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MICHIGAN TAX LAW JOURNAL

October-December, 1983

TAXATION SECTION

MICHIGAN TAX LAW JOURNAL

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University of Detroit 1877

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Dear Tax Council Member:

This issue features a summary of the matters considered at the October 1983 Central Region Internal Revenue Service Bar Liaison Meeting in Cincinnati. In addition, we wish to thank Robert D. Blatz, Jr. for submission of his article, Partial Liquidation Gain Computations: Tax Saving Opportunities for Stockholders, which also appears in this issue.

Michigan law schools have been notified by the Tax Council of the rules and procedures for the 1984 Tax Essay Contest which is currently underway. As in the past, winning articles will appear in future issues of the Tax Law Journal.

We also wish to call your attention to the Annual CPA/Attorney Conference scheduled for Wednesday, June 13, 1984. A notice with further particulars relative to this seminar appears in this issue of the Tax Law Journal.

We invite all of the Tax Council members to continue their comments, observations, criticisms and suggestions for topics to the Journal staff, c/o The University of Detroit School of Law, 651 East Jefferson Avenue, Detroit, Michigan 48226.

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TAXATION SECTION COUNCIL MEETING

Date: Thursday, October 13, 1983

Time: 9:00 a.m.

Place: Michigan Inn - Southfield

A G E N D A

A. Minutes of September 28, 1983 Regular and Annual Meetings

B. Treasurer's Report

C. Committee Reports:

1. Eighth Annual Federal and Michigan Tax Institute -- Donald M. Lansky
2. Annual Taxation Section Meeting -- Stephen R. Kretschman
3. Employee Benefits Committee -- Stephen I. Jurmu
4. Tax Court Luncheon -- William Sikkenga
5. Michigan Tax Legislation -- Peter S. Sheldon
6. Single Business Tax -- Samuel J. McKim III
7. Michigan Tax Law Journal -- Eugene A. Gargaro, Jr.
8. Publication of Michigan Tax Tribunal decisions -- Eugene A. Gargaro, Jr.

D. Project Reports:

1. 50th Anniversary of State Bar of Michigan -- Andrew Savel
2. Proposal to establish merit scholarship for editorial work on Michigan Tax Law Journal -- Eugene A. Gargaro, Jr.

E. Bar Liaison Reports:

1. CPA's

   a. Federal Tax Committee -- Stephen R. Kretschman

   b. State and Local Tax Committee -- Andrew M. Savel

2. State Bar Sections:

   a. Administrative Law -- Peter S. Sheldon

   b. Corporation/Finance/Business Law -- Richard Abbott

   c. Real Property -- Donald M. Lansky

F. Bar Liaison Meetings:

1. Central Region IRS: October 27-28, 1983

2. CPA's:

   a. Federal Tax Committee

   b. State and Local Tax Committee

3. Bar Committees and Sections

4. Fourth Annual Conference of State Bar Tax Sections: October 21-22, 1983

G. Appointment of Committee and Project Chairpersons:

1. Ninth Annual Federal and Michigan Tax Institute
2. Annual Taxation Section Meeting -- September 1984
3. Michigan Taxation Essay Contest
4. Michigan Tax Law Journal
5. Michigan Tax Legislation
6. Employee Benefits Committee
7. Inheritance Tax
8. Single Business Tax
9. Tax Court Luncheons
10. The Michigan Bar Journal, "Tax Notes"

11. State of the Law: Annual State Bar Meeting
12. Liaisons
13. Joint Seminar with MACPA
14. Publication of Michigan Tax Tribunal decisions
15. Tax Tribunal Judge candidate review
16. State Bar Journal - Taxation Issue

H. New Business

I. Chairperson's Report: Discussion of 1983-1984 Goals and Objectives

J. Next Council Meeting

MINUTES OF REGULAR MEETING OF
COUNCIL OF TAXATION SECTION
OF STATE BAR OF MICHIGAN

A Regular Meeting of the Council of the Taxation Section of the State Bar of Michigan was held at the Michigan Inn in Southfield, Michigan on Thursday, October 13, 1983, commencing at 9 a.m.

COUNCIL MEMBERS PRESENT

James C. Bruinsma
Stephen I. Jurmu
Sanford A. Klein
Stephen R. Kretschman
Donald M. Lansky
Eugene A. Gargaro, Jr.
Samuel J. McKim, III
Andrew M. Savel
Peter S. Sheldon
William J. Sikkenga
Michael F. Stefani
Lawrence R. Van Til

COUNCIL MEMBERS ABSENT

C. Richard Abbott

NON-MEMBERS PRESENT

Austin Anderson - ICLE
Teresa Schaefer - ICLE

MINUTES

Reading of the minutes of the September 28, 1983 regular meeting of the Council and the September 28, 1983 annual meeting of the Section were waived. Copies of those minutes were circulated to the Council members present.

TREASURER'S REPORT

Mr. Savel reported that, because of the close proximity between this meeting and the most recent meeting of the Council, the State Bar had not sent revised computer printouts reflecting any changes in the financial condition of the Section. Accordingly, he reiterated the report given at the September 28, 1983 Council meeting which revealed a beginning balance of $19,244.42 as of May 1, 1983, receipts of $1,144.08, disbursements of $10,983.15 and a balance, as of August 31, 1983, of $9,405.35.

COMMITTEE REPORTS

1. Eighth Annual Federal and Michigan Tax Institute

Mr. Lansky reported that there were 130 registrants for

the Institute to be held October 13 and 14 -- comparing favorably with the number of registrants for prior annual Tax Institutes. He also reported that the presentations given at the Institute would be audio taped for later use as well.

2. Annual Taxation Section Meeting

Mr. Kretschman reported on the 1983 Annual Taxation Section program held at Cobo Hall on September 28. He stated that the program had consisted of a presentation by Regional Counsel, Gene Owens, as well as a liaison meeting with local Internal Revenue officials and that the same had been well received.

3. Employee Benefits Committee

Mr. Jurmu then noted that the Employee Benefits Committee had met on September 28 in liaison with the Internal Revenue Service-Employee Plan Section. He reported that 90 persons had attended and that there had been a very worthwhile exchange of information and ideas between the Internal Revenue Service and tax practitioners present.

Mr. Jurmu also indicated that the Employee Benefits Committee desired to establish a sub-committee for the purpose of reviewing proposed regulations and proposed legislation in the employee benefits area. Mr. Jurmu was appointed as liaison between the Tax Council and the Employee Benefits Committee. Responses to proposed regulations and legislation will be passed by the Council, through its Chairperson, Mr. Gargaro, before these comments are disseminated as those of the Employee Benefits Committee.

4. Tax Court Luncheon

Mr. Sikkenga confirmed that the next tax court luncheon is to be held at the University Club in Detroit on Tuesday, October 18 and that Judge Clapp will be the guest of honor.

5. Michigan Tax Legislation

Various members reported on the following matters related to Michigan tax legislation:

A. Mr. Sheldon first reported on a proposal which, if enacted into law, would offer individuals who have matters pending before administrative agencies of this State an alternative procedure for resolving disputes. After discussion concerning the proposal, Mr. Sheldon was requested to monitor this proposal and to apprise members if any affirmative action with respect to the proposal becomes imminent.

B. Mr. McKim reported that a proposed bill was expected to be introduced which would change the definition of royalties for Michigan single business tax purposes with respect to payments made and received under oil and gas leases.

C. Mr. McKim also reported that, while there were no procedures formally established for securing rulings from the Department of Treasury in connection with single business tax matters, it was possible to secure same on request.

D. Mr. Kretschman reported that House Bill 4238, designed to delete the exemption from use tax on rental receipts where tax has been paid by the lessor on acquisition of the leased property, had passed the House and was now before the Senate. He recommended that, while no hearings had yet been held, the Council should go on record as opposing this bill -- not only because it could result in double tax, but also because it was inconsistent with the underlying complementary basis of the sales and use tax acts of this State. On motion made by Mr. Van Til and seconded by Mr. Kretschman, the Council agreed to authorize Mr. Kretschman to express Council's opposition to House Bill 4238.

6. Michigan Tax Law Journal

Mr. Gargaro indicated that the Tax Law Journal would publish a revised directory for federal and local tax officials in the latter part of this calendar year or in early 1984.

7. Publication Of Tax Tribunal Decisions

Mr. Gargaro also reported that attempts were still under way to secure publication of Tax Tribunal decisions and discussion ensued as to how publication could best be accomplished. It was determined that this project would be reassessed at the next meeting of the Council.

