imposing a service charge; however, the court upheld the user fee as valid in the face of subsequent resolutions of the city council which comported with the dictates of charter.

In reversing the court's decision, the Court of Appeals ruled that the corrective action taken by the city had prospective only effect and stated its belief that plaintiffs' due process rights would be violated by a ruling which permitted the city to retain monies unlawfully collected. The Court remanded a portion of the matter to the circuit court for the purpose of ascertaining whether a valid user charge had been created by the city.

## Tax Sales – No Good Faith Defense to Statutory Provisions for Redemption and Reconveyance

*Hill v Wurm*, 194 Mich App 573; ___ NW2d ___ (1992)

Defendants, land contract vendees with respect to real property situated in Van Buren Township, failed to pay property taxes for tax year 1984, with the result that the property was sold at tax sale. Defendants did not redeem the property within the one year period provided for by law, nor did they or the land contract vendors thereafter seek to have the property reconveyed. During this time, a second tax sale occurred with respect to Defendants' nonpayment of their 1985 property taxes. In connection with this tax sale, one of the Defendants contacted the Treasurer's office and was informed by an unnamed individual that payment of $1,991.36 would temporarily cure the problem. Defendants obtained a loan to pay their 1985 property tax obligation and remitted it to the Treasurer's office in time to redeem the property for the tax sale occurring with respect to Defendants' nonpayment of their 1985 taxes.

Plaintiff, the purchaser of the property at tax sale, brought suit in Wayne Circuit Court for a writ of assistance, to quiet title, and for rent. Although the trial court held that Defendants had engaged in a good faith effort to pay their outstanding tax liabilities, and had received inaccurate information from the Treasurer's office regarding the amount and timing of their payment, and so were excused on equitable grounds from compliance with the statutory dictates relative to redemption and reconveyance, the Court of Appeals disagreed, holding that evidence of good faith efforts on the part of Defendants could not prevail over the requirements of statute. The Court distinguished the facts of this case from those in which a taxpayer attempts to discern the correct amount of taxes owed in a timely fashion, but fails to pay the proper amount by reason of the mistake or fraud of county employees. Of significance to the Court in its weighing of the equities was the fact that the

rights of Plaintiff, the purchaser at tax sale, had come into play; the Court saw no reason to require Plaintiff to divest herself of title to the property as a consequence of situation she did not create.

## Industrial Facilities Exemption Certificate – Industrial Property Defined

*Great Lakes Sales, Inc v State Tax Commission*, 194 Mich App 271; ___ NW2d ___ (1992)

Great Lakes Sales, Inc., a wholesale floor covering distributor, filed an application for an industrial facilities exemption certificate with the City of Wyoming with respect to a proposed addition to an existing building to which an IFT exemption already applied. Although the City approved the application, the State Tax Commission ("STC") took the opposite action, denying it both before and after hearing for the reason that the property did not satisfy the definitional requirements of the Rehabilitation and Industrial Development Districts Act, 1974 PA 198, as amended, MCL 207.551 et seq.; MSA 7.800(1) et seq., i.e., it was not industrial property devoted to the manufacture of goods or materials. The Kent Circuit Court, ruling that the property in question qualified as "industrial property", awarded Great Lakes the exemption.

In affirming the circuit court's determination, the Court of Appeals applied accepted rules of statutory interpretation to find that the language of Act 198 does not require that the applicant actually be a manufacturer, but instead focuses upon whether the activities undertaken by the applicant are akin to those of a manufacturer; in the Court's words, it is important to look to "the primary purpose of the operations at the new facility rather than the primary purpose of petitioner's entire business." In this case, Great Lakes' activities in cutting carpet to size (in the Court's estimation, a "processing by physical change") were seen as similar to manufacturing processes engaged in by carpet and vinyl floor manufacturers; the Court further noted that the warehousing of carpet is incidental to carpet processing, and that carpet manufacturers took part in these activities as well. In response to the STC's contention that the majority of the space in the proposed addition is devoted to storage, not the processing of floor coverings, the Court observed that the statute itself [in §2(6)] recognizes that warehousing is a legitimate component of an industrial facility. Given its determination that the STC's multiple denials of Great Lakes' exemption application were not supported by substantial evidence, the Court awarded Great Lakes an Act 198 exemption.

## City Utility Users Tax Act – Retroactive Revival of a Tax

*Taxpayers United for the Michigan Constitution, Inc et al v Detroit*, ___Mich App___; ___NW2d___ Docket No. 139330; 10/20/92

*American Steel Division of National Steel Corp, et al* v *Detroit*, unpublished opinion per curiam of the Court of Appeals, Docket No. 126144; 10/28/92

The Michigan Court of Appeals recently issued two decisions which have widespread import in state and local taxation jurisprudence, even though they address a fairly obscure tax, the city utility user's tax originally imposed by 1970 PA 198, as

amended, MCL 141.801 et seq.; MSA 5.3194(301) et seq.

The backdrop for the Court's most recent expositions is the history of the sunset provision contained in §7 of the City Utility User's Tax Act and the Court's 1990 decision in *Ace Tex Corp v Detroit*, 185 Mich App 609; 463 NW2d 166 (1990) lv den 437 Mich 986 (1991). The City Utility User's Tax Act contained a provision, MCL 141.807; MSA 5.3194(307), terminating the Act on June 30, 1988. In OAG, 1987-1988, No 6428, p 80 (1987), the Michigan Attorney General opined that the sunset provision was constitutionally infirm, and that the Act therefore remained in effect. In reliance upon the Attorney General's evaluation of the statutory language, the Legislature took no steps before June 30, 1988 to extend the sunset date of the Act. In *Ace Tex*, the Court determined that the City Utility Users Tax Act survived a number of constitutional challenges (thus disagreeing with the posture assumed by the Attorney General), with the result that the Act could not be enforced by Detroit beyond the sunset date of the legislation. In reaction to the appeals maintained in *Ace Tex*, the Michigan Legislature enacted 1990 PA 100, **effective June 13, 1990,** which purported to revive the city utility users tax from July 1, 1988 forward. Sec. 8 of the new legislation expressly stated that the Act: is intended to eliminate the confusion surrounding the legal status of Act No. 198 of the Public Acts of 1970 resulting from an opinion of the attorney general regarding the validity of enactment of various public acts, OAG, 1987-1988, No 6438, p 80 (May 21, 1987) and a circuit court decision in the matter of Ace Tex Corp v Detroit rendered on February 2, 1990 (Wayne Circuit Court Case No., 88-807858-CZ), as to which an appeal is pending, and to resolve legislatively the issues raised by the appeal. MCL 141.1158; MSA 5.3188(258).

