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The *Michigan Tax Lawyer* is a quarterly 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 Eric T. Weiss, Esq., 27777 Franklin Road, Suite 1400, Southfield, Michigan 48034 (248) 355-5000.

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Disclaimer

TAXATION SECTION

STATE BAR  OF MICHIGAN

May 15, 1997

Dear Taxation Section Members:

By the time you read this, my term as Chairperson of the Taxation Section will have come to an end. I wish to thank all of the people who helped make this a very enjoyable and successful year, including my fellow officers, George Gregory and Robert Stead. George and Bob will both do an excellent job in the upcoming years guiding the Section to additional and continued successes.

This organization could not survive without the huge expenditures of time given by the Council Members and the Committee Chairs. I would like to personally thank the three Committee Chairs who have completed their two year term: Eric N. Nemeth as Chairperson of the Practice and Procedure Committee, Sherill Siebert as Chairperson of the Employee Benefits Committee, and Anthony Ilardi as Chairperson of the Partnership Committee, for the wonderful jobs they did for the past two years. I am certain that their successors will continue the leadership exhibited. Many thanks for the time devoted to this significant task.

Our Summer Tax Conference was the most successful event yet with over 100 attendees. This was due in large part to the efforts of Joe Bonventre, Karen Nizol, our facilitator, and Gregory Nowak. I would like to personally thank the three of them for the efforts expended in this successful endeavor.

Lastly, I would like to thank all of you who are involved in the Taxation Section. Your involvement continues to make this one of the most vibrant taxation sections in the country, both in terms of professional education offered, publications presented, and the relationship of the Michigan State Bar with the taxing authorities, both federal and state.

I thank you all for having had this opportunity to serve and look forward to continuing to be active in the Taxation Section.

Cordially,

STATE BAR OF MICHIGAN
TAXATION SECTION

By: _____
Stephen M. Feldman, Chairperson

Report of the Corporation Committee

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1. July 17, 1997 Meeting.
The Corporation Committee held a joint meeting with the Partnership Committee and the Real Property Law Section Committee on Federal Tax Aspects of Real Estate Transactions on July 17, 1997. The primary topic at this meeting was the recent amendment of the Michigan Limited Liability Company statutes. These changes were motivated primarily by the adoption of the "Check-the-box" Regulations by the Internal Revenue Service effective 1/1/97. These Regulations generally allow noncorporate entities to choose between corporate and partnership tax treatment regardless of the presence of corporate characteristics. The corporate characteristics which were used to classify noncorporate entities for federal tax purposes under the old rules included limited liability, transferability, continuity and centralized management. Under the old classification rules, noncorporate entities desiring partnership tax treatment were permitted to adopt no more than two of these corporate characteristics. The original Michigan Limited Liability Company statute was "bulletproof" because it permitted the adoption of only one corporate characteristic in addition to limited liability. The amended Michigan statute has eliminated this "bulletproof" feature in recognition of the new "check-the-box" system, and therefore permits substantially greater flexibility in establishing these entities. The amended statute also permits single member Limited Liability Companies, and eliminates the Sec. 2704(b) valuation discount problem found with the original statute.

2. Annual Meeting.
The Committee's last meeting was held in connection with the annual State Bar of Michigan Convention on September 18, 1997 at Cobo Hall in Detroit. The featured speaker at the meeting was Mr. Samuel Starr, a nationally recognized expert on S Corporations, Limited Liability Companies and related issues who is a partner with the Coopers & Lybrand Washington , D.C. office. He is the author of *Tax Management Portfolios* dealing with these entities, as well as many other publications. His topic at the Annual Meeting was "Choice of Entity Issues for the Twenty-first Century." Mr. Starr also spoke at our Corporation Committee meeting and discussed various current issues and follow-up questions from the morning meeting.

3. *Michigan Tax Lawyer* Article.
The Corporation Committee will submit an article for an upcoming issue of the *Michigan Tax Lawyer* by November 15, 1997. I would welcome volunteers to prepare this article. Please contact me at (313) 963-2500 if you are interested.

Report of the Employee Benefits Committee

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1. Chairperson's Message.
This is my final report as Committee Chairperson. It has been an exhilarating and exciting two years. For that I wish to thank you all for your participation in Committee activities

and attendance at Committee meetings during my term. So many of you have volunteered to write articles, make presentations and otherwise further the Committee's purposes that it has been a real pleasure for me to have been able to serve you as Chairperson.

I am happy to inform you that Charles "Chuck" Lax will be the new Chairperson effective October 1, 1997. Chuck has been an active member of the Committee for many years and I hope you will join me in welcoming him to his new position. Please give Chuck the continued support and enthusiastic participation that you exhibited these past two years.

2. Recent Activities.
The Committee's last meeting was held on September 18, 1997 in conjunction with the State Bar Annual Meeting in Detroit. Joan Sweeney and other representatives from the IRS Northeast Region Key District, EP/EO Division, presented an update on various current issues.

3. Future Schedule.
Please take the opportunity to contact Chuck with topics you would like to see covered at future Committee meetings. In the meantime, watch your mail and future issues of the *Michigan Tax Lawyer* for notices of upcoming meetings.

Report of Estates and Trusts Committee

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1. Chairperson's Message.
The Committee is continuing to monitor federal legislative changes regarding estate and gift tax matters. A discussion of the recently-enacted legislation will be a topic for an upcoming Committee Meeting.

2. Recent Activities.
Our last Committee Meeting took place on September 18, 1997, at the State Bar of Michigan 62nd Annual Conference held at the Cobo Conference/Exhibition Center and Crowne Plaza Ponchartrain. Brian Trindell, Manager of the Estate and Gift Tax Group of the Internal Revenue Service in Detroit, gave an excellent presentation on current topics from the standpoint of the Internal Revenue Service. On behalf of the Estates and Trusts Committee and myself, I want to thank Brian, for his taking the time and effort to attend our meeting and make his presentation.

A subsequent meeting is in the planning stages that will address probate, estate and tax administration when a corporate fiduciary is involved, as well as the recently enacted tax legislation.

3. Recently Enacted Tax Legislation.
As you know, the President signed the Taxpayer Relief Act of 1997 into law on August 5, 1997. Among many other changes, the new law increases the unified credit-equivalent to $625,000 for decedents dying, and gifts made, in 1998, $650,000 in 1999, $675,000 in 2000 and 2001, $700,000 in 2002 and 2003, $850,000 in 2004, $950,000 in 2005, and $1,000,000 in 2006 and thereafter.

There is limited, special estate tax relief for certain "qualified family-owned businesses"; "qualified conservation easements"; provisions to adjust the annual gift tax exclusion, the $1 Million generation-skipping tax exemption, and certain other provisions for inflation; as well as other provisions of interest to individuals, estates and trusts.

Report of the International Tax Law Committee

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1. International Provisions of The 1997 Act.

The Taxpayer Relief Act of 1997 (the "Act") included significant international provisions, which are summarized in part below:

FSC Benefits Extended To Computer Software—This provision prospectively reverses the IRS position that computer software will not qualify as export property eligible for FSC benefits if it is exported in a form which allowed it to be copied for resale after exportation. The change applies to gross receipts from computer software licenses in taxable years ending after December 31, 1997.

Subpart F and PFIC Overlap Eliminated For U.S. Shareholder In CFCs—Pursuant to the Act, the passive foreign investment company ("PFIC") provisions will generally no longer apply to U.S. shareholders (owners of 10% or more of the stock) of a controlled foreign corporation ("CFC"). This provision is generally effective for periods after December 31, 1997. However, the change will not apply if the CFC was a PFIC before such date, unless the U.S. shareholder already had a QEF election in place, or subsequently makes a purging election.

Section 1248 Changes—The Act amends section 1248 to provide for the recharacterization of gain recognized by a CFC on the sale of the stock of a lower-tier CFC as a dividend. Such gain will now be recharacterized as a dividend to the same extent as if the selling CFC were a U.S. person. While the gain is recharacterized as a dividend from the lower-tier CFC to the higher tier CFC, the Act provides that it cannot qualify for the same-country dividend exception from subpart F income. In addition, the Act reduces the amount of subpart F income of a new U.S. shareholder by treating any section 1248 deemed dividends as actual dividends paid to the seller. Both these change are applicable to gain recognized or acquisitions occurring after the date of enactment of the Act.

Limit on Foreign Tax Credits Resulting From Deemed Section 304 Dividends—The Act denies a U.S. corporation a foreign tax credit attributable to a deemed section 304 dividend on certain sales by the U.S. corporation of a foreign subsidiary's stock to a related foreign corporation. The Act provides that a foreign tax credit will only be allowed if the earnings of the foreign acquiring corporation are attributable to the stock of the U.S. corporation seller (or a related U.S. person) and were accumulated during periods in which the acquiring foreign corporation was a CFC and the U.S. shareholder owned its stock. This new limitation is applicable to acquisitions or distributions made after June 8, 1997.

Indirect Foreign Tax Credit Extended Through The Sixth Tier—The Act extends to U.S. shareholders indirect foreign tax credits for certain taxes paid or accrued by lower-tier foreign corporations in the fourth, fifth or sixth tiers in specified circumstances. In order to qualify, the fourth through sixth tier foreign corporation must be a CFC, the foreign taxes must have been paid when it was a CFC and it must meet the usual ownership requirement to qualify taxes paid by such lower-tier foreign corporations for indirect credits. In addition, the Act provides that indirect credits will be denied if these requirements have not been

met at the time the foreign income taxes are incurred, even if a subsequent reorganization causes the foreign corporation to meet such requirements. This provision is effective for foreign income taxes paid or accrued during the foreign corporation's taxable years beginning after the date of enactment of the Act.