PROJECT REPORTS

1. 50th Anniversary Of State Bar Of Michigan

Mr. Savel reported that the 50th anniversary of the State Bar of Michigan was to be celebrated during September of 1984 and that it was currently scheduled to be held in Cobo Hall. He said that the program slated for recognition of the 50th anniversay was to focus on attorney practice -- past and future.

2. Merit Scholarship Proposal - Michigan Tax Law Journal

Mr. Gargaro then submitted to the membership the question as to whether the Council desired to establish a merit scholarship

fund for editorial work performed by law students for the Tax Law Journal. Currently, editorial work on the Tax Law Journal is performed by University of Detroit law students under the direction of Patrick Keenan. Mr. Gargaro asked members to review materials he has sent out regarding this matter and all members were encouraged to offer their comments and suggestions with respect to same. Mr. Gargaro stated that this matter would be considered at the next meeting of the Council.

3. State Bar Journal - Tax Issue

Mr. Gargaro also reported that George Roumell had requested that the Tax Council consider spearheading the assembly of tax articles which would be the focus of an issue of the State Bar Journal later this year or in early 1984. Discussion followed concerning that request and the members were asked to consider how best the Tax Council could support same.

4. Ninth Annual Tax Institute

Austin Anderson advised that Teresa Schaefer would be working with us in connection with preparing for the Ninth Annual Tax Institute and that her involvement would be particularly heavy during the first three months of 1984. In this regard, Mr. Lansky suggested that early attention to framing program topics and securing program participants was the key to conducting a successful presentation.

BAR LIAISON REPORTS

It was reported that there had been no liaison activity with the certified public accountants or with other State Bar Sections since the September 28 Tax Council meeting.

BAR LIAISON MEETINGS

1. Central Region - IRS

Mr. Gargaro reported that the liaison meeting with the Central Region of the Internal Revenue Service is scheduled to be held in Cincinnati on October 27 and 28 of this year. He referred to a letter from Robert B. Pierce and invited anyone interested in attending the liaison meeting to let him know and arrangements would be made for attending same.

2. Fourth Annual Conference Of State Bar Sections

Mr. Gargaro also reported that the Fourth Annual Conference of State Bar Tax Sections is scheduled to be held on October 21 and 22 in Washington, D.C. He indicated that Mr. Savel had volunteered to attend on behalf of the Tax Council.

COMMITTEE AND PROJECT CHAIRPERSONS

Mr. Gargaro then outlined 16 committees and projects that will be continued during the 1983-1984 year. He asked members to give some thought as to which of those committees and projects each would be willing to chair or to offer active participation.

OLD BUSINESS

1. Tax Essay Contest

After discussion with respect to the most recently concluded tax essay contest, it was determined to advise Michigan based law schools that the Council intended to continue same -- in view of the increasing level of participation and the number of excellent submissions that had been received. Mr. Sheldon was asked to see that law schools were advised of the commitment on the part of the Tax Council to continue this contest.

NEW BUSINESS

1. Attendance At Council Meetings

Mr. Gargaro stated that the Law Student Section had requested permission to have one of its representatives present at our Tax Council meetings. The request was considered and approved.

2. Family Law Section Seminar

It was also reported that the Family Law Section had expressed interest in conducting a joint seminar with the Taxation Section. After discussion it was determined that the Council would communicate with the Family Law Section expressing interest in the concept and a willingness to consider participation in same at some future point in time.

3. Tax Practice And Procedure Manuals

The final item for consideration was the suggestion to make available to each Tax Tribunal Judge and each Court of Claims Judge a complimentary volume of the Michigan Tax Practice and Procedure Manual. On motion made and seconded, the proposal was unanimously approved.

NEXT COUNCIL MEETING

No date was scheduled for the next Council meeting, but Mr. Gargaro will announce same to members sometime later this calendar year.

SECTION I

QUESTIONS AND ANSWERS

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SUGGESTED TOPIC FOR REGIONAL LIAISON MEETING

QUESTION #1

To what extent are 1099 forms used in the examination of returns? Does the IRS have plans to increase their use?

ANSWER

Forms 1099 are used in the examination of returns primarily in three ways:

1. Returns selected under by use of DIF (Discriminate Function System) for field examination.
2. Service Center Underreporter Program (IRP).
3. Special requests from field examiners.

The use of 1099's increases as the IRS computer equipment is updated and when new laws are passed by Congress such as TEFRA.

QUESTION #2

Is it still IRS policy to send notices to investors in alleged tax shelters advising them that the shelter will be audited and that tax deductions will be disallowed? If so, what criteria are used to select the shelters and what audit or similar procedures are followed by the IRS before a letter of this sort is mailed to investors?

ANSWER

Under a new national program, the "Tax Shelter — Injunction/Promoter Penalty and Pre-Filing Notification Procedures" which will be incorporated into Chapter 4 of the Internal Revenue Manual, notice will be sent to investors in alleged tax shelters advising that, based on a review of the shelter, their returns will be examined and the deduction and/or credit disallowed.

The investors will be identified from an examination of the books and records of a promoter/salesman of an alleged tax shelter scheme which is currently being or during the tax year has been marketed. The examining agent and a District Counsel attorney will determine, based on a legal and factual basis, that pre-filing action is appropriate. The District Director in the promoter district must than make the final determination to approve or disapprove the issuance of the letters.

The abusive shelter will initially be identified from various sources such as state security agencies, Criminal Investigation, magazines and newspapers, and previously identified promotions.

QUESTION#3

Under the new partnership audit rules, how are notifications to all of the partners being handled when the audit involves years that both preceded and followed the effective date of the rules? How are the methods and degree of participation of partners being handled for pre and post-TEFRA years? If the same issues exist in both periods, does the Service intend to obtain waivers of the statute of limitations from partners of the earlier years and handle the audit and trial of issues under the new partnership rules for later years?

ANSWER

1. Those years covered by the rules will be notified in accordance with the rules. For years that do not fall under the rules, the contacts with taxpayers will be handled under pre-TEFRA provisions.
2. For pre-TEFRA years, partner's degree of participation will not affect the treatment of the partner, while for post-TEFRA years, it will affect such things as notification, the issuance of a Final Partnership Administration Adjustment, and the filing of a petition for readjustment of partnership item.
3. Yes, waivers of statute of limitations will be obtained from partners in pre-TEFRA years and the new rules will apply to later years.

QUESTION #4

Under what circumstances and in what manner will the partnership audit rules be applied to subchapter S corporations under Subchapter S Revision Act of 1982?

ANSWER

Per Sections 6241, 6242, 6243, 6244, and 6245, subchapter S corporations will fall under the partnership provision for tax years beginning after December 31, 1982. Basically, after that date, S corporation will be treated as TEFRA partnerships.

QUESTION #5

How does the Service propose to apply the partnership audit rules in cases in which the status of an organization as a partnership (and, hence, the extent to which it is subject to the rules) is an issue in the audit?

ANSWER

To date, there is nothing definite on this question. The NYSBA has suggested that it should be a partnership item to be resolved in a partnership

proceeding. However, it is more likely that a set of rules such as the following might provide a satisfactory way of resolving classification issues. These rules assume that the "small partnership" exception would not apply to the entity in question.

1. If an entity files a partnership return, the entity will be presumed to be a partnership unless and until there is a contrary determination in a proceeding under Chapter 630.
2. If the entity fails to file a partnership return (including situations in which the entity files a corporation return or the beneficial owners report their shares of the items of the entity as mere co-owners) but the Service begins a proceeding with respect to the entity under new Chapter 630, the entity will be presumed to be a partnership unless and until there is a contrary determination in that proceeding.
3. If the entity fails to file a partnership return but the "partner" asserts in a separate proceeding that Chapter 630 applies to items of the entity, the issue may be resolved in that proceeding (burden of proof is on the partner).
4. A "partner" and the Service may in any case resolve the classification issue by stipulation.

- If the partnership files a partnership return, there is a presumption that the entity is a partnership.
    - A member of the entity may rebut this presumption only in a partnership level proceeding.
- If the beneficial owners of the entity file their individual returns as if the entity is other than a partnership, the Service may asserts that the entity is a partnership only in a partnership-level proceeding.
- If the beneficial owners file their returns as if the entity is other than a partnership, all partnership items become non-partnership items with respect to an owner who asserts that the entity is a partnership.
    - The issue of the status of the entity is determined in a separate partner-level proceeding.

QUESTION #6

Under what circumstances can a revenue agent or supervisor be removed from a case under audit when there is a perceived hostility or bias of the individual against the taxpayer?

ANSWER

Situations involving perceived hostility or bias by the examiner or supervisor should be brought to the attention of that individual and if unresolved, discussed with their immediate manager.