In the first post-*Ace Tex* city utility users tax case decided by the Court, *Taxpayers United for the Michigan Constitution, Inc et al,* Plaintiffs interposed a number of constitutional challenges to 1990 PA 100, primary among them that the retroactive reinstatement of the City Utility Users Tax Act offended the due process provisions of the state and federal constitutions. Most significantly, the Court of Appeals in its per curiam opinion discerned no due process deprivation in the retroactive revival of the tax for the reasons that, in the panel's estimation, these taxpayers suffered no impairment of vested rights, anticipated the levy of the tax—the Court noted that it had been in place for nearly twenty years—and would not have reduced utility consumption had they known that the tax would apply, given the "basic needs" character of the services subject to the tax. The Court distinguished this situation from that involving a voluntary act on the part of these taxpayers which they might have foregone had they known that the tax would one day be imposed with respect to their activities. According to the Court, Plaintiffs acquired no vested rights in non-application of the tax in connection with its determination in *Ace Tex*. As for the other constitutional challenges tendered by Plaintiffs to 1990 PA 100, the Court rejected the taxpayers' contention that the implementation of the new enactment violated a tax limitation measure known as the Headlee Amendment, finding that the revised enactment did not create a new tax, so that the restrictions placed by the Headlee Amendment on the implementation of new tax measures did not apply. In addition, the Court disagreed with Plaintiffs' claim that 1990 PA 100 violates the separation of powers provision of the Michigan Constitution by reversing a judicial decision or repealing a final judgment.

Following the heels of *Taxpayers United,* the Court, in its second recent-vintage city utility users tax opinion, *American Steel Division of National Steel Corp, et al,* considered and affirmed the determination of the lower court relative to several issues that concerned the validity of the city utility users tax ordinance promulgated by Detroit to prescribe the method used to compute the tax liability of certain utility customers; in addition, the Court focused upon the taxpayers' challenge to the validity of the ordinance on grounds that the legislation authorizing the ordinance expired on June 30, 1988, and dispensed with the contention on the basis of its decision in *Taxpayers United.*

## Sales Tax – Four-Year Limitations Period Applied to Bad Debt Deductions

*Meyer Jewelry Co v Michigan Dep't of Treasury*, MTT Docket No. 158451 (10/15/92)

The Michigan Sales Tax Act, 1933 PA 167, MCL 205.51 et seq.; MSA 7.521 et seq. permits a seller at retail to "deduct the amount of bad debts [as defined in the Act] from his or her gross proceeds used for the computation of the tax," MCL 205.54i; MSA 7.525(9). Petitioner, a nationwide jewelry retailer, filed claims for refund of Michigan sales taxes for debts related to sales at retail made on an installment basis that had become worthless or uncollectible. Respondent disallowed certain of the refund claims to the extent that they had been filed more than four years after the date of the sales transactions.

The Tax Tribunal rejected Petitioner's contention that the four-year limitations period outlined in §27a of the Revenue Act, 1941 PA 122, as amended, MCL 205.1 et seq.; MSA 7.657(1) et seq. began to run from the date the debts became worthless, holding instead that the taxpayer must seek a refund based upon a bad debt deduction claim within four years of the date the tax was paid on the original sale of the merchandise. [Editor's note: The Tribunal's decision makes no reference to Revenue Administrative Bulletin 89-61, which addresses the Sales Tax Act's bad debt deduction and mentions the Department's interpretation of the interplay of the four-year limitations period.]

## Personal Income Tax – Michigan S-Corporation's Distributive Shares to Nonresident Individuals Subject to Tax

*Bachman et al* v *Dep't of Treasury,* MTT Docket No. 155009 (9/8/92)

For tax years preceding 1990, §110 of the Michigan Income Tax Act ("MITA"), MCL 206.110 (2) (b); MSA 7.557 (1110) (2) (b) provided that, for nonresident individuals, "all taxable income is allocated to this state to the extent it is earned, received, or acquired...[a]s a distributive share of the net profits of an unincorporated business, profession, enterprise, undertaking or other activity as the result of work done, services rendered and other business activities conducted in this state..." A 1990 amendment to this section deleted the word "unincorporated" and substituted the word "or" for the word "and" preceding "business activities conducted in this state."

Petitioners, nonresident individual shareholders of a Michigan S-corporation, filed a petition in the Michigan Tax Tribunal claiming that, for tax

years 1984 through 1989, distributive shares paid to nonresidents of this state from the net profits of an incorporated business, in this case a Michigan S-corporation, were not allocable to Michigan under the Michigan Income Tax Act ("MITA"). In defense, Respondent, the Michigan Department of Treasury, asserted that the distributive shares constituted business income subject to apportionment under §115 of the MITA.

The Tribunal agreed with Petitioners' contention that §110 applied to the exclusion of §115, but affirmed the assessments issued to Petitioners on grounds that (1) the 1990 amendment to the section did not effect a substantive change to the provision, but instead clarified its prior meaning; (2) a reading of the language of §110 in effect before the 1990 amendment discloses an intent on the part of the Legislature to subject "all income producing activities" to the MITA; and (3) a contrary interpretation "would result in an unintended contradiction with the taxation of Michigan partnerships."

Despite its conclusion that §110 was the operative provision under these circumstances and that it permitted the Department to impose an income tax upon S-corporation distributive shares received by Petitioners, the Tribunal authorized apportionment of the distributive shares "in light of the fact that income in issue is business income as explained earlier in this order." In addition, without discussing the issue of penalty waiver in the body of its opinion, the Tribunal provided in its order that the assessed penalty be waived, "Petitioners having assured the Tribunal at prehearing that the appropriate tax for the dividends received had been paid to the State of Illinois."