New Holding Period Requirement For Foreign Tax Credits—The Act denies a U.S. shareholder the foreign tax credit otherwise allowable if the shareholder has not held the stock for a new minimum holding period (during which the shareholder is not protected from the risk of loss) of 15 full days for common (45 full days for preferred) stock before the ex-dividend date. The new provision applies to dividends paid or accrued more than 30 days after the date of enactment of the Act.

10/50 Basket Phased Out—Under the Act, a U.S. shareholder will combine dividends of pre-2003 foreign source earnings from 10/50 basket foreign companies (i.e., the U.S. shareholder owns at least 10% and less than 50% of the stock) which are not PFICs into a single foreign tax credit basket for dividends paid after December 31, 2002. Dividends of earnings accumulated prior to the year 2003 from each 10/50 basket company will continue to be in separate baskets if they are paid prior to January 1, 2003 (or if the 10/50 basket company is a PFIC). Thus, dividend repatriation strategies for each 10/50 basket company should be carefully planned out well in advance of December 31, 2002.

Rules similar to the look-through rules now applicable only to CFCs will be extended to the earnings of 10/50 basket companies accumulated after December 31, 2002. Moreover, a U.S. shareholder is no longer required to treat pre-acquisition earnings of a CFC as in a separate 10/50 basket for distributions after the date of enactment of the Act. However, the Act grants the IRS regulatory authority to address the treatment of "distributions out of earnings and profits for periods prior to the taxpayer's acquisition of such stock" under this new look-through provision.

Section 1491 Excise Tax Is Repealed—The Act repeals the section 1491 excise tax on transfers of appreciated property to a foreign partnership. The repeal is effective on the date of enactment of the Act.

2. Recent Committee Meeting. On September 18, 1997, the International Tax Committee held a meeting as part of the annual meeting of the Tax Section at Cobo Hall in Detroit. Jim Fuller, a partner in the law firm of Fenwick & West, Palo Alto, California, was the featured speaker and gave an excellent presentation on U.S. International Tax Developments, including a discussion of the international provisions included in the Taxpayer Relief Act of 1997.

Report of the Partnership Committee

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1. Recent Activities.
The Partnership Committee held joint meetings with the Corporation Committee and the Federal Tax Aspects of Real Estate Committee of the Real Property Law Section in June and July.

The June meeting topics included discussion of the new § 708 regulations and the new § 1402 regulations. We also discussed recent proposals amending subchapter K. The principal focus of the July meeting was on the recently adopted Michigan LLC Act amendments.

Sam Starr, from Coopers & Lybrand in Washington, D.C., spoke at the Partnership and Corporation Committee Meeting at the Annual State Bar Meeting in Detroit. Mr. Starr was also the Section's keynote speaker. He gave an excellent presentation on S corporations and other pass-through entities.

2. Recent Developments.
The Taxpayer Relief Act of 1997 contains a number of provisions affecting partnerships. Some of the amendments of which practitioners should be aware include:

- *Section 731* is amended to change the method of allocating basis of properties distributed to a partner. Under prior law, in a nonliquidating distribution, the partner took a carryover basis in the distributed property. In a liquidating distribution, the basis of the distributed property is the partner's basis in the partnership interest. Where multiple properties were distributed, the basis would be allocated in accordance with the partnership's basis. Thus, in a liquidating distribution, the distributee could receive a basis in the property in excess of the partnership's basis.

  Under the new rules, liquidating and nonliquidating distributions are treated the same. Basis is first allocated to the assets to the extent of the partnership's basis in the asset. Next, basis adjustment is allocated in accordance with unrealized appreciation (to the extent of the unrealized appreciation); the balance is allocated in accordance with fair market values. *Effective for distributions after the date of enactment.*
- *Section 751* is amended to eliminate the requirement that inventory be substantially appreciated to give rise to ordinary income. Effective for sales or exchanges after the date of enactment *(with transition rules for certain binding contracts).*
- *Section 704(c)(1)(B)* and *Section 737* are amended to provide that if built-in gain property is contributed and distributed to another partner or the contributing partner receives a distribution of other property within 7 years, rather than within 5 years under prior law, gain will be recognized. *Effective for property contributed after June 8, 1997.*
- *Section 706* is amended to provide that the partnership year will be closed with respect to a deceased partner. Under prior law, the deceased partner's "successor" took into account all partnership items. Thus, items that would be included in the deceased partner's final return, without careful planning, would not offset partnership items. *Effective for partnership taxable*

years beginning after December 31, 1997.

Practitioners should also note that significant flow-through and audit procedure changes were made for electing "large partnerships," generally, partnerships with 100 or more partners. Changes were also made to the investment company rules under Section 7351, which also affects partnerships under Section 721(b).

Last, and perhaps easily overlooked: The proposed regulations on classification of limited partners for *self-employment tax* purposes may be in doubt. The 1997 Act provides that any regulations relating to the definition of limited partner for self-employment tax purposes shall not be issued or effective before July 1, 1998. The Senate had wanted to withdraw the proposed regulations and have Congress determine the rules.

Report of the Practice and Procedure Committee

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I greatly enjoyed the last two years as Chairperson and had an opportunity to make many new friends both inside and outside the Internal Revenue Service and renewed old acquaintances at the same time. I hope that our seminars and meetings have presented opportunities for individuals from both the private sector and government sector to share information and ideas in a constructive and non-confrontational environment. I am very excited that Aaron Sherbin of Finkel, Whitefield, Selik, Raymond, Ferrara & Feldman, P.C. has agreed to assume the duties of Chairmanperson of this Committee. I have had the pleasure of knowing Mr. Sherbin for several years and am confident that he will do an excellent job on behalf of the Committee and its members. I can assure each of you that I will work diligently to make the transition as smooth as possible.

1. Recent Activities.

The last Committee meeting of the Practice and Procedure Section was a joint meeting with the State and Local Section held in conjunction with the State Bar Annual Convention in Detroit on September 18, 1997. See the Report of the Chairperson of the State and Local Section for additional details.

2. Recent Developments.

By far and away the largest development in the Practice and Procedure area was the passage of the Taxpayer Relief Act of 1997. The Act contains a multitude of provisions in every area of tax practice from computation of capital gains, state and gift issues, estate and gift tax issues, various areas of income tax relief and administrative matters. The provisions of the Act are too numerous to analyze here. It is anticipated that each of the Sections will address its specific topic throughout the coming year.

On an unrelated matter, the IRS Director of Practice recently stated that tax practitioners, such as tax attorneys, accountants, and enrolled agents face "certain" suspension for failure to pay payroll taxes. Essentially, a word to the wise.

Report of the State and Local Tax Committee

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1. Next Meeting.
The Committee's last meeting took place in Detroit in conjunction with the annual meeting of the State Bar of Michigan. B.D. Copping, the Department of Treasury's newly-appointed Revenue Commissioner, and Madhu Anderson, the Department's Chief Deputy Treasurer, presented an update on various state tax issues. The Committee also will meet in October at a location to be announced in Detroit for a round-table discussion of hot SALT topics.

2. Thiokol Update.
The United States Supreme Court denied the taxpayers' petition for a writ of certiorari in *Thiokol Corp* v *Dep't of Treasury*, Supreme Court Docket No. 95-1913 on June 9, 1997. Those cases that have been held in abeyance pending Thiokol in the Michigan Court of Claims and Michigan Tax Tribunal are in the process of being identified and dismissed.

3. Legislative Activity.
We have compiled a listing of all legislative tax-related activity that has occurred thus far in 1997 to make available to all Committee members. Please contact the Committee chair if you would like a copy of the list.

Plan Expenses: To Pay with Plan Assets or Not to Pay with Plan Assets–That is the Question

Dennis M. Doherty and Melissa Davis-Hartranft

A variety of expenses are associated with maintaining an employee benefit plan and employers frequently ask what types of expenses may be charged directly to the plan instead of to the employer. While plan assets may be used to pay certain administrative expenses, the use of plan assets to pay other expenses is improper. If the assets are used improperly, a prohibited transaction may occur and, in the case of a tax-qualified plan, its tax-qualified status may be jeopardized. The employer or fiduciary[1] of a plan may be liable for any penalties that accompany a prohibited transaction and/or a plan's disqualification.

In order to appreciate the severity of the consequences that may arise if plan assets are improperly used to pay expenses, it is first necessary to understand the restrictions that the Employee Retirement Income Security Act of 1974, as amended ("ERISA")[2] places on fiduciaries regarding the use of plan assets to pay administrative expenses. Once the ERISA framework is established, this article will discuss guidance provided by the Department of Labor ("DOL") in an effort to aid plan fiduciaries in differentiating between those expenses that may be paid with plan assets and those that may not. Finally, this article will discuss the consequences of improperly using plan assets to pay expenses.

Statutory Framework

Section 403(c)(1) of ERISA states that plan assets must be held for the exclusive purposes of providing benefits to plan participants and beneficiaries and defraying reasonable expenses of administering the plan. In addition, ERISA prohibits plan assets from ever inuring to the benefit of an employer.[3] ERISA also imposes an obligation on a plan fiduciary to discharge his duties for the exclusive purposes of providing benefits to plan participants and beneficiaries and defraying reasonable expenses of administering the plan.[4] In addition, a plan fiduciary must discharge his duties while acting in accordance with the documents that govern the plan.[5]

While plan assets may be used to pay certain administrative expenses, the use of plan assets to pay other expenses is improper.