QUESTION

Similarly, does the taxpayer have any procedural remedy when a revenue agent or other Service official seems to be acting unreasonably?

ANSWER

Situations of this nature should be brought to the attention of the individual involved. If unable to resolve, it should be discussed with the examiner's or supervisor's immediate manager.

QUESTION #7

When a case under civil audit that is beyond the statute of limitations has a proposed 50% fraud penalty, what difficulties are encountered in settling the case without the fraud penalty if both the Service and the taxpayer agree to the settlement?

ANSWER

In this situation, even though the taxpayer is willing to settle the case without the civil fraud penalty, the 50% fraud penalty must be proposed in order to keep the statute open while the case is in the Examination Division. (Examiners do not have settlement authority).

Without fraud, difficulties may be encountered in assessing the deficiency or crediting payment. Two solutions exist.

1. Retain fraud and settle the deficiency to take into account retention of fraud, or,
2. Execute a closing agreement reflecting the settlement.

QUESTION #8

When an application for a determination that an organization is exempt from tax under §501(a) is incomplete (as, for example, when some items on the form are not filled in or some exhibits are not included), the Service's habit is to return all of the materials in the application to the organization, even though the application was filed and a power of attorney supplied. This exposes the attorney to some embarrassment and delays the processing of the request. A preferable approach would be to contact the attorney directly with a request for the missing information and, only if that information is not supplied

within a specified period of time, to return the materials. If the materials are returned at that time, or if earlier if the procedure suggested in the immediately preceding sentence is rejected, they should be returned to the attorney, not to the organization. Even if the application is incomplete, the power of attorney should stand on its own.

ANSWER

When an application for exemption is filed with a properly completed power-of-attorney, the incomplete application should be returned to the power-of-attorney. A courtesy copy of the cover letter should be forwarded to the organization. All areas have been alerted to ensure this occurs. We will forward to National Office for their consideration the suggestion that the incomplete application be retained by the Service while telephone contact is made with the power-of-attorney to obtain the information that is missing on the application.

QUESTION #9

Discussion as to how the IRS will handle review of TEFRA amendments to qualified plans.

ANSWER

Our primary objective for utilizing technical resources during FY 1984 is to process determination letter applications due to the passage of TEFRA.

The region has substantially increased technical staffing to respond to the anticipated increase in determination workload due to TEFRA.

Instructions have been issued that all TEFRA amendments or restated plans including TEFRA changes should be labeled as either TEFRA or TEFRA-ONLY on the application form. If there is no such identification on the application form, the determination letter subsequently issued will not apply to the provisions of TEFRA. We request that you submit your TEFRA amendments as early as possible; the earlier the submission, the quicker will be the response. Now that there is only one key district in the region (located in Cincinnati), all applications should be mailed directly to:

Internal Revenue Service
P.O. Box 3159
Cincinnati, OH 45201

Attention: CSB

TEFRA applications will be subject to our merit closure procedures. These procedures which are now manual are expected to be automated before the end of FY 1984. TEFRA amendments will be worked in conjunction with all other applications on a first-in, first-out basis.

TEFRA worksheets have been developed by the National Office and will be used by our specialists in processing TEFRA cases.

QUESTION #10

Training of Hearing People in the Branch of Collection Office - Complaints have come to me concerning the attitude of some of the hearing people in the office branch. They don't seem to care about working out a problem with taxpayers. In a number of cases it is impossible to talk to someone about a payment plan until the case gets to a revenue officer in the field. I believe that the office branch in collection is the greatest cause for the unnecessary disrespect for the Internal Revenue Service by the taxpayers in the United States.

ANSWER

The mission of the office function is to collect as much revenue as possible through batch processing techniques and to thereby close cases so that they do not have to be sent to a field revenue officer. Our employees are instructed to make a demand for full payment, and only then if the situation warrants to consider an installment payment agreement. The nature of this job creates a confrontation with taxpayers. We do agree, however, that training can be improved and we are making some efforts in this regard. We are in the process of eliminating our office branch function and replacing it with an automated collection system. This system, which integrates computer monitoring and control of cases with telephone circuitry, makes it easier to locate cases and to ensure that cases reflect current information. This in itself should improve taxpayer relations. In addition, telephone monitoring of employees will be substantially increased. Managers will be able to identify and correct employee relations problems. Some taxpayers consider it unreasonable to have to pay their tax even when they have received up to four prior notices and failed to pay the amount due when the return was filed. The Service also has a Problem Resolution Program which is available to resolve problems that a taxpayer identifies in the collection or in any other Service function.

QUESTION #11

Discussion of IRS standards for acceptance of Offers-in-Compromise and Collateral Agreements.

ANSWER

Offers in Compromise

Offer in Compromise Philosophy

The offer provisions in the Code are not designed to reduce tax or hardship, but to realize maximum collections at the least possible cost or loss to the Government. An accepted offer in compromise is a legal contract whereby both the taxpayer and the Government benefit at the expense of mutual concessions.

Penalty Offers Premised on Doubt as to Liability

Offers on delinquency penalties submitted solely on the grounds of doubt as to liability are considered in the Service Center Collection Branches. Compromise is possible in such cases when some doubt exists as to the taxpayer's liability for the penalty; the penalty cannot be abated for reasonable cause; the amount offered corresponds to the degree or doubt; and the taxpayer has no other outstanding liabilities.

Tax Offers Premised on Doubt as to Collectibility

Frequently, a taxpayer has property interests or access to funds which are beyond the reach of the federal tax lien and, though unable to pay the tax in full, is desirous of being relieved of the stigma and credit hindrance of the federal tax lien.

In evaluating the acceptability and collectibility of an offer in compromise, consideration is given to the taxpayer's net realizable equity in all assets, including those not subject to the tax lien (e.g., assets located outside the United States). An offer premised on doubt as to collectibility will not be considered acceptable unless the amount offered exceeds the taxpayer's net realizable equity in assets.

Offers May be Rejected for Public Policy Reasons

If the acceptance of an offer might in any way be detrimental to the Government's interests, it may be rejected even though it is shown conclusively that the amounts offered are greater than could reasonably be collected in any other manner.

Certain Assets to be Included in Offer

Appropriate amounts should be included in the schedule of assets accompanying an offer-in-compromise based on inability to pay, to reflect the taxpayer's interest in jointly owned property, the loan value of life insurance and future income from trust and similar sources.

Transferee Liability to be Considered

Where transferee liability exists, an acceptable offer in compromise submitted by the transferor must include an amount substantially equal to the amount which the government might reasonably expect to collect from the transferee.

Employment and Withholding Tax Compromises Restricted for "Going Concerns"

Offers in compromise of employment and withholding tax will be rejected unless the amount of the offer is equal to the unpaid tax, exclusive of interest and penalties, or unless the employer is no longer in the same business as that in which the liability was incurred; has completely liquidated; is in receivership; or is involved in bankruptcy, reorganization or other proceedings under the National Bankruptcy Act, as amended; or is exempt from income tax.

100 Percent Penalty Should be Considered as Source of Collection of Employment, Withholding, and Excise Tax Cases

An employment, withholding, or excise tax offer submitted by or on behalf of a corporation which does not equal the unpaid trust fund tax or taxes involved will not be accepted unless it is clearly shown that an amount in excess of that offered cannot be collected from the responsible officers of the corporation. Whenever such an offer is filed, consideration should be given to the assertion of the 100 percent penalty applicable to employment and withholding taxes deducted or withheld and to collected excise taxes.

Closing of Returns and Payment of Tax and Interest will be Required for Delinquency Penalty Offers

Before final action may be taken on any offer to compromise a delinquency penalty, the return must be audited or accepted on survey and closed. The tax and interest must also be paid before a delinquency penalty can be compromised.

Certain Compromise Offers not Acceptable

Offers in compromise shall not be accepted for penalties for failure to file information returns, for failing to make required deposits of taxes, and for tendering bad checks, except where the taxpayer does not have the ability to pay.

Collateral Agreements

Even when the amount offered exceeds the taxpayer's net realizable equity and assets, the taxpayer may be asking the government to set aside substantial liabilities or may reasonably be expected to enjoy an improved financial position in the future. For such reasons, the taxpayer is frequently expected to furnish as additional consideration one or more collateral agreements providing for additional payments from future income, reduction in basis of assets, or waiver of various tax credits or deductions. Agreements for payment from future income are usually for periods of 5 years, though in some instances they may run for as long as 10 years. Substantial amounts may be collected through such agreements in addition to the amount paid on the offer. The amounts recouped under an offer and collateral agreement are limited to the amount of the original liability plus all additions which would have accrued in the absence of the offer. Other collateral agreements may be required to amend or clarify the terms of an offer or to protect the government's interest in the case of an offer submitted by one co-obligor.