## Personal Property Tax – Exemption for Farm Equipment

*Wm. Bolthouse Farms, Inc* v *Newaygo County*, MTT Docket No. 142362 (10/19/92)

Respondent assessed a personal property tax against machinery used by the taxpayer to clean, sort, dry, grade, cool, store, bag and ship carrots and onions, the majority of which were produced on the taxpayer's own farm. Petitioner claimed that the machinery was exempt under the General Property Tax Act, 1893 PA 206, as amended, MCL 211.1 et seq.; MSA 7.1 et seq., which exempts "any practices performed by a farmer or on a farm as incidence to, or in conjunction with, farming operations, but excluding retail sales operations". MCL 211.9(j); MSA 7.9(j).

The Michigan Tax Tribunal granted the taxpayer's request for exemption, rejecting Respondent's assertion that the machinery actually was commercial in nature because it also was used to process carrots and onions grown by other farmers, and that the exemption therefore was inapplicable under MCL 211.34(c)(2)(a); MSA 7.52(c)(2)(a), which provides that "commercial storage, processing, distribution, marketing or shipping operations" shall not be considered part of a farming operation. The Tribunal noted that the majority of the produce processed by the equipment for which the exemption was claimed were grown by the taxpayer, so that the commercial operation provision did not apply in this instance.

## Ad Valorem Real Property Taxation – Exemption from Real Property Tax Denied for Christian Recreational Facility

*Christian Adventures, Inc* v *City of Grand Rapids*, MTT Docket No. 103272 (9/14/92)

Petitioner, a non-profit corporation, organized and operated activities including bicycling, rafting, skiing, climbing, backpacking and canoeing with a special emphasis on religious fellowship and witnessing. Petitioner also organized tours and wilderness adventures for the general public, and advertised for such on a national basis. Petitioner exacted fees to partake in the outdoor activities and tours it organized, although in a few instances, it provided financial assistance to those unable to pay.

Petitioner claimed that its real property qualified for exemption under the provision of the General Property Tax Act, 1893 PA 206, as amended, MCL 211.1 et seq.; MSA 7.1 et seq., which exempts "real estate . . . owned and occupied by non-profit charitable institutions . . . while occupied by them solely for the purposes for which they are incorporated". MCL 211.7(o); MSA 7.7(4-R).

The Michigan Tax Tribunal's analysis cited the rule that a charitable exemption is available only if there is a "gift . . . for the benefit of an indefinite number of persons . . .". *Michigan United Conversation Clubs* v *Lansing Twp,* 423 Mich 661, 671; 378 NW2d 737 (1985). The Tribunal declined to accord the exemption to Petitioner on grounds that no charity existed because Petitioner had not bestowed a gift for the benefit of an indefinite number of persons.

## Ad Valorem Real Property Taxation – Partial True Cash Value Reduction for Private Country Club

*Spring Meadows Country Club* v *City of Linden*, MTT Docket 129619 (8/25/92)

Petitioner, the owner of an 18-hole private golf course, claimed that, in view of the income generated by the facility, the value of the property was overstated by the assessment issued by Respondent, which was premised upon a cost approach for the clubhouse and improvements and a market approach for the land.

The Michigan Tax Tribunal rejected Petitioner's income methodology as "highly speculative" for the reason that the appraisal presented by Petitioner in support of its value contention represented an estimate of the golf course's total business value, inclusive of real property, tangible personal property and intangible assets, and did not properly substantiate the reductions taken by the appraiser to segregate a true cash value of the real property. The Tribunal ascertained its value conclusion in reliance upon the body of sales submitted by Respondent, as adjusted for economic obsolescence.

## Ad Valorem Real Property Taxes – Poverty Exemption Denied to Residential Property Owner

*Growney* v *West Bloomfield Township*, MTT Docket Nos.130355 and 146728 (10/13/92)

Petitioner, a homeowner, appealed to the Michigan Tax Tribunal under MCL 211.7u; MSA 7.7(4r), a provisions that allows a real and personal property tax exemption for persons deemed by the unit of government's supervisor and board of review to be unable to contribute to the public charges "by reason of poverty".

Before the board of review, Petitioner unsuccessfully alleged that her income levels were sufficiently reduced to enable her to avail herself of a poverty exemption. The Tax Tribunal sustained the determination of the Township that Petitioner was not eligible for exemption under this provision, holding that the unit of government has the ability to establish reasonable standards for poverty exemptions and that the sliding scale formula utilized by Respondent was appropriate. The Tribunal declined to define the statutory terms "poverty" and "ability to contribute to a public charges", deciding instead to leave such to the judgment of the supervisor and the board of review.

**PATRICK R. VAN TIFLIN** and **MICHELE L. HALLORAN** prepared the state tax case summaries in this issue. Pat and Michele are members of the law firm of Howard & Howard Attorneys, P.C. in Lansing. Pat directs the firm's state and local tax practice; Michele is a former Hearing Officer with the Michigan Tax Tribunal.

**ROGER M. GROVES** prepared the local tax case summaries in this issue. Roger is a member of the law firm of Howard & Howard Attorneys, P.C. in Lansing and is a former Judge of the Michigan Tax Tribunal.

## News About Tax Lawyers

**A. Stephen Lacy** recently received his LL.M. in Taxation from DePaul University School of Law. As Manager of Financial Services for the Midwest Stock Exchange in Chicago, Mr. Lacy functions as the Exchange's Tax Attorney.

**Raynor D. Zillgitt, Jr., Esq.** has joined the firm of Willingham & Cote, P.C., to establish all aspects of the firm's bankruptcy and debtor/creditor practice. Ray will continue all other aspects of his corporate practice.

Ray received his B.A. in Political Science from Michigan State University in 1979, a Master's in Urban Planning from the University of Michigan in 1983, and his J.D. from the University of Toledo in 1986. He is a member of the American Bar Association and State Bar of Michigan.

Willingham & Cote, P.C. has been serving the business community in mid-Michigan for over 25 years. They are a full service law firm with clients that include large and small corporations, individuals, partnerships, associations, foundations, charitable organizations and trusts.