Analyzing Whether Expenses May be Paid with Plan Assets

While ERISA contains a general statement that plan assets may be used to defray the reasonable expenses of administering a plan, the statute does not provide specific guidance on the types of expenses that may be classified as "reasonable expenses of administering a plan." Plan fiduciaries often seek guidance from the Department of Labor ("DOL") on whether plan assets may be used to pay certain expenses. However, the DOL usually will not issue an opinion letter on whether a plan expense may be classified as a "reasonable expense of administering a plan" thereby allowing plan assets to be used to pay for the expense. Instead, the DOL takes the position that a factual determination must be made on a case by case basis to determine if an expense may be classified as a "reasonable expense of administering a plan."[6] However, the DOL recently issued an opinion letter, which provides specific guidance on the use of plan assets to pay certain plan termination expenses, thereby shedding some light on its view of what constitutes reasonable administrative expenses.[7]

...a fiduciary must examine each expense to determine if it constitutes "a reasonable expense of administering a plan."

A. Examination of Plan Document

As stated earlier, a plan fiduciary must discharge his duties in accordance with the documents that govern a plan.[8] In response to a request for guidance on whether it was proper to use plan assets to pay certain termination expenses, the DOL examined the plan document to determine if it contained a provision permitting the plan to use plan assets to pay administrative expenses. Although this particular plan contained a provision which stated that plan assets could be used to pay expenses, the DOL stated that even if a plan document is silent on the issue, plan assets may be used to pay reasonable administrative expenses.[9] However, the DOL implied that if a plan does not contain a provision that permits plan assets to be used to pay reasonable administrative expenses, an employer should amend its plan prospectively so it explicitly contains such a provision.[10]

B. Reasonable Administrative Expenses

Assuming a plan document states that plan assets may be used to pay reasonable administrative expenses, a fiduciary must examine each expense to determine if it constitutes "a *reasonable* expense of administering a plan." A fiduciary must make this determination in light of the following fiduciary duties: plan assets must never inure to the benefit of an employer and fiduciaries must act solely in the interest of a plan's participants and beneficiaries.[11] The DOL has stated that "reasonable expenses of administering a plan" include those direct expenses that properly and actually are incurred when a fiduciary discharges his duties with respect to a plan.[12]

1. Improper Use of Plan Assets to Pay Expenses

The DOL has long taken the position that certain "settlor" functions relate to the business activities of an employer and the employer, in the normal course of its business, reasonably is expected to bear the costs associated with performing settlor functions. Consequently, plan assets may not be used to pay for those particular expenses. When an employer decides whether or not to establish or terminate an employee benefit plan, the employer is performing a settlor function and reasonably is expected to bear the costs that arise from making that decision. For example, if an employer is deciding if it should establish a plan, an employer may incur expenses for the legal, consulting, and actuarial advice that it receives. The employer receives such advice because the issues surrounding the employer's decision relate to the employer's business. Therefore, it is reasonable to expect the employer to pay for those legal, consulting and actuarial services and plan assets may not be used to pay for such expenses.

2. Proper Use of Plan Assets to Pay Expenses

The DOL has stated that an expense will be considered to be "a reasonable expense of administering a plan" if the expense: 1) is sustained only because a service is provided

to a plan; 2) properly can be allocated to a particular service provided to a plan; and 3) does not represent an allocable portion of employer overhead costs.[13] If an expense may be classified as a reasonable expense of administering a plan, the expense may be paid with plan assets. For example, if the three conditions stated above are satisfied, plan assets may be used to pay for telephone calls, travel expenses, computer costs, printing charges, mailing costs, and office supply costs that are incurred in connection with providing services to a plan.[14] In addition, it also appears that plan assets may be used to pay the salaries and fringe benefits of employees whose sole duties involve providing administrative services to a plan, provided the three above-stated conditions are met.[15]

On the other hand, a plan fiduciary who is receiving full-time employee compensation from a plan sponsor also cannot be compensated from the plan.[16] Such "in-house" fiduciaries only may be reimbursed for those direct expenses[17] that actually are incurred in connection with the establishment or administration of the plan.[18] For example, a company accountant who is a plan fiduciary and is receiving full-time pay from her employer could not receive compensation from the plan to prepare plan allocations. However, the accountant could be reimbursed by the plan for any direct expenses she incurs in her role as a plan fiduciary (e.g., employee benefit plan seminar fees).

ERISA Opinion Letter 97-03A

In its request for an opinion letter from the DOL regarding the payment of certain termination expenses with plan assets, the Insurance Commissioner of California stated that outside legal counsel:
1) amended the plan to comply with regulatory, legislative and case law developments; 2) audited the plan; 3) prepared and filed annual statements; 4) prepared benefit statements and calculated accrued benefits; 5) notified participants and beneficiaries of their benefits under the plan; and 6) requested an IRS determination letter regarding the plan's tax-qualified status upon its termination.[19] The Insurance Commissioner of California wanted to use plan assets to pay the legal expenses incurred in rendering such services.

In its analysis, the DOL distinguished between a decision to terminate a plan and those activities that are undertaken to implement a plan termination. A decision to terminate a plan relates to an employer's business and is classified as a settlor function. In contrast, activities undertaken to implement a plan termination are fiduciary functions and plan assets may be used to pay for reasonable expenses that arise from the performance of such activities.

The Insurance Commissioner of California stated that after the decision was made to terminate the plan, the outside legal counsel conducted an audit of the plan, prepared and filed a final annual report, calculated accrued benefits, and sent statements to participants and beneficiaries to notify them of the plan's termination and their benefits under the plan. The above-stated activities were carried out to ensure an effective termination of the plan; these activities were not part of the employer's ordinary course of business and the employer did not benefit from their performance.

Such "in-house" fiduciaries only may be reimbursed for those direct expenses

Rather, the expenses were sustained because certain termination services were provided on behalf of the plan and were allocable to the plan; the expenses did not represent an allocable portion of employer overhead costs. Thus, the DOL stated that the expenses associated with these services could be classified as "reasonable expenses of administering the plan" and plan assets could be used to pay them.[20]

A fiduciary must proceed with extreme caution if a certain expense falls into the "gray area"

In contrast with those activities described above, both participants in a plan and the plan's employer/sponsor enjoy benefits that are associated with the tax-qualified status of a plan. Consequently, the DOL stated that the Insurance Commissioner of California could use plan assets to pay only a portion of the expenses that were attributed to maintaining the tax-qualified status of a plan. Thus, the expenses incurred to amend the plan to maintain its tax-qualified status upon termination, and any expenses associated with requesting a favorable IRS determination letter, must be allocated among the plan and the employer/sponsor. Furthermore, the DOL noted that it often will be necessary to obtain the opinion of an independent fiduciary to determine exactly how the expenses should be allocated.[21] Unfortunately, the DOL did not provide specific guidance as to how such expenses should be allocated.

Gray Areas

As stated earlier, an expense may be classified as "a reasonable expense of administering a plan" if the following three conditions are satisfied: 1) the expense is sustained only because a service is provided to a plan; 2) the expense properly can be allocated to a particular service provided to a plan; and 3) the expense does not represent an allocable portion of employer overhead costs. Upon examination of a certain expense, it may be unclear if it satisfies each of the three above-stated conditions.

A fiduciary must proceed with extreme caution if a certain expense falls into the "gray area" in order to avoid engaging in a prohibited transaction. Examples of types of expenses that may fall into this "gray area" include: fees for revising a plan's integration formula to comply with the law; fees that relate to the addition or elimination of a benefit payment option, investment feature, loan program, or hardship withdrawal provision; actuarial, legal or consulting fees charged for analyzing or adjusting a plan's funding assumptions; and actuarial fees relating to the computation of a plan's maximum funding limitation.

The facts and circumstances surrounding the nature of an expense must be scrutinized to determine whether (and to what extent) the expense is chargeable to the plan. If plan assets are used to pay an expense that is not chargeable to the plan, the payment will constitute a prohibited transaction and will jeopardize the plan's tax qualified status.

Prohibited Transactions

ERISA and the Internal Revenue Code of 1986, as amended (the "Code") prohibit most transactions between an employee benefit plan and parties related to the plan (e.g., the employer and service providers).[22] These related party transactions are referred to as "prohibited transactions" and include the plan's payment of expenses to a service provider. For example, Section 406(a)(1)(C) of ERISA prohibits a fiduciary from involving a plan in a transaction in which the fiduciary knows or should know that the transaction directly or indirectly furnishes goods, services, or facilities between the plan and a related party.[23] Similarly Section 406(a)(1)(D) of ERISA prohibits a fiduciary from transferring plan

assets to a related party of the plan.[24] Such transactions are prohibited even if the parties act in good faith[25] and the transaction is beneficial to the plan.[26]

Although it seems as if a plan fiduciary may have a difficult time authorizing the payment of expenses with plan assets without violating ERISA's prohibited transaction rules, ERISA provides for certain exceptions to these rules. Specifically, Section 408(b)(2) of ERISA provides an exemption for any contract or reasonable arrangement with a related party for office space, accounting, legal or other services that are necessary to establish and maintain a plan.[27] The DOL's regulations provide guidance as to what constitutes a "necessary service" and state that the compensation paid for such services must be reasonable. Furthermore, the terms of a contract entered into by the plan must be reasonable. For example, a reasonable contract is one which the plan can terminate on reasonably short notice.[28] Even if a contract contains a provision that permits the related party to recover any losses due to the plan's early termination, it still is considered a reasonable contract.[29] However, if a plan enters into a contract with a related party that is found to be unreasonable, unnecessary or provides for excessive compensation, a prohibited transaction will occur and penalties may be assessed.