Situations in Which Collateral Agreements Will be Obtained

Collateral agreements will be obtained whenever such agreements have a future revenue producing potential. These agreements may take the form of future income agreements, reducing the basis of specific assets for depreciation, gain or loss, or other federal tax purposes, or various other types of collateral agreements, such as those relating to the waiver of net

operating of capital losses, bad debt and other deductions. Further, ordinarily the taxpayer will be required to submit a future income collateral agreement in (a) any case involving a large liability and a nominal offer, or (b) involving a criminal violation under the Internal Revenue laws.

Doubt as to Liability Offers

The Examination Division has jurisdictional responsibility for investigation and processing of tax offers based solely on doubt as to liability.

The offer may be immediately rejected without assignment for field investigation in the following instances:

1. The offer is frivolous or has been submitted for the purpose of delaying collection.
2. The offer is based solely on doubt as to liability and the liability has been finally determined by the Tax Court or other courts, or by a Commissioner's final closing agreement.

In considering an offer based on the merits of the liability, the doubt as to the liability issue must be supported by tangible evidence and there must be a thorough discussion of all the reasons why the tax may be of doubtful legality.

QUESTION #12

To what extent are the minutes of this IRS-Bar Liaison meeting circulated within the Service?

ANSWER

In the past, it is unclear as to what distribution, if any, was made of the minutes.

In the future, we (Counsel) will send a copy to the Regional Commissioner, each District Director, Service Center Director, and each District Counsel.

QUESTION #13

Practitioners have noted with increasing concern the frequency with which the IRS loses documents and returns. What is being done to correct the problem?

ANSWER

Missing or temporarily unlocatable documents and returns are of great concern to us, also. In fact, we recently completed a study which identified several areas where our procedures or performance could be improved to alleviate the problem.

We are now in the process of implementing recommended changes in these areas which we expect will significantly reduce the frequency of these occurrences.

Prepared by: Management Staff
Cincinnati Service Center
10/21/83

QUESTION #14

The IRS often asks taxpayers for copies of tax returns which the IRS has in its files. Why can't the Service get copies from its own records?

ANSWER

There are times when returns are not readily accessible. Examples are when they are awaiting classification by our Examination function, en-route to Federal Records Centers, or in the inventory of a particular project; for example, a Deferred Adverse Tax Consequence issue such as energy credit or IRA deduction, underreporter, etc.

In such instances, it is often to the taxpayer's advantage for us to ask for a copy from the taxpayer rather than taking the additional time to obtain a copy from our own records. In this way, the taxpayer's current issue (an inquiry, a balance due, a claim, etc.) can be resolved more quickly.

Prepared by: Management Staff
Cincinnati Service Center
10/21/83

QUESTION #15

When a sole proprietorship becomes a partnership, what is the ability and what are the mechanics of the partnership continuing to use the same identification number as the pre-existing sole proprietorship?

ANSWER

When a business ceases to be a sole proprietorship and becomes a partnership, a new and distinct entity is created. Therefore, the partnership must be issued a new employer identification number (EIN) and cannot continue to use the one issued to the sole proprietorship.

All liability, tax deposits, etc., pertaining to the partnership must be reported under the new EIN and name. Likewise, all liability, tax deposits, etc., for the sole proprietorship should be reported under the original EIN.

In addition, the sole proprietorship should indicate on the return(s) that it is the final one for that entity. This is very important as it prevents future

unnecessary requests for returns and possible misuse of the now inactive sole proprietorship's EIN.

Prepared by: Management Staff
Cincinnati Service Center
10/21/83

QUESTION #16

Some service center personnel seem not to be aware that subchapter S corporations can use a taxable year other than a calendar year under certain circumstances. Can the Service advise its people of the circumstances under which this can be done? See Revenue Procedure 83-25, IRB 1983-15, 13.

ANSWER

We are aware that subchapter S corporations can elect a fiscal year under certain circumstances. The May 1983 revision (attached) of the Form 2553 has specific instructions and a special section to be completed if the taxpayer wishes to select a tax year under Revenue Procedure 83-25. We also have corresponding processing procedures.

However, there was a period of time early this year when we had to suspend processing Forms 2553 requesting fiscal years pending receipt of procedures which were developed based on the Revenue Procedure 83-25 published on April 11, 1983. This is probably when you encountered the problem.

Prepared by: Management Staff
Cincinnati Service Center
10/21/83

QUESTION #17

What happens if a subchapter S election is filed on an old form? Would if be rejected until a new form is supplied? Does this affect the timeliness of the filing?

ANSWER

If the election filed on an old form has an attachment which provides the additional information required by the new form, we will process it.

If not, we will return the old form and a new blank revision with a letter requesting the taxpayer to complete the new form and return it.

If the election filed on the old form was timely, we will consider the new form timely if it is returned within 30 days of the date of our letter requesting it.

Prepared by: Management Staff
Cincinnati Service Center
10/21/83

QUESTION #18

It is sometimes hard to find the right people to talk to at the regional service centers. Would it be possible for the Service to issue a telephone directory identifying key people in specified areas and to publicize its availablity?

ANSWER

This would not be feasible at present because service centers do not have resources which can be allocated to a taxpayer service function. If we initiate something where telephone contact is desirable, we will include a specific service center telephone number if we want the taxpayer to call us or we will request the taxpayer's number so we can call him/her.

Otherwise, it would not be conducive to an efficient service center operation, where the chief activity is processing high volumes of tax returns.

Taxpayer service (including explanation of service center originated notices and correspondence and answering general questions) is primarily the responsibility of the district offices. Your questions should be directed there.

Prepared by: Management Staff
Cincinnati Service Center
10/21/81

QUESTION #19

It is sometimes difficult to handle complicated cases with the problems resolution officer by correspondence and telephone. Would it be possible to develop procedures under which conferences at the service center can be held with the problems resolution officer in appropriate cases?

ANSWER

The experience of the service center Problem Resolution Officer does not reflect a need for developing conference procedures. We have found that even extremely complicated causes can be resolved satisfactorily if both the taxpayer/authorized representative and the Service have all the pertinent facts/information before them.

Often, it is necessary for one or both to study this information thoroughly before telephone contact is made. Once that is done, the telephone feedback is almost certain to be effective in resolving the issue.

In addition to our experience not revealing a need for conferences, the service does not have the proper facilities for holding them.

Prepared by: Management Staff
Cincinnati Service Center
10/21/83

QUESTION #20

When a trust is funded for the first time many years after it is established and the application for an employer identification number shows the earlier year as the starting date of the trust, the service center computer generates individual follow-up letters for each intervening year asking why no tax return was filed for that year. Can the follow-up letter program be adjusted so that a single letter is sent out for all intervening years?

ANSWER

Our return delinquency programs are designed to periodically issue a sequence of notices from the service center requesting information about tax forms which we have not received. Each notice pertains to one particular form and period.

In the instance you describe, once the trust fund is assigned an EIN and established on the master file with a much earlier starting date, we would issue separate requests for information about each return that would have been due but had not been received after the trust's inception.

It would not be practical to combine different types of returns and/or different periods on a single notice. Our delinquency programs for each type of return are tailored to that particular return's due date as well as some internal considerations concerning effective use of our resources.

When separate notices are received for several periods at the same time and the taxpayer was not liable, a cover letter explaining this could be used to return all of the notices instead of completing each one individually. However, these multiple notices could be avoided if you were permitted to use the later of the date the trust was legally created for the date it was funded as the "date you acquired or started this business" on the Form SS-4, Application for Employer Identification Number.

At present, the Form SS-4 instructions do not allow this. You may wish to suggest this change to the Tax Forms and Publication Division T:FP in

our national office. We will also initiate a request to change the instructions for the Form SS-4. However, your suggestions would provide additional support toward securing approval.

Prepared by: Management Staff
Cincinnati Service Center
10/21/83

QUESTION #21

Criminal — Use of "shopping" techniques and other covert forms of criminal investigation.

ANSWER

SHOPPING

The Internal Revenue Service uses undercover techniques when appropriate. These investigative techniques, although rarely used, are very effective when put into operation. Our statistics show that in the types of cases where special investigative techniques are appropriate and used, we have a high conviction rate.

Stringent controls are placed on our investigators to insure IRS management is involved in the investigations at the approval level as well as continuing involvement throughout the investigation. In our more sensitive areas, our National Office must approve the techniques before they are used. This includes certain types of undercover activity.