**Walter J. Russell**, Partner of Russell & Batchelor, Grand Rapids, Michigan, participated in two panels at the American Bar Association annual meeting in San Francisco in August. Both were presented by the Section of Taxation.

"Can Medicaid Trusts Save the Family Fortune?" was sponsored by the Committee on Small Firm Lawyers, and in addition to general planning in this area dealt with the income tax aspects as well as the ethics of Medicaid planing. This panel was moderated by Walter J. Russell, and panelists included Clifton B. Kruse, Jr. of Kruse & Lynch, P.C. of Colorado Springs, Colorado and Brian E. Barreira of Winokur, Winokur, Serkey & Rosenberg, P.C. of Plymouth, Massachusetts.

"Ethical Considerations of Procedural Matters" was sponsored by the Administrative Practice Committee and discussed the day-to-day ethical problems facing a practitioner in the tax world of the 1990s. The discussion was with members of the private bar as well as the Director of Practice, Internal Revenue Service. There was analysis of problem areas of San Francisco, California was the moderator. Panelists included: Leslie Shapiro, IRS, Washington, D.C.; Jules Ritholz, New York, NY; Mark G. Ancel, Los Angeles, CA and Walter J. Russel, Grand Rapids, MI.

**Robert L. Hood and Patricia F. Claire** of Willingham & Cote, P.C. spoke at a seminar entitled, "Developing Successful Multiple Employer Welfare Arrangements: A Practical Refresher Course" at Michigan State University on September 10, 1992. Co-presenters included the head of the Michigan Insurance Bureau MEWA Division, and representative of the team of professionals with which Bob and Pat serve their MEWA clients, including an actuary, a CPA, an excess loss insurance expert and an investment advisor.

Willingham & Cote, P.C, presented its annual Fall Business Seminar Series during September, 1992, addressing issues of current interest to businesses. Patricia F. Claire spoke on "Cafeteria Plans and Health Care Issues", James R. Duby, Jr. spoke on "Intellectual Property Rights", Robert L. Hood spoke on "Raising Capital by Private Placements, Venture Capital or Banks", John W. Person spoke on "Qualified Retirement Plans", and Raynor D. Zillgitt, Jr. spoke on "Bankruptcy Issues".

# Newest Tax Court Judge is from Michigan

On November 6, 1992, Mark Larson had the distinct privilege to attend the investiture of Judge David Laro as a Judge of the United States Tax Court in Washington, D.C. Judge Laro was sworn in by Supreme Court Justice Sandra Day O'Connor in a ceremony which included remarks by Governor John Engler.

Prior to his appointment, Judge Laro was a sole practitioner in Flint and Ann Arbor, Michigan, where he practiced tax law for 25 years. Judge Laro formerly was Chairman of the Board of Republic Bank and Durakon Industries, Inc. Judge Laro has written and lectured on tax matters and has participated in tax and other activities for various associations and organizations, including the State Bar of Michigan and the Michigan Association of Certified Public Accountants.

On behalf of the State Bar, we convey our warmest congratulations to Judge Laro and his wife Nancy on his appointment.

*The following is Revenue Administrative Bulletin 1992-13, approved October 6, 1992:*

## DEFICIENCY INTEREST RATE

For period January 1, 1993 through June 30, 1993
(Replaces Revenue Administrative Bulletin 1992-7)

**RAB-92-13.** This bulletin establishes the annual rate of interest due on a deficiency for the period beginning on January 1, 1993 and ending on June 30, 1993.

A daily rate of interest of .0002 based on an adjusted annual rate of 7.3% shall be added to a tax deficiency or an excessive claim for the period stated above. The effective annual rate of 7.3% was established pursuant to section 23(2) of the revenue act, MCL 205.23(2); MSA 7.657(23)(2), at one percentage point above the adjusted prime rate charged by three commercial banks to large businesses.

The following annual and corresponding daily rates of interest are in effect and will accrue on any deficiency due during these periods:

| Period | | | Rate | |
|---|---|---|---|---|
| October 1, 1967 | - | June 30, 1986 | 9.0% | (.0002466) |
| July 1, 1986 | - | December 31, 1986 | 10.4% | (.0002849) |
| January 1, 1987 | - | June 30, 1987 | 9.2% | (.0002521) |
| July 1, 1987 | - | December 31, 1987 | 8.5% | (.0002329) |
| January 1, 1988 | - | June 30, 1988 | 9.2% | (.0002514) |
| July 1, 1988 | - | December 31, 1988 | 9.7% | (.0002650) |
| January 1, 1989 | - | June 30, 1989 | 10.2% | (.0002795) |
| July 1, 1989 | - | December 31, 1989 | 11.6% | (.0003178) |
| January 1, 1990 | - | June 30, 1990 | 12.0% | (.0003288) |
| July 1, 1990 | - | December 31, 1990 | 11.3% | (.0003096) |
| January 1, 1991 | - | June 30, 1991 | 11.0% | (.0003014) |
| July 1, 1991 | - | December 31, 1991 | 10.6% | (.0002904) |
| January 1, 1992 | - | June 30, 1992 | 9.5% | (.0002595) |
| July 1, 1992 | - | December 31, 1992 | 8.1% | (.0002213) |
| January 1, 1993 | - | June 30, 1993 | 7.3% | (.0002) |

**Example:** Taxpayer A, who is on a calendar year basis, filed an NU-1040 return for 1990 showing tax due of $2,000.00. If the tax is not paid until March 15, 1993, the amount of interest calculated due from April 16, 1991 through March 15, 1993 is as follows:

| Period | | | Calculation | Interest |
|---|---|---|---|---|
| April 16, 1991 | - | June 30, 1991 | 76 days x .0003014 x $2,000 = | $ 45.81 |
| July 1, 1991 | - | December 31, 1991 | 184 days x .0002904 x $2,000 = | 106.87 |
| January 1, 1992 | - | June 30, 1992 | 182 days x .0002595 x $2,000 = | 94.46 |
| July 1, 1992 | - | December 31, 1992 | 184 days x .000213 x $2,000 = | 78.34 |
| January 1, 1993 | - | March 15, 1993 | 74 days x .0002 x $2,000 = | 29.60 |