Prohibited Transaction Penalties

Under ERISA and the Code, the primary penalties for engaging in a prohibited transaction are excise taxes, liability for damages[30], and civil penalties. The excise tax equals 15 percent[31] per year of the amount involved in the transaction.[32] In addition, unless the transaction is corrected by the earlier of (a) the date a notice of deficiency is mailed by the Internal Revenue Service, or (b) the date on which the 15 percent tax is assessed,[33] a 100 percent excise tax applies.[34] Both of these taxes are assessed against the party related to the plan who participated in the transaction (e.g., the employer and service provider).[35] In addition, the responsible plan fiduciary is liable for any losses to the plan and may be subject to a civil penalty of 20 percent of the amount recovered for the plan.[36] Examples of losses to the plan include lost earnings and, in the case of a tax-qualified plan, could include the costs of plan disqualification.[37]

Specifically, Section 408(b)(2) of ERISA provides an exemption

Who is the Client?

As stated earlier, only a portion of plan assets may be used to pay for legal services that benefit both the plan and another party (e.g., the employer). However, a question may arise regarding who the client is whenever legal fees are paid with plan assets. Employers often believe that they are the attorney's client because they select the attorney to be used for the company's employee benefit plan matters. However, if legal fees are paid with plan assets, courts have held that an attorney-client relationship exists between the plan and the attorney.[38] The significance of this relationship is that it grants the plan and its beneficiaries access to attorney work product and communications between the attorney and the employer.

Conclusion

In general, if a plan expense is motivated by a business purpose or is one that is incurred in the normal course of an employer's business, it cannot be paid from plan assets even if participants may benefit from the payment. On the other hand, if the plan expense is necessary in the operation or administration of the plan and allocable to the plan, any benefit to the employer is incidental

and does not represent the employer's overhead costs. No payment is to be made to the employer or "in house" fiduciaries other than as a reimbursement of direct expenses and, if such expense is reasonable, it may be paid from plan assets. Clearly, the facts and circumstances surrounding the nature of an expense must be scrutinized to determine whether (and to what extent) the expense is chargeable to the plan or to the employer.

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ENDNOTES

1. A person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. 29 U.S.C. §1003(21)(A).
2. 29 U.S.C. §1001 et. seq.
3. 29 U.S.C. §1103(c)(1).
4. 29 U.S.C. §1104(a)(1)(A).
5. "[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title and title IV." 29 U.S.C. §1104(a)(1)(D).
6. *See* Letter from Elliot Daniel to Kirk Maldonado (March 2, 1987). See also ERISA Op. Ltr. F-3273A (October 22, 1986).
7. ERISA Op. Ltr. 97-03A (January 23, 1997).
8. *See* supra note 5.
9. *See* supra note 7.
10. An employer may make such an amendment to its plan provided the employer has reserved the right to amend the plan. However, the employer must incur the costs associated with making such an amendment; plan assets MAY NOT be used to pay the expenses associated with making this particular amendment to a plan.
11. 29 U.S.C. §§1103(c)(1) and 1104(a)(1)(A).
12. In *Engelhart v. Consolidated Rail Corp.*, 1996 U.S. Dist. LEXIS 13610, at *37 (E.D. Pa. Sept. 16, 1996), plan assets were used to pay the following administrative expenses: 1) annual premium payments to the PBGC; 2) fees charged by plan actuaries for services related to administering the plan; 3) fees charged by plan consultants for services related to administering the plan; 4) fees charged by accountants for services related to administering the plan; 5) fees paid to the trustee or trustees of the plan; 6) fees charged by investment managers for investment of plan assets; and 7) fees charged by financial institutions for the disbursement of benefits paid out of the plan. See also ERISA Op. Ltr. 1995 ERISA LEXIS 22 (March 3, 1995) (requesting guidance on whether the following expenses may be classified as "reasonable expenses of administering a plan": 1) the fees of the plans' trustees; 2) a portion of the fees charged for outside actuarial services; and 3) the fees charged by outside investment managers and outside consultants).
13. ERISA Op. Ltr. 97-03A.
14. ERISA Op. Ltr. 1995 ERISA LEXIS 22 (March 3, 1995).
15. ERISA Op. Ltr. 89-09A (seeking guidance on the use of plan assets to pay the salaries and fringe benefits of company employees who devote 100% of their time to one or more of the company's benefit plans). *See* also, *Engelhart v. Consolidated Rail Corp.*, 1996 U.S. Dist. LEXIS 13610, at *38 (authorizing plan to pay salaries and fringe benefits of Consolidated Rail Corporation's employees who solely provided administrative services to the plan).

ENDNOTES (continued)

16. 29 U.S.C. §1108(c)(2); *Gilliam v. Edwards*, 492 F. Supp. 1255 (D.N.J. 1980)(union compensated full-time employee).
17. An expense is not a direct expense to the extent it would have been sustained had the service not been provided or if it represents an allocable portion of overhead costs. 29 C.F.R. §2550.408c-2(b)(3).
18. *See* supra note 16.
19. ERISA Op. Ltr. 97-03A.
20. *Id.*
21. *Id.*
22. Under ERISA, a party related to a plan is referred to as a "party in interest;" the terminology used under the Code is "disqualified person." The definition of a prohibited transaction under ERISA generally corresponds to the definition under the Code. This article addresses ERISA and uses ERISA terminology; it addresses the Code where necessary.
23. 29 U.S.C. §1106(a)(1)(C).
24. 29 U.S.C. §1106(a)(1)(D).
25. *E.g., Lowen v. Tower Asset Management, Inc.*, 829 F.2d 1209, 1213 (2d. Cir. 1987).
26. *E.g., Zabolotny v. Commissioner*, 97 T.C. 385 (1991), *aff'd in part and rev'd in part*, 7 F.3d 774 (8th Cir. 1993).
27. 29 U.S.C. §1108(b)(2).
28. 29 C.F.R. §2550.408b-2(c).
29. *Id.*
30. 29 U.S.C. §1132(a)(2).
31. For prohibited transactions occurring prior to August 21, 1996, the tax is five percent per year. However, the enactment of the Small Business Job Protection Act of 1996 raised the tax to 10 percent for prohibited transactions occurring on or after August 21, 1996, but prior to August 5, 1997. The Taxpayer Relief Act of 1997 once again raised the tax to 15 percent for prohibited transactions occurring on or after August 5, 1997. 26 U.S.C. §4975(a).
32. 26 U.S.C. §4975(a).
33. 26 U.S.C. §4975(b) and (f)(2).
34. 26 U.S.C. §4975(b).
35. 26 U.S.C. §4975.
36. 29 U.S.C. §1132(l)(1).
37. The Taxpayer Relief Act of 1997 now permits a participant's benefit to be attached or assigned upon conviction of a crime against the plan or in the event of a breach of fiduciary duty.
38. *In Re: Gulf Pension Litigation*, 764 F. Supp. 1149 (S.D. Tex. 1991), *aff'd sub nom., Borst v. Chevron Corp.*, 36 F.3d 1308 (5th Cir. 1994), *cert. den.*, 115 S. Ct. 1699 (1995).

Bust-outs, Bleed-outs, and The Tax Gap: The Increasing Use of the Criminal Tax-Related Statutes in the Area of Bankruptcy Fraud

By: James M. Delehant

Overview

During the last decade, bankruptcy fraud has emerged as one of the most lucrative white collar crimes, and as a major cause of the huge amount of missing tax dollars known as the "Tax Gap." With over 1 million bankruptcies each year, many of which are fraudulent, and with the Internal Revenue Service being the largest and most frequent creditor, the drain on the Treasury has become enormous. Until recently, bankruptcy fraud was the sole realm of the FBI. The IRS, for the most part, remained an uneasy creditor in the civil courts and was content to sit on the sidelines in the criminal arena. But in the last several years the IRS has awakened to the fact that its arsenal of newly evolved tax, conspiracy, and money laundering statutes is not only an extremely potent weapon with which to fight bankruptcy crime, but that these statutes used in tandem, are almost custom-made for the sophisticated financial world of bankruptcy fraud.

...bankruptcy fraud has emerged as one of the most lucrative white collar crimes

Attorneys, accountants, and other bankruptcy practitioners need to be cognizant of the IRS's entry into the criminal area. This will have a far reaching effect on everyone: from the client who is considering bankruptcy as an option for the first time, to the "bust-out and bleed-out" artists who make a living out of going bankrupt. The rules of engagement have now changed.

The Nature of the Beast

Congress dramatically changed the bankruptcy law by passing the *Bankruptcy Reform Act of 1978*.[1] This Act repealed he previous Bankruptcy Act in its entirety. The new Act's intended purpose was to bring the bankruptcy system in line with modern commercial transactions and to encourage the entrepreneurial risk-taking required in a capitalistic society. In this spirit, Congress greatly liberalized the bankruptcy rules to give the unsuccessful risk taker much easier access to the bankruptcy court and the ensuing desired fresh start.

The liberalized rules accomplished their intended purpose. Nationwide, bankruptcy filings increased from 300,000 in 1980 to approximately 1 million in 1994.[2] Some estimates for 1996 are even higher.