QUESTION #22

Under what circumstances are tax fraud investigations being conducted by grand juries rather than the traditional methods; i.e., referrals by revenue agents to the Criminal Division, to Regional Counsel, to Chief Counsel, to the Justice Department, and then back to the U.S. attorney for presentment to the grand jury for indictment?

ANSWER

CIRCUMSTANCES FOR TAX FRAUD INVESTIGATIONS IN GRAND JURIES

Tax fraud investigations conducted by grand juries are done so under three conditions, as follows:

1. The information which would generate the investigation is grand jury information and can be used only for criminal purposes within a grand jury setting.
2. Mutliple Federal criminal investigative agencies are conducting an investigation on the same individual, at the same time, requiring close coordination. Because of the need for coordination

among the various federal agencies and current restrictions of the Disclosure laws, the grand jury process allows for a more effective and more expedient means to reach a conclusion.

3. The investigation being conducted by IRS personnel cannot proceed further because normal investigative procedures are ineffective, e.g., the need to grant immunity to specific witnesses.

QUESTION #23

Criminal — Discussion of use of grand jury in criminal tax investigations including: (1) reasons; (2) case processing details stressing differences between "regular" criminal investigation by Special Agent; and (3) description of how the case moves forward from Grand Jury to Regional Counsel to Department of Justice and identification of which agency is in control of case at different processing times.

ANSWER

GRAND JURIES: REASON FOR AND REVIEW PROCEDURES

The use of grand jury for a tax investigation is considered very carefully before requesting the authorization. In most instances, the primary reason for a grand jury investigation is a request from a U.S. attorney to cooperate with other federal agencies in a joint investigation. This accounts for approximately 95 percent of our grand jury cases.

A significant difference between a non-grand jury tax investigation and a grand jury tax investigation is that the Criminal Tax Division, Department of Justice, has to authorize a criminal tax investigation utilizing the grand jury. In non-grand jury investigations, the Criminal Tax Division, Department of Justice, is not involved until a recommendation for prosecution has been made by the special agent and concurred with by District Counsel.

When prosecution is recommended in a non-grand jury investigation, the report is reviewed by District Counsel, then forwarded to the Department of Justice, Criminal Tax Division. In a grand jury investigation, the prosecution report is generally reviewed by Regional Counsel, then forwarded to the Department of Justice.

A grand jury investigation is a U.S. attorney-controlled investigation. While the U.S. attorney does have input during the review process, the IRS attorney in Regional Counsel acts independently in reviewing the recommendation for prosecution. In administrative investigations, District Counsel may offer the defense an opportunity to present evidence during the review process, however, in a grand jury case, this offer is made only by the U.S. attorney, and then only when he/she feels it appropriate.

PARTIAL LIQUIDATION GAIN COMPUTATIONS: TAX SAVING OPPORTUNITIES FOR STOCKHOLDERS

By: Robert D. Blatz, Jr.*

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)[1] has produced significant changes in the statutes which define and govern the tax consequences of a partial liquidation.

It will be the object of this article to briefly summarize these changes and describe, in detail, the gain or loss computations the distributee-stockholder is required to make once the distribution is properly characterized as one in partial liquidation. As will be shown below, these computations are not as obvious as one might ordinarily expect and may provide an excellent tax saving opportunity for the distributee-stockholder.

TEFRA MODIFICATIONS TO PARTIAL LIQUIDATIONS

Prior to TEFRA a partial liquidation was defined in Sections 346(a) and (b) while the operational tax consequences to the distributee-stockholder and the distributing corporation were determined respectively under Section 331(a) and Section 336(a). TEFRA significantly modifies this statutory scheme. The "series" liquidation definition of old Section 346(a)(1) is now classified as a complete liquidation in new Section 346(a). The "contraction" definition of old Section 346(a)(2) and the "termination" definition of old Section 346(b) are retained in new Sections 302(e)(1), (2) and (3), but only as to individual stockholders. Corporate stockholders are, therefore, foreclosed from partial liquidation treatment with the resulting consequence that receipt of distributions which formerly qualified as partial liquidations will now ordinarily receive dividend treatment under Section 301.[2]

The statutes determining the operational tax consequences to the distributee-stockholder and the distributing corporation in a partial liquidation have similarly been altered. All language relating to "partial liquidations," has been removed from old Sections 331(a) and 336(a). The tax treatment of the individual distributee-stockholder is now governed by Section 302(a) in conjunction with new Section 302(b)(4) while the tax treatment of the distributing corporation will be determined under Section 311 rather than Section 336. A summary of these changes and the definitional changes is set out below:

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PARTIAL LIQUIDATIONS

Pre-TEFRA	Post-TEFRA
Definition	**Definition**
Section 346(a)(1) "series" "contraction" Section 346(a)(2) "contraction" "termination" Section 346(b) "termination"	Section 302(e)(1) Section 302(e)(2)&(Section 3)
Tax Consequences to Distributing Corporation	**Tax Consequences to Distributing Corporation**
Section 36	Section 311
Tax Consequences to Distributee-Stockholder	**Tax Consequences to Distributee-Stockholder**
331(a)(2)	302(a) and 302(b)(4)

STOCKHOLDER GAIN OR LOSS COMPUTATIONS

The practical effect of the TEFRA operational modifications on an individual distributee-stockholder, once a distribution qualifies as a partial liquidation, remains the same as that under prior law. Section 302(a) states that such a distribution is to be treated by the distributee-stockholder "as (received) in part or full payment in exchange for stock."[3] Ordinarily stock in the hands of a shareholder is a capital asset.[4] Thus, the distributee-stockholder will receive capital gain or loss treatment in a qualifying partial liquidation measured by the difference between the aggregate adjusted basis of shares surrendered or cancelled and the fair market value of the distribution.[5]

The fair market value of the *distribution* would include cash distributed plus the fair market value of other assets distributed.[6] Remember, however, that only the assets (including working capital)[7] of the discontinued business activity or the proceeds from their sale will qualify as a distribution in partial liquidation.[8] If anything over and above is distributed, such as additional working capital not needed in the continuing operations, the other operational subsections of Section 302 must be consulted to determine if this excess distribution will also be accorded capital gain treatment.[9] If it is not accorded such treatment, then the excess distribution will be taxed under Section 301 (i.e. dividend treatment to the extent of the distributing corporation's earnings and profits).[10] The parties must also make certain to fully distribute the assets of the discontinued business activity or the proceeds from their sale. Case authority holds that a corporation's retention of some of the assets of a discontinued business will disqualify the transaction from partial liquidation treatment.[11]

The *aggregate adjusted basis* of the shares cancelled or surrendered is a function of two elements: (1) the number of shares cancelled or surrendered, and (2) the respective bases of such shares. Thus, the aggregate adjusted basis can be "planned" to the extent that the distributing corporation is permitted to determine, at will, the *number* of shares to be cancelled or surrendered and the distributee-stockholder is permitted to determine, at will, the *specific shares* to be cancelled or surrendered. To illustrate, suppose X Corporation has 1,000 shares outstanding each having a current fair market value of $200. A, an individual, acquired these shares in two purchases: 500 shares were acquired several years ago for $50,000 (block 1) while the remaining 500 shares were acquired 13 months ago for $90,000 (block 2). X Corporation has two operating divisions, each possessing equal shares of assets, liabilities, and equity. Its current tax-based balance sheet indicates the following:

BALANCE SHEET

Assets		Liabilities	
Cash	$ 50,000	Current Liabilities	$ 50,000
Other Current Assets	50,000*	Stockholders' Equity	
Fixed Assets	150,000*	Paid-in Capital	100,000
		Retained Earnings	100,000
Total	$250,000	Total Liabilities and Equity	$250,000

*Assume fair market value

Further, suppose that X Corporation sells the assets (excluding cash) of one of its divisions to an unrelated third party for $75,000 cash and the assumption of one-half of its current liabilities ($25,000). X Corporation's tax-based balance sheet immediately after the sale would indicate the following:

BALANCE SHEET

Assets		Liabilities	
Cash	$125,000	Current Liabilities	$ 25,000
Other Current Assets	25,000	Stockholders' Equity	
Fixed Assets	75,000	Paid-in Capital	100,000
		Retained Earnings	100,000
Total	$225,000	Total Liabilities and Equity	$225,000

If X Corporation distributes $125,000 (i.e. sales proceeds plus one-half of the before-sale cash balance) to stockholder A in partial liquidation, there will be approximately 251,000 separate gain or loss possibilities[12] depending on the number and type of shares A surrenders. For example, if only one share must be surrendered then A's gain would be either $124,900 ($125,000 - $100) or $124,820 ($125,000 - $180) depending on which share he surrendered. Whereas, if A were required to surrender 999 shares, he would realize a *loss* of either $14,900 ($125,000 - $139,900) or $14,820 ($125,000 - $139,820) again depending on which

shares he surrendered. Notice that regardless of the number of shares stockholder A surrenders he will continue to own 100% of X Corporation after the distribution and surrender of the share or shares.