Total Interest Due $355.08

Book Review

***The Insurance Counselor Series***

***The Life Insurance Counselor: Federal Income Taxation of Life Insurance***

Authors: Donald O. Jansen, Lalia M. Asmar and Corinne B. Kahn

Section of Real Property, Probate and Trust Law
American Bar Association
750 N. Lake Shore Drive
Chicago, IL 60611-4497
(312)988-5555

107 Pages - $44.95

This book, the second in the Counselor Series (the first book, Life Insurance Products, Illustrations, and Due Diligence, is not being reviewed), is an exhaustive analysis over 13 chapters of the Federal Income tax issues involved in the use of life insurance in estate planning. Among the subjects covered are the definition of the life insurance contract, cash value growth, deductibility of premium payments and policy loan interest, the corporate alternative minimum tax, income taxation of the life insurance trust, split-dollar life insurance, life insurance of qualified plans, and insurance "funding" of non-qualified deferred compensation plans. Each chapter is filled with the relevant Internal Revenue Code Sections and Treasury Regulations as well as case law. The style and format of this book are relatively straight-forward and easily understood. However, this book may have been more "user-friendly" if the authors were to use more illustrations and utilize an index of Code Sections, Treasury Regulations and case law for quick reference.

***The Insurance Counselor: Federal Gift, Estate, and Generation-Skipping Transfer Taxation of Life Insurance***

Authors: Kevin D. Millard, Lawrence Brody, Norman H. Lane and Michael D. Weinberg

Section of Real Property, Probate and Trust Law
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750 N. Lake Shore Drive
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(312)988-5555

129 Pages - $44.95

This book, the third in The Insurance Counselor Series, provides an in-depth study of Federal transfer tax aspects of life insurance. Federal gift, estate, and generation-skipping transfer tax areas are each discussed in separate chapters that analyze the issues arising under each of those taxes in estate planning with life insurance. More specifically, in the gift tax section, evaluation of life insurance, present interest gifts and Crummy withdrawal powers are closely scrutinized. In the estate taxation section, the following areas are covered: inclusion of life insurance proceeds under §2042, taxation of death proceeds in the insured's estate under §2035, and the estate tax marital deduction. The generation-skipping transfer tax ("GSTT") chapter covers generation-skipping transfers (taxable termination, taxable distribution and direct skip), the application of GSTT to life insurance owned by trusts, the effect of lapses of Crummy withdrawal powers, and leveraging techniques involving second-to-die life insurance and split-dollar life insurance agreements. A chapter also addresses the community property aspects of life insurance.

The authors and the publisher evidently learned from the shortcomings of the previous book (Federal Income Taxation of Life Insurance) as this work provides a table of cases, a table of IRC sections, Regulations and Rulings, and a helpful topical index.

***The Insurance Counselor: Split-Dollar Insurance***

Author: Stanford A. Wynn
Section of Real Property, Probate and Trust Law
American Bar Association
750 N. Lake Shore Drive
Chicago, IL 60611-4497
(312)988-5555

210 Pages - $54.95

For the practitioner who wants to understand split-dollar insurance arrangements, this volume is a must. The author has skillfully incorporated into one work, an extensive discussion and analysis of the income, gift and estate tax issues and consequences regarding split-dollar arrangements and also a brief examination of the ERISA area.

This volume provides an interesting case study; checklist for establishing, servicing, and terminating split-dollar plans; sample documents; reference materials; and key Regulations and Revenue Rulings regarding split-dollar arrangements. Also provided are detailed end notes as well as a table of cases, table of IRC Sections, Regulations and Rulings, and a fairly extensive topical index. The general practitioner may find it difficult reading at times, but, all in all, this volume is an excellent research and reference source for any practitioner who wants to understand the complex area of split-dollar.

***The Insurance Counselor: "S" Corporations and Life Insurance***

Authors: William D. Klein and David C. Bahls
Section of Real Property, Probate and Trust Law
American Bar Association
750 N. Lake Shore Drive
Chicago, IL 60611-4497
(312)988-5555

173 Pages - $54.95

This book, the fifth in the Insurance Counselor Series, examines the Federal Income tax implications of the use of life insurance by "S" Corporations and their shareholders. The authors survey in depth the sub-chapter "S" rules covering eligibility, election, termination, taxation of shareholders of "S" Corporations, basis in "S" corporation stock and debt, distribution of the shareholders and corporate level taxes. It may be that the authors could have condensed this analysis into 10 to 15 pages, and devoted more of the volume to the analysis of the tax effects of life insurance in sub-chapter "S". Notwithstanding this complaint, the remainder of the work covering the use of life insurance in a sub-chapter "S" setting is well-written and thoroughly researched. This volume's strong suit is its ample use of illustrations. These illustrations are more detailed, yet easier to understand than those contained in the previous volumes. Moreover, the authors assist the reader by consistently referring to the previous volumes for a more in-depth analysis of a particular topic.

In short, with the use of life insurance being so prevalent in the area of estate planning and business succession planning, the Insurance Counselor Series is an excellent source of information covering virtually every conceivable topic. As with any work, hopefully the authors and publishers will see the necessity of periodically supplementing these volumes to insure their usefulness and timeliness in the practitioner's library.

***Lawyers' and Accountants' Guide to Purchase and Sale of a Small Business***

Author: Willard D. Horwich
Warren, Gorham and Lamont, Inc.
210 South Street
Boston, MA 02111
1-800-450-1216

$96.00
Supplemented at least yearly

As every young practitioner, including this reviewer, quickly learns, advising a client in connection with selling or purchasing a business can be an intimidating and overwhelming project. Regardless of whether you represent the buyer or seller, the quantity of information and documents that must be prepared and reviewed as well as the vast array of issues that must be considered necessitate that the practitioner take an organized approach in order to properly advise his or her client.