However, this increase in filings has had a not so intended consequence. The Executive Office for the United States Trustees estimates that 10 percent of bankruptcy filings involve some type of fraud[3]. Some practitioners believe that bankruptcy fraud is even much more pervasive. A Dallas-based accountant often hired by the courts to find bankruptcy fraud states: "In 100 percent of the bankruptcy cases I have seen, there has been some element of fraud. The size of the fraud usually depends on the size of the case."[4]

Therefore, in addition to allowing the honest businessman his fresh start, the new laws made it possible for unscrupulous debtors to use the system to take an unfair advantage of their creditors. In fact, it has even encouraged a whole new criminal element to spring up. Specialists in bankruptcy fraud, which includes members of traditional organized crime, have made going bankrupt into an art form. Two of their creations are known as "bust-outs and bleed-outs." Bust-outs occur where a business is set up for the express purpose of running up huge amounts of credit, diverting the inventory, and then filing for bankruptcy protection, or

"busting-out," leaving the creditors empty handed. Bleed-outs result from taking an otherwise legitimate company and slowly "bleeding" it dry with similar consequences for the unsuspecting creditors. In 1994, *Forbes Magazine* estimated that "bust-out operators probably account for at least $1 billion a year."[5]

The situation is made worse in some parts of the country where bankruptcy practitioners have formed tight-knit groups. Allegedly, in Dallas, a self-styled "Bankruptcy Club" at one time controlled the bankruptcy work in the area. Critics charged that they were a closely-knit insiders group that often short-changed creditors and debtors.[6] Whether this is true or not, one thing that is true is that the bankruptcy system handles billions of dollars in assets where the business is no longer in business. The professionals make their fees no matter who ends up with the leftover assets, and the creditors and creditors committees, with little chance of finding hidden assets, are reluctant to incur the cost of tracing them. Thus the incentives for those in the natural watch-dog role, if not non-existent, are at least greatly diminished. And also, the Office of the United States Trustee, which was created to help police this area, can at times be overwhelmed by the sheer number of filings. Because of these problems, bankruptcy has become an area, which, due to its vast wealth, liberal filing laws, and thinly stretched oversight, has attracted con-men, organized crime, and even to some extent unscrupulous bankruptcy professionals.

The Drain On The Treasury

Although there are no firm estimates of how much money bankruptcy fraud costs the taxpayers, it can be inferred from the facts that the number is quite substantial. The Internal Revenue Service is the largest and most frequent creditor. In 1996 the Treasury was owed over $12 billion dollars by bankruptcy debtors.[7] With a conservative estimate that of the 1 million bankruptcy filings, 10 percent contain some degree of fraud, the figure must be in the hundreds of millions of dollars. The $12 billion owed by bankruptcy debtors to the government is comprised of various debts, the largest being payroll taxes and other "trust fund" taxes, and corporate and personal income taxes. Of course the government does have its historic sovereign preference status in civil bankruptcy court. But over the last few years, even this has weakened. In an article entitled *The Tax Collector In Bankruptcy Court: The Government's Uneasy Role As Creditor In Bankruptcy*, the author, after thoroughly examining the weakening of the government's preferences in recent cases, concludes that *"This examination of the burgeoning case law dealing with points of tension between the tax law and the bankruptcy system leaves one with the clear impression that the bankruptcy environment is becoming increasingly inhospitable to the tax collector."*[8] Even the afforded preference status is of little value if the assets have been transferred, concealed, or the bankruptcy "carcass" has been picked clean by numerous other methods. The IRS, like all of the other creditors, is left out in the cold, hat in hand, with a "no asset case." The IRS Collection Officers, under pressure to collect more taxes per hour expended, often feel relief to be able to close the more complicated case out of inventory and, therefore, not waste time chasing well-hidden assets.

Thus, notwithstanding even the government's superior status, hundreds of millions of dollars are lost to the taxpayers each year because of bankruptcy fraud.

In 1996 the Treasury was owed over $12 billion dollars by bankruptcy debtors.

Changes In Attitude

Coincidentally, the emergence of the bankruptcy fraud problem occurred at the same time that the IRS changed its overall criminal strategy. After

being criticized by the General Accounting Office and others for spending too much effort on related financial crimes such as money laundering and narcotics, the IRS announced in May of 1996 that they were going to refocus on the "Tax Gap."[9] Assistant Commissioner of the Criminal Investigation Division, Donald Vogel, stated that the agency was shifting its focus back toward the tax gap, and would soon be spending about 60 percent of its time on pure tax cases. Instead of assisting other Federal agencies in investigating illegal organizations, they would be concentrating on illegal activity within legal industries. Earlier, at a panel conference on the shift in priorities, bankruptcy fraud had been identified as one of the major emerging areas of concern.[10]

Early Investigations

The criminal bankruptcy laws are the exclusive domain of the FBI.

The criminal bankruptcy laws are the exclusive domain of the FBI. Generally, these statutes prohibit the concealment of bankruptcy assets from the court, or the transferring of property in contemplation of bankruptcy.[11] The IRS does not investigate bankruptcy crime per se. Instead they investigate tax related crimes in the area of bankruptcy where the IRS is a major creditor. In the early 1990s, the IRS began joining Task Forces around the country to work with the FBI, the United States Trustee's Office, and other agencies to investigate bankruptcy fraud. Particularly successful Task Forces were developed in Chicago and Los Angeles.[12] The expertise gained from these early ventures became the basis for what was and is to follow. On February 29, 1996, Attorney General Janet Reno unveiled a nationwide crackdown to prosecute fraud and abuse in the federal bankruptcy system. The initiative, named "Operation Total Disclosure," produced charges against 125 defendants in 27 states. At the same time both the Justice Department and the IRS emphasized that there would be a major continuing effort in this area.[13]

The IRS's Role In The Task Force

The very nature of bankruptcy fraud is the hiding, concealing, and fraudulent transfer of large amounts of money and other assets. Very often the crime is perpetrated by sophisticated businessmen, with the aid of lawyers and accountants, using alter ego corporations, nominees, shell companies, offshore bank accounts, and other entities and devices that IRS agents are well accustomed to seeing. Bankruptcy fraud investigations essentially are "follow the paper trail, follow the money type" crimes. These are much the same techniques used in proving tax related crimes. In fact, in almost every case where there is bankruptcy fraud there is sure to be a tax related fraud. A person contemplating a fraudulent bankruptcy quite often stops making his payroll tax payments for the previous three quarters, or "pyramids' the payments in a "Ponzi" type scheme where he pays older liabilities with newly collected money. He then must lie to the Revenue Officer trying to collect the quarterly payroll taxes. He also begins transferring assets to related entities or family members often falsifying the company's books and records to conceal the nature of these transfers. The need to conceal these assets from the creditors and the court also require that this diverted income from the corporation not only be hidden or mislabeled on the corporate books, but also not be reported by the debtor-taxpayer himself. Also, the movement of the money usually requires the assistance of others who engage in a conspiracy to defraud or impede the government. In addition, this movement of money usually must be structured in amounts that will not cause the

banks to fill out the required currency transaction reports. And finally, the illegal gains from the bankruptcy crime are usually laundered in various ways.

This conduct is almost inevitable in every bankruptcy fraud. And this conduct is the exact same conduct that is prohibited in the statutes investigated by the IRS.

IRS's Arsenal of Weapons

At one time, the IRS investigated basically *pure* tax crimes. Again, coincidentally with the emergence of the bankruptcy and tax gap problems, the use of tax-related statutes has increased and their use has been in a state of evolution. Now, not only is the IRS investigating the pure Title 26 tax crimes, such as failure to file, tax evasion, failure to pay, and filing false returns, they are combining these with the conspiracy statutes, the Bank Secrecy Act laws, and the money laundering crimes. A look at the IRS's arsenal reveals the following weapons:

- Tax Evasion.....26 USC 7201
- Failure To File.....26 USC 7303
- Failure To Pay.....26 USC 7203
- Filing False Returns.....26 USC 7206(1)
- Aiding In The Preparation Of A False Return...26 USC 7206(2)
- Conspiracy.....18 USC 371
- Structuring Currency Transactions.....31 USC 5324
- Money Laundering.....18 USC 1956 & 1957
- Corrupt Obstruction.....26 USC 7212(a)
- Seizures of Assets.....18 USC 981

Just the use of any of these laws in a financial crime can have a great impact. But the real power of these statutes is in their ability to be used in combinations and in subtle ways. They can be used to not only charge the taxpayer-debtor with the tax related crime, but they can be used in an "organizational approach" to bring sanctions against everyone involved in the bankruptcy scheme, cut off possible defenses to the substantive bankruptcy offense, emphasize the luxurious lifestyle of the debtor who cheated his creditors, and bring out other bad acts committed by the defendants.

The Pure Tax Statutes

By placing a typical bankruptcy scheme in juxtaposition to the criminal tax-related statutes, the real power of this approach can hopefully be appreciated.

In an article entitled *The Looting of Chatham*, which describes the conviction of the owner of the Chatham Super Market Chain after a ten week trial in 1991 on tax and bankruptcy charges, the effect of the IRS statutes in an actual case can be seen.[14]

The target of the investigation came to Michigan in the early 1980s as a "white knight" who would rescue the failing super market chain. He was an influential businessman who associated with governors, congressmen, ambassadors, and was even a one-time business partner with war hero Audie Murphy. However, as described in the article, his "white knight" status didn't last:

> *"In fact, despite his claims to the contrary, he had earlier been paid $50,000 a month during Chatham's dramatic free fall into bankruptcy. But that was chumpchange compared to the more than $7 million he plundered from the company during his single year at the helm, when the real task he had set for himself was to get as much as he could in phony stock-option transfers, supplier kickbacks, and the sale of land, buildings and equipment that didn't belong to him."*

The kickbacks were uncovered during an IRS civil audit, which led to a joint IRS-FBI investigation totaling 4,000 man-hours, thousands of docu-

But the real power of these statutes is in their ability to be used in combinations and in subtle ways.

ments, 250 witnesses, and 3 separate grand juries. In addition to the one count of bankruptcy fraud, he was charged with tax evasion, filing false returns, and obstructing an IRS investigation. Thus, all of the schemes he used to "milk" the Chatham Corporation were also violations of the IRS statutes.