An interesting aspect of partial liquidations relates to whether a distributing corporation and a distributee-stockholder may "plan" the aggregate adjusted basis and thus manipulate the gain or loss to the distributee-stockholder. The remainder of this article will analyze relevant Internal Revenue Code sections, treasury regulations, I.R.S. revenue rulings and court cases to determine to what extent, if any, such "planning" may occur.

Internal Revenue Code sections define the rights of taxpayers and fix standards by which such rights are to be measured. Treasury regulations constitute a step in the administrative process. Although they are generally accorded the "force of law", such regulations do not, and cannot alter a code section. This reasoning applies with even greater force to IRS revenue rulings.[13] A revenue ruling is merely the opinion of a lawyer in the IRS and must be accepted as such. It has no more binding or legal force than the opinion of any other lawyer.[14] Revenue rulings should not be accorded a presumption of correctness but must be analyzed for consistency with the code section involved. Nevertheless, they are entitled to some consideration by the courts and carry some weight, especially when the statutory language is considered ambiguous.[15]

Although numerous revenue rulings and court cases have considered the issue, neither the Internal Revenue Code nor the Treasury Regulations specifically address the mechanics of calculating gain or loss to the distributee-stockholder in a partial liquidation. The closest "statutory" authority relating to this computation is found in the Conference Committee Report to TEFRA:[16]

> "Under present law, a distribution in parital liquidation may take place without an actual surrender of stock by the shareholders (*Fowler Hosiery Co. v Commissioner),* 301 F.2d 394 (7th Cir. 1962). A constructive redemption of stock is deemed to occur in such transactions (Rev. Rul. 81-3, 1981-1 C.B. 125). The conferees intend that the treatment of partial liquidations under present law section 346(a)(2) and (b) is to continue for such transactions under new section 302(e)." (at page 530)

While a conference report is not, in and of itself, a source of positive statutory law, it may indicate to the courts that the committee, and hence, the Congress, was aware of a problem and thought the present law adequate to deal with it.[17] Furthermore, a long-continued administrative interpretation, whether reflected by revenue ruling, or otherwise, may of course achieve the force of law when it interprets a statute which has been re-enacted unchanged after such interpretation was expressly called to congressional attention.[18] Thus, Revenue Ruling 81-3, which is expressly cited in the Conference Committee Report, must be accorded greater deference than one ordinarily might expect.

Revenue Ruling 81-3 is the most recent in a series of revenue rulings considering the gain or loss calculations in a partial liquidation.[19] The prime issue addressed in the ruling is whether a pro-rata distribution by a corporation of the net proceeds of the sale of all the assets of one of its two divisions may qualify as a partial liquidation, even if there is no actual surrender or cancellation of stock. After disposing of this issue with an affirmative answer, the ruling proceeds to address the collateral issue of gain calculation:

> "(T)he shareholders of X will be deemed to have constructively surrendered that number of shares the total fair market value of which equals the amount of the distribution." (at pages 125 and 126)
>
> "See Rev. Rul 77-245, 1977 C.B. 105, for computation of the tax consequences to the shareholders of X resulting from the partial liquidation." (at page 126)

Revenue Ruling 77-245, cited in Revenue Ruling 81-3, specifically addresses the determination of the *number* of shares considered redeemed in a partial liquidation as well as the effect of a partial liquidation on the adjusted basis of the stockholder's retained shares:

> "The number of shares of stock considered redeemed in a partial liquidation, *regardless of the number of shares actually surrendered,* is computed based upon the fair market value of the stock of the distributing Corporation. . . ." (at page 105; emphasis added)
>
> "For this purpose the taxpayer . . . will be considered to have surrendered that number of shares the total fair market value of which equals the amount of the distribution." (at page 106)
>
> "(T)he taxpayer's adjusted basis of the X (corporate) stock must be reduced by the amount of the adjusted basis used in determining gain on the partial liquidation." (at page 106)

While Revenue Rulings 81-3 and 77-245 seemingly resolve the problem of determining the number of shares considered cancelled or surrendered in a partial liquidation,[20] they leave unresolved the issue as to which specific shares will be deemed cancelled or surrendered. Thus, even though the number of shares considered cancelled or surrendered in the previously stated illustration can be calculated, 675 ($125,000 FMV of distribution/ $200 FMV of share of stock), 325 separate gain possibilities (ignoring fractional shares) still exist. For example, if 500 shares of block 1 and 175 shares of block 2 are considered redeemed, stockholder A's gain will be $43,500 ($125,000 - ($50,000 + $31,500)). Whereas, if 175 shares of block 1 and 500 shares of block 2 are considered redeemed, A's gain will only be $17,500 ($125,000 - ($17,500 + $90,000)).

No authority—legislative, administrative or judicial-comes squarely to grips with this issue in the context of partial liquidations. Therefore,

one must consult other code sections and their administrative and/or judicial interpretations for possible solutions.

Generally, where shares of stock are sold or transferred by a taxpayer, he must be able to adequately identify the block from which that particular share came before using it to calculate his gain. If he is unable to do this, then the taxpayer is required to apply a FIFO flow method of identification.[21] So where shares will be actually surrendered or cancelled in a partial liquidation, the distributee-stockholder can "plan" his gain or loss by selecting those identifiable shares (low or high basis and long or short holding period) which best fit his particular tax situation.

But what about those situations when no shares are cancelled or surrendered? Three feasible alternatives exist. First, since no shares are actually surrendered or cancelled, specific identification would most likely be inapplicable. However, utilization of the FIFO flow method would seem quite appropriate. As shown above, utilization of this method would lead to a $43,500 gain. Secondly, a portion of the aggregate adjusted basis of all outstanding shares can be allocated to the constructively redeemed shares in the proportion that the number of shares considered constructively redeemed bears to the total number of shares outstanding despite the existence of several blocks of stock.[22] This would lead to a gain of $30,500 ($125,000 - (675/1000 x $140,000)) in the above illustration. Thirdly, Revenue Ruling 68-348[23] suggests that the distribution must be allocated ratably among the blocks of stock in the proportion that the number of shares in a particular block bears to the total number of shares outstanding. Gain or loss must be computed separately with respect to each block of stock. Relating these requirements to the illustration facts results in a gain of $30,500 (($62,500 - $33,750) + ($62,500 - $60,750)).[24]

Revenue Ruling 68-348 addressed the calculation of gain in the "series" type partial liquidation of old Section 346(a)(2) which is now classified as a complete liquidation under new Section 346(a). Its apparent purpose was to provide equality of treatment between complete liquidations accomplished through a series of liquidating distributions and those accomplished through a single liquidating distribution.[25] Thus, its efficacy with respect to partial liquidations as defined in new Sections 302(e)(1), (2) and (3) is in serious doubt.

In *Fowler Hosiery Co. v CIR* and Revenue Ruling 81-3 language can be found to the effect that "since there was only one stockholder" or "since the distribution was 'pro-rata'" an actual redemption or surrender of shares would be "immaterial" or "a meaningless gesture". These statements are certainly accurate with respect to the control aspect, but they are patently inaccurate with respect to the computation of distributee-shareholder gain or loss. By mandating an actual surrender of shares in return for a partial liquidation distribution, the distributing corporation creates a situation whereby a distributee-stockholder, through the skillful selection of shares, can "plan" his gain or loss as best fits his interest. Failure to require such a surrender or cancellation precludes stockholder use of this important planning technique and leaves gain calculation to the IRS or the courts.

CONCLUSION

In enacting Section 222 of TEFRA, Congress has clearly expressed its support for Revenue Ruling 81-3. This Revenue Ruling should be adhered to by the parties to a qualified partial liquidation. Although this ruling mandates a specific mechanical computation in determining the *number* of shares considered redeemed in a partial liquidation, the distributee-stockholder still has some latitude in "planning" his gain or loss through the judicious selection of the *specific shares* required to be actually cancelled or surrendered by the distributing corporation.