The author concedes that this work is not intended to be a treatise in accounting, contracts, taxes, or litigation in connection with the purchase or sale of the business. This work is organized into 13 broad chapters:

(1) Organizing the Investigation;
(2) Financial Statements and Tax Returns;
(3) Interpreting the Financial Statements;
(4) Preliminary Investigation of the Target Business Structure;
(5) The Buyer's Investigation;
(6) The Seller's Investigation;
(7) Tax Considerations for Purchase;
(8) Collection of Payments: Seller's Tax Considerations;
(9) Tax Considerations in the Event of Buyer's Default;
(10) Remedies for Default;
(11) Agreement Form for the Sale of Stock; and,
(12) Agreement Form for the Sale of Assets.

The volume concludes with an appendix containing a model agreement as well as a model non-negotiable Promissory Note. Additionally, for easy reference, the author provides a table of IRC Sections and miscellaneous citations (including California, Delaware, New York Business and Tax Law; Federal Rulings and Regulations; and, Uniform Commercial Code and United States Code), table of cases, and a topical index. Much to this reviewer's surprise and delight, this work has been supplemented not once, but twice in 1992.

At first glance, a seasoned transactional attorney, accountant or other professional may find this volume to be fairly basic and fundamental and not offer much in the way of detailed insight. Nevertheless, one will find that the effectiveness of this work is in the organization of the material and the brevity of each topic. Even though this volume was not intended as a treatise, the transactional practitioner, as well as the general practitioner interested in entering this area of practice, will undoubtedly find this work to be a useful starting point in advising their clients.

**CYRUS RAAMIN KASHEF** is a graduate of the University of Michigan (B.A., 1987), the University of Detroit School of Law (J.D., 1990) and Boston University (LL.M., 1991). He is associated with the law firm of Couzens, Lansky, Fealk, Ellis, Roeder & Lazar, P.C. in Farmington Hills, and concentrates his practice on federal income, state and local tax law, business and corporate law.

Shortcuts

# Asbestos Ruling Burns Responsible Tax Policy©

By: Theresa A. Orlaske-Rich

In a recently-released Technical Advice Memorandum, the IRS went beyond the bounds of reasonableness to issue a ruling that misapplies the law and creates irresponsible tax policy. TAM 92-40-004 (June 29, 1992) concludes that the taxpayer must capitalize the costs incurred for removal and replacement of asbestos insulation. In other words, if a company, originally compliant with governmental standards yet nonetheless causing unforseen work place health risks, in later years steps up to responsibly remove the health risks and clean up the environment, it will have adverse tax implications.

***The IRS went beyond the bounds of reasonableness to issue a ruling that misapplies the law and creates irresponsible tax policy.***

The facts of the ruling are similar to the facts facing taxpayers throughout the U.S., i.e., prior to 1980, insulation of the taxpayer's facilities was generally done with asbestos. In 1986, OSHA decreed that airborne asbestos fiber levels in the work place could not exceed certain levels due to employe health risks; state laws were even more restrictive. The taxpayer was left with two options: (1) remove the asbestos insulation and replace it with a less effective insulation; or (2) encapsulate the asbestos, continually monitor airborne fiber levels, and take special precautions during repairs. The taxpayer in the TAM chose to be a responsible citizen and remove the asbestos (while experts differ whether asbestos removal is more beneficial or more harmful, this was a responsible course of action).

In treating the cost of removal and replacement as a deductible repair, the taxpayer looked to the Treasury regulations under I.R.C. § 162 which permit a current deduction so long as the expenditure is on account of incidental repairs which do not materially add value to the property or appreciably prolong the property's life, but which do keep the property in ordinarily efficient operating condition.[1] The expenses were not capitalized because they were not believed to be incurred to add value or to substantially prolong the useful life of the property.[2]

***Misapplication of Precedent***

In its attempt to prove that the removal and replacement neither materially added value to the property nor prolonged the property's life, the taxpayer principally relied on *Plainfield-Union Water*.[3] In that case, the taxpayer deducted most of the cost of cleaning tar-lined cast iron pipes and relining the pipes with cement. When the pipeline was originally laid, tar lining was the industry standard, cement lining was unavailable, and only well water was carried. Decades later, the pipes also carried river water. The acidic nature of river water caused tuberculation (the formation of rust nodules) where the water came into direct contact with cast iron. In holding that the cost of cleaning and cement lining the pipe was a deductible repair, the Tax Court stated that:

[A]ny properly performed repair adds value as compared with the situation existing immediately prior to that repair. The proper test is whether the expenditure materially enhances the value, use, life expectancy, strength, or capacity as compared with the status of the asset prior to the condition necessitating the expenditure.[4]

The *Plainfield-Union Water* test was dismissed by the Service on the grounds that "it is impossible to value the asset prior to the existence of the asbestos ... or prior to the condition necessitating the expenditure" because the asset was manufactured with asbestos. But then the Service went on to state that the asset's value increases after remediation because

of so-called subjective factors (e.g., safer working conditions, improved marketability) which, for some unstated reason, are not compatible with the objective measurement test of *Plainfield-Union Water.*

If the TAM had properly applied the *Plainfield-Union Water* test, it would not have considered it to be relevant whether the asset was manufactured with a product later found to be a carcinogen. The proper application would have been to compare the value of an asset using previously acceptable but flawed technology (i.e., technology for which health risks were unforeseen and which meet the industry standard) to the value of an unflawed asset (i.e., one whose pollution qualities have been remediated). This aligns with the stated test of comparing the repaired asset to the asset prior to the condition necessitating the expenditure. Instead, the IRS compared the subjective value of an asset containing known health risks with the value of a remediated asset. The comparison stated in the ruling is plainly wrong.

The TAM also opines that *Plainfield-Union Water* is not relevant to the facts because it *"is relevant only in situations where repairs are necessary because the property has progressively deteriorated."* This reading of *Plainfield-Union Water* is not only incorrect, but in point of fact, just the opposite of the Service's position in arguing *Plainfield-Union Water.* While the Tax Court stated that *"we do not agree that the deduction in the instant case requires a relatively sudden, unexpected, or unusual external factor which results in casualty damage"*[5], it certainly did not require progressive deterioration.