In short, the jury was allowed to see ...the lavish, extravagant way the money was used.

In proving the tax charges, evidence was admitted showing his luxurious lifestyle. Witnesses testified about his homes in Maryland, Florida, and Michigan. The jury saw his $18 million dollar financial statement and heard about lavish expenditures. They saw checks from Chatham for his swimming pool water, his $575-a-day vacation hotel room, his limousine rentals, the purchase of two large-screen TVs for $5,100, and his daughter's trip to Tokyo. In short, the jury was allowed to see not only the damage done to Chatham and the resulting two thousand unemployed workers that the bankruptcy caused, but the lavish, extravagant way the money was used.

The tax charges complimented the bankruptcy charges. Bankruptcy concentrates on the damage done to the creditors, the company, and the employees. False corporate tax return charges emphasizes the schemes used to "milk" the money out of the corporation. And tax evasion shines a bright light that illuminates the dark corners of greed.

In this case, the combination of these statutes was devastating. The jury quickly returned their verdict. He was found guilty on all ten counts.

A recent article published in the *American Bankruptcy Institute Journal* entitled *"The IRS Responds to Bankruptcy Fraud: A Case Study"* explores a hypothetical bankruptcy and the techniques used by a hypothetical IRS agent to follow the assets.[15] The analytical skills used by the agent in tediously following the leads derived from the checks, the brokerage account statements, the long distance telephone bills, and other documents are shown coupled with the forensic laboratory and computer abilities that the IRS can bring to the investigation. These techniques are shown against a backdrop of bankruptcy court hearings where the creditors can question the debtor without the need for the Miranda advise of rights, and where the investigators can follow the leads supplied by the debtor's own testimony.

From these examples it can be seen that in almost every bankruptcy fraud situation, tax laws are violated, and that by combining the tax and bankruptcy laws in the indictment a synergistic effect occurs.

The Web and the Keel

This synergy is even more enhanced when the Federal conspiracy statute is combined with the tax and bankruptcy charges.[16]

The power of this statute, commonly referred to as a "Kline-type" conspiracy, is well known. In an article titled *"Conspiracy to Defraud the IRS: The Importance of Being Particular"* the author leads with the following:

> *"As part of the Government's intensifying war on tax evasion, the IRS and the U.S. Department of Justice with increasing frequency have selected the "conspiracy to defraud" statute as their prosecution vehicle. From the Government's viewpoint, prosecuting tax fraud and tax-related crimes under the conspiracy statute has substantial legal, evidentiary and tactical advantages."*[17]

He then lists all of the advantages to the government and all of the problems facing the defense including:

1. The statute of limitations is lengthened in that it does not start to run until the last overt act has been committed.
2. The government need not prove

a tax deficiency as they must for tax evasion.
3. Jury instructions tend to be lengthy and confusing.
4. The indictment can be laced with a multitude of sinister sounding overt acts.
5. The defendant is liable for the acts of the co-conspirators and their statements are admissible against the defendant.
6. The indictment can be drafted in broad language that allows the government to "bob and weave" and change its strategy as it goes.

The wide web that a conspiracy statute casts is well known. It in effect allows the government to use an "organizational approach" and indict not only the main subject, but his whole "organization."

Again, the crime of bankruptcy fraud fits the conspiracy statute perfectly. It was first used in cases like *U.S. v. Ayotte*[18] and *U.S. v. Piccini*[19] where the conspiracy statute, 18 USC 371, was used to charge the defendants with conspiracy to commit bankruptcy fraud. In 1990, in *U.S. v. Levine*,[20] it was used in its full force. In *Levine*, the defendant was charged with not only conspiring to commit bankruptcy fraud, but with conspiring to "defraud the Department of the Treasury by impeding, impairing, obstructing, and defeating the lawful functions of the Internal Revenue Service in the collection of income taxes." The Court ruled that, inter alia, charging the two conspiracies was not duplicitous. In this case, 12 defendants were indicted on 53 counts of criminal conduct.

By charging the conspiracy to commit bankruptcy fraud with the conspiracy to obstruct the IRS, the web can tie together seemingly unrelated parties. The "fence" receiving the inventory for ten cents on the dollar in a bust-out, is tied to the debtor's brother who acted as a nominee for the diverted assets, who is tied to the attorney who orchestrated the bankruptcy, who is tied to the accountant who hid the transfers in the corporate books, and so on and so on and so on.

The conspiracy statute acts like a web to ensnare all those who committed crimes, although dissimilar. However, it also acts like a "keel" of a ship. In this subtle fashion, it can be used as the main beam to which not only are somewhat dissimilar defendants brought together, but to which somewhat dissimilar statutes are joined. The conspiracy "keel" is the backbone of the case, to which the defendant "planks" and the statute "planks" are attached. It provides coherence and order from what the web entraps. In this way, the Federal conspiracy statute is becoming a very effective tool in the area of bankruptcy fraud.

The conspiracy statute acts like a web to ensnare all those who committed crimes

The Shift In The Use of The Money Laundering Statutes—From The Cartels To The Tax Gap

A 1990 article in the *Journal of Taxation entitled "IRS Likely to Increase Use of Money Laundering and Related Statutes"* gives the following prophecy and listing of the money laundering laws:[21]

> *"Practitioners are seeing an ever-increasing use of money laundering and forfeiture (both civil and criminal) statutes against taxpayers. Money laundering cases now make up a significant portion of IRS actions and are expected to be almost one quarter of the Service's investigations in fiscal 1990. ...Thus, money laundering is potentially the criminal and regulatory offense of choice against tax violations in the 1990s.*
>
> *The Bank Secrecy Act of 1970, the Money Laundering Control Act of 1986, The Anti-Drug Abuse Act of 1988, and the Money Laundering Prosecution Improvements Act of 1988 gave the IRS formidable powers and, in some cases, the opportu-*

nity to use nontax statutes against taxpayers."

Generally, the Bank Secrecy Act requires that a financial institution fill out a form called a Currency Transaction Report for all non-exempted transactions over $10,000, and makes it illegal for a person to structure their transactions in an attempt to circumvent this requirement. The money laundering statutes made it illegal to carry on a transaction in furtherance of, or with the proceeds from what are called *specified unlawful activities*. Bankruptcy fraud violations are specified unlawful activities.

The term "money laundering" usually conjures up the picture of the Cali and Medellin drug cartels shipping tons of drug money through international money exchangers. Of course, this was the main reason these laws were enacted. But, like narcotics, bankruptcy fraud is also a source of"dirty money," whose laundering is prohibited. In many bankruptcy frauds, the money being diverted from the companies is structured to hide the source and to also cause the banks not to report the transaction to the IRS. In addition, in almost every case the proceeds from the bankruptcy fraud is put in the names of nominees, wire transferred offshore or into hidden accounts, or used to purchase other assets. Money laundering is present in almost every instance.

like narcotics, bankruptcy fraud is also a source of"dirty money

The use of these statutes is not so subtle. They are simple and relatively easy to prove. They also carry heavy penalties. The penalty for violating *18 USC 1956* is 20 years in prison. Just the threat of these sanctions makes the government's position in the plea bargaining process much stronger.

Therefore, the use of the money laundering statutes will remain a potent weapon, but it will be aimed less at the drug cartels and more at the tax gap areas, including bankruptcy fraud.

A "New" Statute Is Discovered

In addition to all of the previously discussed statutes, the IRS is now using an "old" statute in a new way. On November 18, 1996 *Tax Notes Today* reported "*Stanley F. Krysa, a senior division counsel in Justice's tax division warned practitioners to be on the lookout for section 7212 prosecutions. Krysa said the IRS's use of the section in conducting tax prosecutions is on the upswing*" [22]

This "newly" discovered statute has been called the "one man conspiracy" statute and the "omnibus clause" statute. The section of this statute which will be increasingly used is *26 USC 7212(a). Section 7212(a)* prohibits in any way the corrupt or forcible endeavor to obstruct or impede the due administration of *Title 26*. The statute was used in the past in the "forcible interference" sense where IRS agents had been assaulted or threatened. The new trend is the use of the statute with the word "corrupt" being the operative word. In *U.S. v. Popkin*, the Court held that the word "corrupt" is independent of the word "forcible," and upheld the conviction for corrupt interference with the administration of the Internal Revenue Code, for creating a corporation to enable the client to disguise the character of income earned on narcotics transactions.[23] No force was required. In a very recent case, *U.S. v. Benjamin Sisti and Jonathan Googel*, decided in July of 1996, this statute was used in the bankruptcy fraud area.[24] The defendants perpetrated what was described as the largest real estate scandal in Connecticut's history and they were charged with bankruptcy fraud violations, structuring violations, and *26 USC 7212 (a)*. Sisti transferred assets through various family members to keep the assets out of the bankruptcy estate, and Googel solicited several straw purchasers in which fees were paid in cash out of the sales commissions to frustrate revenue collection by the IRS. On appeal, the Second

Circuit upheld the sentencing enhancements that were based on the obstruction charges in *section 7212 (a)*.

The *section 7212* (a) charge has several possibilities for use in the bankruptcy fraud area. First, it seems to be a broad "web-like" conspiracy statute. Secondly, it does not require an actual conspiracy, so there is no need for a co-conspirator to be found. Third, it can be used in tax cases where the actual tax evaded can not be established. Finally, as seen in *Sisti and Googel*, it can be used to enhance the sentencing guidelines, adding to the sentence given for the substantive bankruptcy fraud charge.