FOOTNOTES

1. Tax Equity and Fiscal Responsibility Act of 1982, P.L. 97-248, 96 Stat. 324.
2. However, if the distribution qualifies as a redemption under Sections 302(b)(1), 302(b)(2) or 302(b)(3) or as a complete liquidation under new Section 346(a) then it may receive capital gain treatment.
3. Old Section 331(a)(2) stated that a distribution in partial liquidation is to be treated "as (received) in part or full payment in exchange for stock."
4. I.R.C. Section 1221.
5. I.R.C. Section 1001(a).
6. I.R.C. Section 1001(b).
7. Rev. Rul. 60-232, 1960-2 CB 115 and Rev. Rul. 76-289, 1976-2 CB 100.
8. S. Rep. No. 1622, 83d Cong. 2nd Sess. 233 (1954).
9. *See Supra* note 2.
10. I.R.C. Section 302(d)
11. Gordon v CIR, 424 F.2d 378 (2d Cir. 1970).
12. (501x501)-1. Two sets were assumed, each containing 501 elements running from 0 through 500. Combination 500. 500 was excluded on the pretext that corporation law requires at least one outstanding share. This calculation ignores the possibility of fractional shares which would only increase the number of separate gain or loss possibilities.
13. Dixon v US, 381 US 68, at 74 and 75 (1965).

14. Stubbs, Overbeck & Associates v US, 445 F.2d 1142, at 1146-1147 (5th Cir. 1971).

15. Farmar v US, 689 F.2d 1017, 1024 (Ct. Cl 1982).

16. C. Rep. No. 97-760, 97th Cong. 2nd Sess. 528 (1982).

17. Pridemark, Inc. v CIR, 345 F.2d 35, 41 (4th Cir. 1965).

18. Estate of Grace E. Lang, 64 TC 404, 407 (1975).

19. See Rev. Rul. 56-513, 1956-2 CB 191.

20. Interestingly, the IRS in Fowler Hosiery Co. v CIR, 36 TC 201 (1961) computed the taxpayer's gain as if all 3500 of its outstanding shares had been constructively redeemed. The IRS ignored Rev. Rul. 56-513 which, like Rev. Rul. 81-3, called for the constructive redemption of only 2,058.55 shares ($1,500,000 FMV of distribution/ $728.67 FMV of share). Perhaps, this was because the partial liquidation in *Fowler* was a "series" type in which the taxpayer recovered its total cost basis ($382,039.75) in the first distribution. *See* Rev. Rul. 68-348, *infra* note 23.

21. Reg. Section 1.1012-1(c)(1).

22. Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders,* 4th Edition, Boston: Warren, Gorham & Lamont, Inc., 1979, paragraph 9.61.

23. Rev. Rul. 68-348, 1968-2 CB 141.

24. This result is the same as the second alternative due to the fact that the blocks in the illustration are equal (i.e. 500 shares apiece). If the blocks were not equal then the results of alternatives two and three would differ.

25. Reg. Section 1.331-1(e).

CASE DIGESTS

REAL PROPERTY EXEMPTION – PUBLIC USE – PRIVILEGE TAX

Proceeds from a non-profit lessee's sublease of county buildings to private persons are not taxable when wholly applied to a public purpose. The public use of such funds also renders inapplicable the privilege tax imposed on users of exempt property.

County of Midland & Midland Agricultural & Horticultural Society v Larkin Twp., MTT Docket No 57412, 71040, October 27, 1983.

FACTS:

The Midland County Agricultural and Horticultural Society ("Society") operates the county fair and leases the fairgrounds from Midland County. The Society subleases storage space in certain buildings on the grounds to private parties. Space is so leased only when the fair is not in progress, and the revenues therefrom are applied to the maintenance and improvement of the property and the promotion of the fair. Petitioner argued, *inter alia,* that the property was exempt pursuant to either MCLA 211.7m; MSA 7.7 (4j) or MCLA 2ll.7w; MSA 7.7 (4t). Respondent contended that the buildings used for private storage produced rental income and were thus not entitled to exemption.

HELD:

The property is entitled to an exemption under MCLA 211.7m; MSA 7.7(4j). The Tribunal held that the Society's rental of space to private persons was not for profit but for the public purpose of maintaining the fairgrounds and operating the fair since none of the proceeds inured to the benefit of a private individual.

The Tribunal also considered whether the privilege tax upon private and corporate lessees or users of exempt property, (MCLA 211.181; MSA 7.7(5)) applied in this situation. Concluding that the Society, although being a private non-profit corporation, was not subject to the privilege tax, the Tribunal distinguished Petitioner's public use of the proceeds from "business conducted for profit" to which the tax expressly applies. MCLA 211.181(1). Apparently as an alternative ground for its decision, the Tribunal also cited, but did not discuss, the subsection of the privilege tax statute which excepts from the tax property used in conjunction with various fairs, including county fairs. MCLA 211.181(2)(c).

PERSONAL PROPERTY ASSESSMENT

The market approach to valuation was held to be more appropriate than the income approach when there are sufficient sales of the type of

property assessed and where difficulties in the application of the income method render it less accurate as a measure of true cash value.

Xerox Corp v Oakland County, MTT Docket No 46584-46600, 56047-56052, 56054-56058, and 67288-67290, December 12, 1983

and

Xerox Corp v City of Grand Rapids, MTT Docket No 46601, December 12, 1983

FACTS:

Petitioner in these consolidated cases is in the business of, among other things, leasing copiers that are subject to the *ad valorem* personal property tax. MCLA 211.1 et seq.; MSA 7.1 et seq. Respondents had been using the capitalization of income approach to assess the true cash value of the subject property and sought to replace this method with the market approach for tax years 1980-1982. Respondents adjusted the commercial list price for new machines by deducting one half of the Option to Purchase allowances in the lease agreements. Petitioner objected that this method was improper and that it subjected the copiers to assessments exceeding 50% of their true cash value in contravention of the Michigan Constitution, Const 1963, Art 9, ® 3, and MCLA 211.27(4); MSA 7.27

HELD:

Citing *Antisdale v City of Galesburg,* 109 Mich App 627; 311 NW 2d 432 (1981), the Tribunal noted that it is bound to select from among the methods of valuation repeatedly endorsed by Michigan courts (income, market, and cost) that which is most appropriate to the particular case. The Tribunal adopted Respondents' method after finding the cost approach wholly inapplicable and concluding that the income approach advocated by Petitioner was less accurate than the market approach. The Tribunal explicitly rejected the contention that the income producing nature of the property dispositively establishes the income method as most appropriate.

The income method was found to be imprecise because of the difficulty of attributing income to any one facet of Petitioner's customer sales and services. Further, Respondents' respective audits revealed that a significant number of sales were at amounts higher than indicated by Petitioner's income approach. Finally, the Tribunal distinguished *Mowhawk Data Sciences Corp v Detroit,* 63 Mich App 102; 234 NW 2d 420 (1975), relied on by Petitioner, on the ground that an insufficient number of market sales prevented the application of the market approach in that case. The Tribunal concluded that the significant increase in Petitioner's copier sales in the tax years at issue rendered the Mowhawk decision inapposite and justified the adoption of the market approach.

ACCRUAL OF INTEREST ON REFUND

A taxpayer obtaining a refund upon redetermination of Franchise Fee is entitled to interest beginning 45 days after redetermination was requested from the Department of Treasury.

Chesapeake & Ohio R Co v Michigan Department of Treasury, MTT Docket No 29535, 29585, 29586, 29587, 29588, 29589 October 27, 1983.

FACTS:

Respondent assessed against Petitioner deficiencies with respect to Petitioner's payments from 1969-1974 of the Michigan Corporation Franchise Fee under the Fees, Taxes and Charges Act. MCLA 450.309; MSA 21.210 (Repeal ed 1975). After each deficiency was assessed, the Petitioner requested redetermination. These redeterminations were subsequently appealed by Petitioner and consolidated for hearing by the Corporation Tax Appeal Board (which has since been replaced by the Michigan Tax Tribunal) in 1975. The Board's decision was appealed by Petitioner to the Court of Appeals which remanded certain issues to the Tax Tribunal. Petitioner then took an appeal from the Tribunal to the Court of Appeals and finally obtained judgment in its favor. The case was again remanded to the Tax Tribunal, this time for determination of the refunds and interest due Petitioner. The amounts to be refunded were undisputed and the Petitioner's right to interest at 9% per year was prescribed by statute. MCLA 205.23(2); MSA 7.657(23). The only issue, then, was whether the interest should run from the dates redeterminations were requested as Petitioner contended, or whether, as Respondent argued, interest should run only from the date on which Petitioner filed its computation of the exact amount in controversy.