Not discussed in the TAM, but relied upon in *Plainfield-Union Water* are two cases which are very similar to the asbestos situation. The taxpayer in *Midland Empire Packing Co.* v. *Comm'r*[6] cured hams in its unsealed concrete basement. For many years water from a nearby river seeped into the basement with no change in operation by the taxpayer. At some point oil from a neighboring refinery began to seep into the basement (as had the water) and leave a smelly oil scum on the floor. After Federal meat inspectors ordered the taxpayer to seal the basement or cease curing operations, the taxpayer sealed the basement. The Tax Court held that the sealing was a deductible repair because it did not enable the taxpayer to operate in a manner different than before the basement was sealed. The fact that there was a governmental requirement to repair the basement or cease operations made no difference.

Relied upon in *Midland Empire Packing* was *American Bemberg*[7], in which the taxpayer's rayon spinning facility was built on a geological fault, resulting in frequent cave-ins (in one instance a spinning machine was swallowed-up). Rather than abandon the plant, the taxpayer drilled through the ground below the facility and filled in the void with grout and cement. These expenditures were held to be deductible repairs because they neither prolonged the life of the facility nor increased its utility.

### *Misuse of Indopco*

In addressing whether the insulation replacement increases the life of the asset, the Service acknowledges that the thermal efficiency of the equipment is not increased, but that the asset's value increases due to the elimination of the need to take special precautions in performing other equipment repairs. In addition, the Service also argues that the decision to remove the insulation was made because it presented *"a health hazard and because removal was the most cost effective way of dealing with*

*regulatory guidelines."* The relevance of these arguments is not clear. However, it is certainly not reasonable to assume that because the insulation is replaced in an asset that operating efficiencies are achieved. This is particularly true given that the replacement insulation is less efficient than that previously used. Such analysis does not comport with the other cases. It does, however, lay the groundwork for the Service to cite *Indopco Inc.* v. *Comm'r.*, 112 S.Ct. 1039 (1992), by alleging that asbestos removal results in significant long-term benefits to the taxpayer.

***Through this ruling, the Service encourages taxpayers to procrastinate in remediating polluted facilities.***

*Indopco* provides that professional fees incurred by a target company during a friendly takeover must be capitalized when they result in a significant long-term benefit to the taxpayer. The *Indopco* dictum that deductions are considered to be exceptions to the general rule of capitalization is invoked in the TAM's discussion of the taxpayer's burden of proof. Then the capitalization standard for takeover expenses (i.e., *"whether the taxpayer realizes benefits beyond the year in which the expenditure is incurred"*) is applied to the question of whether a repair expense should be deducted or capitalized. This standard is inapplicable to a repair situation because any properly done repair will have a carryover beneficial effect. The standard that should have been applied is that set forth in Treas. Reg. § 1.162-4. Application of that standard would have led to the conclusion that operating conditions had not changed, the asset's life had not changed, and value had not increased over the point when the facility was placed in service. Given the backlash from practitioners over the TAM's overzealous broad application of *Indopco,* the Service has back-pedalled by stating that *"Indopco wasn't the sole source of deciding the issue ... primarily we looked at other core cases."*[8]

### *Impact on Taxpayers Is to Encourage Procrastination of Clean-Up Efforts*

The impact in the area of pollution remediation is potentially huge. Through this ruling, the Service encourages taxpayers to procrastinate in remediating polluted facilities. While there may be some tangential reduction in health risk going forward, it is illogical to conclude that pollution remediation predominantly serves a future benefit and should therefore be capitalized. If anything, sound tax policy would be for Congress to encourage more hasty environmental cleanup by permitting taxpayers to currently deduct. This only makes sense because the taxpayer's "benefit" was of being able to pollute (albeit within the bounds of the law) over a prior-year period. This "benefit" occurred because taxpayers did not have to make additional prior-year expenditures to avoid polluting their facilities.

The need for pollution abatement does not occur overnight. As a rule, taxpayers follow the guidelines set forth by its government and then, as more about the effect of certain substances becomes known, are directed by the government to take additional action or take remedial action on their own initiative. To argue that the costs of such additional action should be capitalized to offset future earnings does not provide proper matching of income and expense. More properly, the costs of remediation might better be matched against those prior-year revenues which were otherwise overstated for taxpayer's failure to incur costs to correct earlier or initially.

It has been published that the taxpayer in the subject TAM has requested reconsideration.[9] One should hope that if the ruling is reconsidered, then the Service will vacate the current ruling in favor of

sound policy and return to permitting current deduction for this type of repair. To do otherwise not only makes bad law, but it also financially discourages taxpayers from assertively cleaning-up polluted facilities. The likely result will be for taxpayers to aggressively lobby Congress and the Treasury Department[10] to make appropriate legislative or regulatory changes expressly to provide for current deduction of pollution remediation efforts.

**THERESA A. ORLASKE-RICH** is a Tax Attorney with the General Motors Corporation Tax Staff and an Assistant Adjunct Professor with the Wayne State University School of Business Administration. She is a graduate of Grand Valley State University (B.B.A. 1982, M.B.A. 1983) and Wayne State University (J.D. 1986, LL.M. 1990).

**FOOTNOTES**

1. Treas. Reg. § 1.162-4.
2. Treas. Reg. § 1.263(a)-1(b).
3. *Plainfield-Union Water Co. v. Comm'r*, 39 T.C. 333 (1962), nonacq., 1964-2 C.B. 8, accord 25 T.C.M. (CCH) 1216 (1966) (emphasis added).
4. *Plainfield-Union Water Co.*, 39 T.C. at 338.
5. *Plainfield-Union Water Co.* 39 T.C. at 340.
6. *Midland Empire Packing Co. v. Comm'r.*, 14 T.C. 635 (1950).
7. *American Bemberg v. Comm'r.*, 10 T.C. 361 (1948), aff'd 177 F.2d (6th Cir. 1949).
8. Comment of Thomas Luxner, Branch 7 Chief, Assistant IRS Chief Counsel (Income Tax & Accounting), quoted in 207 Daily Tax Report G-10 (Oct. 26, 1992).
9. "Paper Institute Objects to Ruling on Asbestos Removal," 57 Tax Notes 25 (Oct. 5, 1992).
10. On September 21, 1992, the American Institute of Certified Public Accountants, the National Realty Committee, the United States Chamber of Commerce, and the Tax Executives Institute, together with Mr. Donald C. Alexander of Cadwalader, Wickersham & Taft, sent a letter to Fred T. Goldberg, Jr., Assistant Secretary (Tax Policy) at the Department of the Treasury requesting regulatory or other guidance that asbestos removal and replacement costs are currently deductible. 92 Tax Notes Today 198-36 (Sept. 30, 1992).