Inevitably, this charge will appear more and more in bankruptcy fraud indictments. It too seems tailor-made for this emerging area.

Conclusion

As we move into the next century, all facts point to bankruptcy fraud being a major area of white collar crime and a major contributor to the tax gap. Practitioners in this area will be confronted with criminal tax-related statutes that have evolved into extremely powerful tools seemingly custom-made for use in this arena, and an IRS more willing to use them. Attorneys, accountants and anyone else practicing in the bankruptcy area will be better able to serve their clients if they understand these trends.

Practitioners in this area will be confronted with criminal tax-related statutes

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22. Tax Notes, Nov. 18, 1996.
23. *U.S. v. Popkin*, 943 F.2d 1535 (11th Cir. 1991).
24. *U.S. v. Benjamin Sisti and Jonathan N. Googel*, 91 F.3d 305 (2nd Cir. 1996).

Recent Cases

Tax: Single Business Tax/ERISA Preemption
Case: *Thiokol Corp v Dep't of Treasury*, United States Supreme Court No. 95-1913 (6/9/97)
Court/Tribunal: United States Supreme Court
Outcome: Petition for writ of certiorari denied.

Tax: Income Tax/NOL Deductions
Case: *Beznos v Dep't of Treasury*, ___ Mich App ___; ___ NW2d ___ (7/25/97)
Court/Tribunal: Michigan Court of Appeals (on remand)
Judge: Neff/Wahls/Taylor (per curiam)
Issue: Whether the Michigan Legislature intended to limit the amount of the Michigan NOL deduction to either the federal NOL deduction amount or to federal modified taxable income?
Outcome: The Michigan Legislature intended no such limitation, nor does the fact that an NOL limitation exists with respect to the homestead credit mean that the same limitation extends to other portions of the income tax act.

Tax: Tax-Exempt Status/Cooperative Library Organization
Case: *OCLC Online Computer Library Center, Inc v City of Battle Creek*, ___ Mich App ___; ___ NW2d ___ (7/22/97)
Court/Tribunal: Michigan Court of Appeals
Judge: Sawyer/Neff/Hoekstra
Issue: Whether Petitioner, a nonprofit cooperative member organization of libraries, is eligible for exemption from personal property taxation under various provisions of the General Property Tax Act?
Outcome: Although the Court of Appeals agreed with the Michigan Tax Tribunal's determination that the library association is not a library within the meaning of §§ 7n and 9(b) of the GPTA because it includes for-profit libraries in its membership, it reversed the MTT's ruling that the association was ineligible for exemption as a charitable or scientific institution. The Court was persuaded that the association's goals in enhancing access to broad information bases sufficiently conferred a benefit upon the public at large. Moreover, the Court held that the organization is scientific in character, and relieves a governmental burden by enabling libraries to efficiently serve their patrons.

Tax: Use Tax/Nexus
Case: *Scholastic Book Clubs v Dep't of Treasury*, ___ Mich App ___; ___ NW2d ___ (5/20/97)
Court/Tribunal: Michigan Court of Appeals
Judge: MacKenzie/Wahls/Markey
Issue: Whether the taxpayer, through its reliance on Michigan teachers to take orders for books and deliver books to students, satisfies the substantial nexus requirement of the Commerce Clause?
Outcome: The Court of Appeals determined that Scholastic does not have a physical presence in Michigan, as the teachers are not its employees, agents or sales force; the Department therefore is without authority to require that Scholastic collect, report and remit use tax.

Tax: Inheritance Tax
Case: *In re Estate of Nell M. Wagner*, ___ Mich App ___; ___ NW2d ___ (7/8/97)
Court/Tribunal: Michigan Court of Appeals
Judge: Fitzgerald/MacKenzie/Hathaway (per curiam)
Issue: Whether the probate court exceeded its jurisdiction in waiving penalties assessed to the decedent's estate as a consequence of the failure to timely pay inheritance taxes?
Outcome: The Court of Appeals

dispensed with the Department's assertion that only the Department has the power to a penalty under MCL 205.204(2); MSA 7.565(2), stating that the probate court has the power to hear and decide all questions arising in connection with the inheritance tax act, including penalty matters which may arise in a given case. In this case, equitable considerations — such as the Department's own delay in assessing the tax occasioned by its loss of the taxpayer's file — wholly supported the taxpayer's request for penalty waiver.

Tax: Single Business Tax/Throwback Rule
Case: *Michigan Sugar Co v Dep't of Treasury*, MTT Docket No. 220328 (5/21/97)
Court/Tribunal: Michigan Tax Tribunal
Judge: Shinkle (proposed judgment by Straatsma)
Issue: Whether Petitioner had sufficient nexus with the destination states to enable it to avoid the throwback of sales to those states into the sales factor numerator for apportionment purposes?
Outcome: Contrary to the Department's assertions, no permanent or continuous physical presence by the taxpayer in the destination state is required to satisfy Commerce Clause "substantial nexus" dictates. The requisite physical presence may be made out through a showing by the taxpayer through situations inclusive of the presence of resident sales personnel in the state, whether employees or independent sales representatives or a significant dollar volume of business done in a target state evaluated in relation to the number of customers in that state.

Tax: Tax-Exempt Status/Charitable-Religious Exemptions
Case: *Corp of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints v Meridian Twp*, MTT Docket No. 217065 (1997)
Court/Tribunal: Michigan Tax Tribunal
Judge: Martell
Issue: Whether the Petitioner, a nonprofit corporation organized for religious and charitable purposes, which operates a Student Living Center which provides university students with living quarters and religious services qualifies for exemption under MCL 211.7o; MSA 7.7(4-1) and/or MCL 211.7s; MSA &.7(4p)?
Outcome: The Student Living Center qualifies for the charitable exemption because the housing is open to all persons, as opposed to selected students, on a first-come, first-serve basis without regard to church membership, race, color or creed at reduced fees subsidized by charitable donations. The Center thereby effectively lessens a burden of government by relieving the state of having to provide housing for those students. The Center further qualifies for the religious exemption as it is used extensively for religious activities in a manner consistent with its organizational purposes as stated in its Articles of Incorporation.

Tax: Tax-Exempt Status/Res Judicata and Collateral Estoppel
Case: *Wayne Co v Detroit*, MTT Docket Nos. 173694 and 191894 (1997)
Court/Tribunal: Michigan Tax Tribunal
Judge: Hughes
Issue: Whether, under the doctrines of res judicata and/or collateral estoppel, a previous finding by the Tribunal that the subject property was exempt from taxation precludes assessment and taxation in subsequent tax years?
Outcome: The doctrines of res judicata and collateral estoppel apply to tax cases. A prior decision between the parties is conclusive as to the same legal questions raised in

another case between the parties for subsequent tax years as, other than the tax years involved, the material facts and statutes at issue are the same. In an era of crowded dockets, public policy dictates that parties be prevented from relitigating matters that have already been decided. Subsequent litigation between the parties, on different causes of action for subsequent tax years, is limited to issues being presented for the first time.

Tax: Jeopardy Assessment
Case: *Eaton & Centerfolds, Inc. v Dep't of Treasury*, MTT Docket No. 174092 (1997)
Court/Tribunal: Michigan Tax Tribunal
Judge: Dean
Issue: Whether the Department of Treasury may estimate the amount of income earned by a taxpayer when issuing a jeopardy assessment, where written records related to income are incomplete or nonexistent?
Outcome: The law does not require that the Department devise a method for determining income which will produce an exact result. It is sufficient if the method employed produces a result which is substantially correct. In this case, while the Tribunal made adjustments to the jeopardy assessment issued by the Department, it was appropriate for the Department to extrapolate Petitioner's income based on partial records and testimony from Petitioner's employees and witnesses familiar with Petitioner's business.

MICHELE L. HALLORAN and DONNA M. CLARKE, members of the law firm of Howard & Howard Attorneys, P.C. in Lansing, prepared the state tax case summaries in this issue.

Recent Legislative Changes to Michigan's Limited Liability Company Act

By: Mitchell Bean and Marjorie Bilyeu, House Fiscal Agency

The Limited Liability Company ("LLC") is a relatively new form of business entity that is rapidly rising in popularity and replacing other forms of business organization in Michigan. With recently passed state legislation,[1] drafted in response to new federal regulations,[2] there is increased opportunity for using a Michigan LLC as a choice of business entity. Fewer restrictions applying to this relatively new form of business entity make it easier for businesses to qualify for favorable tax treatment. The resulting expansion in tax and nontax planning possibilities for Michigan businesses has further contributed to the pro-business climate of the state.

As a noncorporate form of business, an LLC combines the benefits of a corporation with those of a partnership. Like corporations, an LLC limits the personal liability of its owners (known as members) and managers, shielding them from the LLC's debts, liabilities and obligations. Like partnerships, LLCs allow for a single layer of taxation which, if structured correctly, can permit members to receive "pass-through" partnership tax treatment. This means that the income, losses, credits and deductions of an LLC can pass directly to a company's members for use on their own respective income tax returns. In contrast, a corporation is generally taxed separately on its federal income,[3] while its shareholders are taxed separately on distributions from the corporation. Partnership income, taxed on just one level of federal income rather than two, is therefore generally preferred from a taxpayer's standpoint.

Because of these advantages, the LLC has become a desirable entity through which to conduct business. Use of the LLC as a type of business has steadily increased over the last five years; since 1993, when Michigan adopted its LLC statute, over 23,000 LLCs have formed in this state.[4] Because of certain statutory limitations in Michigan's approach to LLCs, many businesses formed in the last few years have either chosen alternative forms of business, or have been doing business here as foreign entities after organizing as LLCs in states such as Delaware (which has flexible LLC organizational requirements.) With the recently passed legislation, these statutory limitations have disappeared, and Michigan is now likely to see exponential growth in the number of LLCs formed in the state. As the role of LLCs increases in Michigan, it becomes important to understand this type of business entity and how the recent amendments affect business entity classification in this state.