HELD:

MCLA 205.30; MSA 7.657(30) provides that when a claim is filed after the filing date for returns,"interest shall be added to the refund commencing 45 days after the claim is filed." Rejecting Respondent's argument that a "claim" was not filed until Petitioner submitted its computations, the Tribunal noted that these were actually recomputations necessitated by previous Court of Appeals decision in this matter. It was held that Petitioner was entitled to interest beginning 45 days after each date the Petitioner originally requested a redetermination. Moreover, the Tribunal held that this applied even to portions of the refund directly attributable to issues raised for the first time on appeal from the Treasury Department's redetermination.

The Tribunal also held, citing *Wallace v Glaser,* 82 Mich 190; 46 NW 227 (1890), that the rule applying partial payments first to interest and then, after the interest debt is retired, to discharging the principal, applies to credits against Petitioner's current tax liability which Respondent had allowed as partial payment of Petitioner's refund.

EQUIPMENT LEASING LOSSES – PARTNERSHIP TRUST

A Michigan financial institution was allowed to deduct from its Michigan income tax its proportional share of losses as partner in a leasing trust even though the trust was a partnership domiciled in a foreign state.

Detroit Bank & Trust Co v Michigan Department of Treasury, MTT Docket No 48953, December 8, 1983

FACTS:

Petitioner, a Michigan domiciled bank, was a partner in two Utah based partnership trusts formed by equity lenders from several states to pursue a leveraged leasing arrangement whereby the trusts financed the acquisition of 100 diesel locomotives by Amtrak. In a letter ruling, the Internal Revenue Service ruled that for federal income tax purposes the leases involved were true leases; the trusts had achieved partnership status; and, therefor that the partners were entitled to take their proportionate shares of losse (or income), depreciation and interest expense deductions, and investment tax credits. Petitioner deducted its distributive share of the partnership's losses in 1974 and 1975 for those tax years in determining its Federal and Michigan tax liability. The income tax provisions then in effect with respect to financial institutions have been replaced by the Single Business Tax Act, 1975 PA 228.

Respondent assessed Petitioner with deficiencies for both years and argued that the out of state partnerships were separate and distinct taxable entities, not a part of Petitioner's regular financial business, and therefore that the losses were not allocable to Michigan under the apportionment formula provided by MCLA 206.115 (amended 1975). Respondent asserted that its assessments were consistent with the result in *Gruenwald & Wortley v Department of Treasury,* 104 Mich App 601 (1981), wherein the distributive shares of partner's losses from an out of state partnership were held not attributable to Michigan and were thus added back to the taxpayer's federal adjusted gross income for purposes of determining Michigan taxable income.

Petitioner contended that the assessment was erroneous because participation in an equipment leasing partnership is in the regular course of a lending institution's business. Further, a partnership was not specified as a taxable business entity by the income tax act, or defined as a "person", MCLA 206.16, subject to the act. Finally, Petitioner argued that *Grunewald* was distinguishable.

HELD:

Petitioner properly attributed to Michigan its distributive share of losses from the out of state partnerships and thus correctly construed MCLA 206.103 (amended 1970), MCLA 206.105, and MCLA 206.151

(repealed 1975); although the trust agreements were designated "partnerships'" they were still an integral part of Petitioner's banking business and not separate entities. The Tribunal concluded that the legislature did not intend for partnerships to be considered "persons" within the income tax act (but note that the Single Business Tax Act does define a partnership as a "person" subject to tax thereunder. MCLA 208.6.) The Tribunal also held that *Grunewald* was distinguishable on several grounds.

SPECIAL ASSESSMENT DISTRICTS — SPECIAL BENEFITS

When it is reasonable to conclude that there are benefits to the property owner, the scope of judicial review of special assessments will be limited.

Mullendore v City of Farmington Hills, MTT Docket No 48373-48380, September 20, 1983.

FACTS:

Petitioners were owners of property abutting Nine Mile Road between Halsted and Haggerty Roads in the City of Farmington Hills. Respondent created a special assessment district to change the surface of the road from gravel to asphalt.

Petitioners sought review of the special assessment by the Michigan Tax Tribunal. The Petitioners contended that they did not receive a benefit equal to that which was assessed to them for the improvements to Nine Mile Road. Specifically, they alleged that the character of the area was changed from rural flavor to that of a city, that the traffic volume had increased on the road, and that the Petitioners' use constituted only 3% of the total usage of the road.

HELD:

The scope of judicial review of special assessments is limited. In absence of a showing of mistake or abuse of discretion, the Tribunal cannot substitute its judgment for that of the elected officials of the local unit of government.

A special assessment is sustained on the theory that there exists a special benefit to the properties subject to the assessment beyond that conferred on the public at large. A special benefit will be found to exist where there is an increase in the value of the property, relief from an existing burden, or creation of a special adaptability in the land. Furthermore, a test which questions whether it is reasonable for a person to believe the property is specially benefitted is applicable in judicial review of special assessments.

The Tribunal found that the Petitioners enjoyed benefits as a result of the paving including increased property values and less expensive road

maintenance costs. The Tribunal found that the area's rural character remained in spite of the paving. Furthermore, the Tribunal noted that it was unrealistic for the Petitioners to believe that their 1,928 foot frontage of Nine Mile Road would not be paved as the remainder was already paved. In addition, use of a traffic count to determine traffic volume, without a prior standard by which to compare, is not indicative of a change in volume. Further, the Tribunal concluded that a small amount of total road usage by the property owners does not result in an invalid special assessment.

The Tribunal concluded that under the reasonableness test, the Petitioners had failed to meet their burden of proof, and as a result, the special assessments were affirmed.

NON-CONFORMING USE ZONING – ECONOMIC OBSOLESCENCE

A non-conforming use zoning classification may cause a reduction in property value.

Laboratory Research Enterprises, Inc. v Texas Township, MTT Docket No 55984, 69281, October 13, 1983.

FACTS:

Laboratory Research Enterprises petitioned the Michigan Tax Tribunal to review its 1981 and 1982 real property assessments. Petitioner operated an animal laboratory, research, and breading facility in Texas Township. The 55 acre facility contained eleven buildings used in conjunction with the business and one farmhouse.

In 1979 and 1980, Respondent had changed its zoning ordinance. One change eliminated the "grandfather clause" which had permitted agricultural uses on parcels zoned R-1. Petitioner, who was affected by the change, filed suit against the township. A consent judgment resulted which granted the Petitioner building permits to complete a number of building projects but restricted the operations and further expansion of the facility.

The Petitioner adopted the cost approach to valuation and contended that the zoning restrictions rendered all the improvements on the property worthless, except for the dwelling. The Petitioner valued the parcel at $45,000. The Petitioners appraisal concluded that there was no market for the subject property due to the restrictions and assigned 100% of the building improvement value to economic obsolescence. Respondent argued that the zoning restriction did not affect the value of the property and determined the value to be $882,000.

HELD:

The Tribunal first found that there was a market for the Petitioner's property for use as an animal research and breading facility. The Tribunal also found that the Petitioner's facility was one of the best adapted physical plants in the industry with a potential market for the property composed of competitors of the Petitioner or newcomers to the industry.

The Tribunal next considered the impact of the zoning restrictions on the market value of the property. The Tribunal found that the use restrictions would limit the growth of the facility. The Township argued that the Petitioner's abandonment of its legal challenge to the change in zoning demonstrates the Petitioner's consent to the restrictions on future growth. The Tribunal, however, concluded that the abandonment of the suit does not change the effect of the restriction on the property. Therefore, the Tribunal held that the legal restrictions would result in a market price less than what the Petitioner would receive for the same property absent the governmental restrictions. Further, it was decided that the economic obsolescence factor imposed on the parcel by the non-confirming use zoning classification and the attendant use restriciton was 42%.

The Tribunal noted that effects of a zoning classification would vary upon the facts of the case. The Tribunal cautioned that this case does not stand for the proposition that a non-conforming use zoning classification will always (or even usually) result in diminution in value.

LEGISLATIVE UPDATE

1.	PA 254 Property	Sublessors or tenants will be subject to property tax on the incremental value resulting from a sublease or physical change in leased property.
2.	HP 5029, 5030 Sales	These bills would impose the sales tax upon sales of "canned" computer software but exempt sales of custom software from the tax.
3.	HP 4463	Lump-sum distributions from retirement plans which are reported for federal income tax purposes on the ten-year averaging method, presently not subject to the Michigan income tax, would become taxable.
4.	HB 5201 Tax Tribunal	Codifies the fee schedule of the Michigan Tax Tribunal.
5.	SB 583	Provides an express exclusion of social security benefits from Michigan taxable income, continuing present law.

UPCOMING LEGISLATION

The Michigan Tax Journal has learned that the legislature may be considering action in the next few months concerning the following subjects:

1. Definition of household income for purposes of the property tax credit circuit breaker.
2. Change of tax day from December 31 to June 30.