TAXFILE.PC

# Put a Little Byte Into Your Work

By: Brian D. Rich

While tax attorneys have frequently used calculators in determining the tax effect of transactions or when completing returns, personal computers are rapidly becoming the tool of choice. On the other hand, some practitioners still resist making the relatively short-term time and financial commitment required to integrate a computer into their work. Most of them are aware that manufacturers are constantly upgrading the technology, but fail to recognize the long-term advantage which is available to their practices. The benefit of a personal computer lies not in its abstract potential, but in the specific tasks it performs. This article will provide an overview of some of the applications which make a personal computer a valuable addition to any office.[1]

*While payroll tax returns for large employers have for some time been required to be filed on magnetic media, the IRS now accepts tax returns filed via computer.*

## Tax Returns

When members of the general public think of tax, the next word that usually comes to mind is return. Many tax attorneys are familiar with companies that provide tax return preparation services. Typically, the attorney enters information on a form, sends it to the company to be input into a mainframe computer for processing, and waits for hard copy of the return to come back. As filing deadlines approach, reducing turnaround time for draft and the final return is critical. With the advent of personal computers which can be linked to the mainframes, a preparer may input the information directly and print returns on site in hours or even minutes.

Software designed specifically for personal computers is increasing in popularity. While these programs have more limited capabilities than those for mainframes, they are more than sufficient for completing most standard tax returns. PC packages enable a firm to budget a fixed cost for purchase of the software rather than plan to pay a fee per draft or final return often charged by outsource companies. One fact which may be either an advantage or disadvantage is that the entire system is in the attorney's office. The risk of backlogs created by the flood of data from other firms to a mainframe is eliminated, but the risk of system failure rests solely with the preparer.

## Communications

Many personal computer systems now include a fax/modem. An attorney may quickly and accurately transmit and receive information from clients, other attorneys or taxing authorities.

The IRS has recognized the benefit of technology. While payroll tax returns for large employers have for sometime been required to be filed on magnetic media, the IRS now accepts tax returns filed via computer. This saves time and reduces errors by eliminating the need to transcribe mailed returns into the IRS computers. Some firms offer computer filings for fees which clients are willing to pay in order to expedite their receipt of refunds. Note also that the Service now permits fax filing of powers of attorney so that examinations and other communications are not unreasonably delayed.

The written word is one of the most basic forms of communication and word processing is one of the most commonly used computer functions. Standard letters, forms and documents for everything from buy-sell agreements to wills and trusts can be stored, then retrieved and customized to meet client needs. Information may be entered manually or through use of such new devices as optical scanners. Prepackaged software is on

the market or you may develop your own standard files.

## Research

### Databases

Most attorneys are familiar with legal databases such as Lexis and WestLaw. Access to these services can substantially reduce the time required to find a particular case or statute, find related authorities or provide for a quick overview of materials available regarding a particular topic. Information formerly available only when received by mail such as the BNA *Daily Tax Report* and *Tax Notes Today* is often accessible almost immediately.

Many research materials are now available to offices with limited space. CD-ROM format permits an office to maintain copies of RIA, CCH and BNA materials on disks when library space is limited. In addition, research can be much faster using the CD-ROM which provides instant access to the information desired. Searching for books or misfiled pages in a looseleaf service can be a thing of the past.

### Networks

One of the advantages of practice in a large firm or corporation is economies of scale. Attorneys can share information and avoid "re-inventing the wheel" every time an issue arises. To the extent that a colleague has already dealt with an issue, the new attorney can use the research and conclusions as a starting point for his/her own analysis. This benefit is only possible if the information is available to others. Unfortunately, many times an attorney must start from scratch. By linking personal computers to create a database of information for all who might use the data, attorneys can save substantial time. Effort can then be devoted to approaching a problem from a new direction or updating prior research, making conclusions more reliable.

In the future, a network, computer conference or billboard might be available so that sole practitioners or small firms and companies might attain similar economies of scale. Attorneys would be able to enroll in a network or conference which would provide a forum for discussion on topics of interest.

## Quantitative Analysis

The personal computer performs repetitive calculations with ease. Lotus 1-2-3 is just one of many spreadsheet programs which are often used to calculate the effect of transactions. Once an attorney develops a formula, he/she can produce a spreadsheet to calculate a result consistently. Potential utilities include original issue discount amortization, application of uniform inventory capitalization rules, tracking long term contracts, depreciation calculations and interest allocation for purposes of the foreign tax credit. The ability to change scenarios and play "what if" is of great benefit to clients.

New restrictive rules for making estimated tax payments often require attorneys to prepare income projections during the year. Programs such as BNA's individual and corporate tax planning applications can make it much easier to assist a client in deciding on courses of action. Of course, self-developed templates can also prove to be just as satisfactory. Note that an attorney should always check to be sure a vendor's program applies the law in the way he/she deems appropriate. Remember that a computer will not decide whether to take an aggressive position on an issue nor does it know the history of a law or ruling for which your interpretation might differ from that of the programmer's. The computer is a tool to assist you in providing more efficient client service. You must decide

***By linking personal computers to create a database of information for all who might use data, attorneys can save substantial time.***

how to make your performance more effective. The computer will only crunch the numbers you give it.

## Office Management

Although primary consideration is given to directly serving clients, attorneys also need to provide for efficient office operations. Software for time management, billing, internal accounting, etc., can assist in organizing a smooth-running office which indirectly serves the client and can make the practice of law more rewarding.

## Conclusion

The applications for a personal computer discussed above do not comprise a comprehensive list. New uses will continue to be discovered. Practitioners who identify the need for automating additional tasks will create the demand for new programs. The number of applications is limited only by the imagination of software and hardware engineers.

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**FOOTNOTES**

1. This article will occasionally mention brand names of certain products. These are only examples of generic applications.