Michigan is now likely to see exponential growth in the number of LLCs formed in the state.

Federal Legislation: "Check the Box" Regulations

On January 1, 1997, the Internal Revenue Service ("IRS") issued its final "check the box" regulations. Among other things, these regulations simplify entity classification rules and make it easier for an LLC to receive partnership tax treatment. Unless a taxpayer affirmatively elects to be taxed as a corporation, pass-through partnership tax treatment at the federal level will now be automatic for all LLCs. This is a significant departure from the IRS' prior position, which gave partnership tax treatment to an LLC only when it possessed no more than two of the four traditional corporate characteristics: limited liability, centralized management, continuity of life, and

free transferability of assets.[5] In the past, when an LLC was found to have more than two of these characteristics, it was classified as a corporation and taxed accordingly. Because of these new IRS regulations, an LLC can now take on an unlimited number of corporate characteristics without risking loss of pass-through partnership tax treatment on the federal level. This provides more business planning options, and allows the flexibility to structure a business entity according to the needs of a particular company.

a Michigan LLC can now take on an unlimited number of corporate characteristics

State Legislative Amendments

Before the recent amendments to the Michigan Limited Liability Act[6] ("the Act"), a Michigan LLC was not able to take full advantage of the flexibility of the new IRS classification rules. This was because under Michigan law, it was impossible for an LLC to possess more than two corporate characteristics. Changes to the Act were therefore necessary so that Michigan LLCs could benefit from the new federal regulations. On July 1, 1997, such legislation went into effect making appropriate changes to the LLC classification requirements, adding enabling provisions for cross-entity mergers, and clarifying certain points.

Corporate Characteristics: The most significant change to the Act involves the effect on an LLC possessing more than two corporate characteristics. Prior to the amendments, a Michigan LLC could obtain favorable partnership tax treatment only when an LLC had no more than two of the four traditional corporate characteristics. Under the new amendments, a Michigan LLC can now take on an unlimited number of corporate characteristics and still receive pass-through partnership tax treatment. This will allow greater flexibility in business planning, permitting an organizer to choose as many corporate characteristics as are desired.

One-Member Organizations: No longer will a Michigan LLC be required to have at least two members. §102(i) allows one individual to conduct business as an LLC and obtain the limited liability protection not available for sole proprietorships.

Duration: Prior to the amendments, an LLC adopting the corporate characteristic of perpetuity risked being considered a corporation for tax purposes. (Whereas a corporation is perpetual for tax purposes, an LLC is traditionally considered to be an entity of limited duration.) §202(2) eliminates this concern by making "perpetual" the maximum duration of an LLC.

Conflict: §214 specifies that the articles of organization (original documents filed with the state officially organizing an LLC) will control where there is a conflict with the operating agreement (a written agreement among the members of the LLC relating to conduct of the business).

Managers: §402-405 add certain technical provisions relating to managers. For example, §402(2) specifies that an operating agreement can require that a manager also be a member. §402(4) specifically gives notice to third parties that managers, where their powers are designated by the articles of organization, have agency power and can bind the LLC. This codifies the common law rule and provides public protection for those entering into contracts with LLCs.

Distributions / Contributions: §303 directs how an LLC's cash and assets are distributed in the absence of an operating agreement. LLCs formed after July 1, 1997 will distribute cash and assets in equal shares to all members, unless an operating agreement specifies otherwise. LLCs formed prior to July 1, 1997, in the absence of an operating agreement provision stating otherwise, will continue to distribute cash and assets according to each member's equity interest in the LLC. In addition,

pursuant to §501, a member no longer has to make a contribution to be admitted to an LLC, but, in the case of a newly formed LLC, can simply sign the initial operating agreement or articles of organization. In the case of an existing LLC, a member can be admitted by unanimous vote of the other members, or by any other means specified in an operating agreement.

Voting Rights: Pursuant to §502, in the absence of an operating agreement otherwise establishing member voting rights, members of LLCs each receive one vote. Members of LLCs in existence prior to July 1, 1997 will continue to vote in proportion to their respective shares in the company (in the absence of an applicable operating agreement provision) — although this can be changed by an amendment to an operating agreement.

Member Withdrawal / Expulsion: The amendments restrict the ability of a member to withdraw from an LLC. The prior statute allowed a member to withdraw either pursuant to an operating agreement, or by giving 90 days written notice to the LLC and its members. Because of concern that the unrestricted right of a member to withdraw might cause harm and instability to an LLC, the 90-day written notice provision was removed; §509(1) now provides that a member may withdraw from an LLC only as stated in an operating agreement. In addition, a provision was added (§509(2)) giving an LLC the right to include reasons for the expulsion of a member in its operating agreement. Before this addition, expulsion of a member led to automatic dissolution of the LLC, unless one of two things occurred: (1) within 90 days after the expulsion, the majority of remaining members voted on the LLC's continuing existence, or (2) an LLC chose the corporate characteristic of continuity of life, with a specific provision in its operating agreement stating that the expulsion or other occurrence would not result in automatic dissolution.

Court Actions: §515 changes procedures and broadens the rights of members to bring court action against LLCs and its managers or other members. While the prior Act allowed a member to bring an action on behalf of the LLC where certain requirements were met, the amendments give broader remedies and allow members to personally sue an LLC and its members and managers for acts that are "illegal, fraudulent or willfully unfair and oppressive." Patterned after a similar provision of the Michigan Business Corporation Act[7] dealing with wrongful distributions, this section is designed to protect members with minority interests from the oppressive acts of majority members. This is an especially important safeguard in light of the new restrictions placed on a member's ability to withdrawal from an LLC.

a member may withdraw from an LLC only as stated in an operating agreement.

Mergers: §701-705A add many new technical provisions relating to mergers between an LLC and other business entities. In general, these merger provisions specify how cross-entity mergers are to be accomplished and what requirements must be met. Until amendments are adopted which add identical provisions to Michigan's Business Corporation Act and Uniform Partnership Act,[8] these merger provisions will be of limited effectiveness.

Conversion: It is now simpler to convert from a partnership to an LLC. §707 sets forth the requirements and procedures for converting to an LLC from an existing domestic partnership. In general, conversion from a partnership to an LLC can be accomplished tax-free and automatically (after partnership agreement) by filing a certificate of conversion with the state. After the conversion, all assets, liabilities and rights of the partnership become that of the LLC.

Dissolution: The prior version of the Act specified that an LLC auto-

The opinions in this article are those of the authors and do not necessarily represent opinions held by the House Fiscal Agency or the Michigan House of Representatives.

matically dissolved upon the occurrence of a certain event. For example, the death, withdrawal, expulsion, bankruptcy, or dissolution of a member resulted in automatic dissolution of the LLC, unless the majority of members voted to continue the LLC within 90 days of the happening of the event, or unless the operating agreement chose the corporate characteristic of continuity of life. Amendments to §801 now specify that an LLC will dissolve only in one of four situations: (1) when and where the members have so specified in their articles of organization; (2) upon the happening of an event specified in the article of organization or operating agreement along with a vote of the members; (3) upon the unanimous vote of all members entitled to vote; or (4) upon the entry of a decree of judicial dissolution.

Conclusion

Because of recent changes to Michigan's Limited Liability Company Act, it is now easier for a business entity to qualify as an LLC in Michigan, and it will no longer be necessary to go out of state to find more flexible LLC requirements. Clarifications and changes to many of the old provisions make the statute easier to apply; additional provisions will facilitate the merger of cross-entities such as partnerships and corporations. The State's current law governing LLCs helps ensure that in the future, the LLC will be the business entity of choice in Michigan.

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ENDNOTES

1. H.B. 4606, 89th Leg., (Mich. 1997). This bill was sponsored by Rep. Kirk A. Profit (D-Ypsilanti). It amends Public Act 23 of 1993.
2. Treas. Reg. §§1.581-1, 1.581-2, 1.761-1, 301.6109-1, 301.7701-1, 301.7701-2, 301.7701-3, 301.7701-4, 301.7701-6, 301.7701-7, 602.101 (as amended by T.D. 8697, 1997-2 I.R.B. 11).
3. An exception applies to an S corporation which allows pass-through tax treatment to its shareholders, but which has very strict eligibility requirements. An S corporation is still subject to certain types of corporate-level taxes, including those on built-in gains and excess net passive losses.
4. Source: Corporation and Securities Bureau of the Michigan Department of Commerce.
5. "Limited liability" assures that in general, an entity's owners are not personally responsible for the entity's debts, liabilities or obligations. This characteristic is inherent in all LLCs. An entity has "centralized management" where it delegates management authority and power to a person or group of persons. "Continuity of life" is a concept that implies the entity is intended to endure forever, notwithstanding what may happen to the owners of the entity. "Free transferability of interests" means that owners are free to assign their respective interests in the entity to another owner.
6. MCL 450.4101, et seq.
7. MCL 450.1551, MSA 21.200 (551).
8. S.B. 414, 88th Leg., (Mich 1996) would amend the Business Corporation Act to provide for, among other things, mergers with cross-entities. The bill has passed the Michigan Senate, but is still pending in the Michigan House of Representatives. A bill in the House of Representatives, H.B. 6182, 88th Leg., (Mich. 1996), which would have amended the Uniform Partnership Act, died in Committee.