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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. The Taxation Section web address is www.michigantax.org. If you have suggestions or an article you wish to have considered for publication, please contact Lynn A. Gandhi, lgandhi@honigman.com; 660 Woodward Avenue, Detroit, MI 48226-3506.

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June 3, 2009

The fiscal year for the Taxation Section is quickly flying by. The section recently conducted its annual tax conference on April 29th at St. John's Inn. Based on the feedback and evaluations from attorneys that attended the event, the conference was a big success. Many speakers provided important updates regarding new matters. The afternoon breakout sessions provided considerable depth in particular topics. Many thanks to Marjorie Gell for her work as the chair and organizer of the annual tax conference. She did a great job. Also, many thanks to our section administrator, Deb Michaelian, who works from year to year on facility planning for the conference, as well as making sure the section runs smoothly. If you are interested in the written materials provided at the conference (for a nominal fee), please e-mail Deb Michaelian at dlmichaelian@varnumlaw.com.

The Taxation Section's annual dinner is scheduled to be held at 5:00 p.m. on Thursday, September 17, 2009 at the Hyatt in Dearborn. It will be held in conjunction with the State Bar annual event in Dearborn this year. This may add some convenience for those attorneys who are involved in more than one section of the State Bar. Please notify Deb at dlmichaelian@varnumlaw.com if you plan to attend. Dinner will be served and there will be an interesting speaker immediately following the dinner. Many of the former chairs of the Taxation Section (a formidable crew) commonly attend this event. It is a great evening to share ideas and collaborate with qualified colleagues.

The Taxation Section is becoming increasingly concerned about the growing backlog of cases in the Michigan Tax Tribunal. It is taking a number of years for certain cases to be resolved. Such delays cause attorneys to be reluctant to handle cases on a contingent fee basis. This hurts the ability of our attorneys to adequately represent the interests of Michigan taxpayers. The Taxation Section is in the process of considering what legislation should be pursued in order to address issues with the tribunal.

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We are not aware of any further changes being contemplated for the State Real Estate Transfer Tax Act at this time. In light of the changes that could be pursued by the State of Michigan during a financial crisis, no news is good news.

Please remember that the Taxation Section has the following committees that meet regularly to discuss issues and continuing education matters: *Business Entities; Employee Benefits; Estates and Trusts; Practice and Procedure; State and Local; International Tax Section*. If you are interested in receiving E-mails about particular committee activities, please send an E-mail to Deb at dlmichaelian@varnumlaw.com.

For more information regarding upcoming events, please see our calendar posted on the Taxation Section website at www.michbar.org/tax/.

Very truly yours,

Jess A. Bahs
Chairperson, Taxation Section

REPORT OF THE BUSINESS ENTITIES COMMITTEE

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Recent Activities

The Business Entity Committee invited Mark Sutton from Plante & Moran to speak at its break-out session during the annual conference of the Tax Section of the State Bar of Michigan. His thoughtful presentation covered tax issues that are commonly overlooked in operating agreements of limited liability companies. Please let me know if you were unable to attend and are interested in receiving an outline of Mark's presentation. Also, please let me know if there are particular topics that you would like to see covered in future presentations.

Since my last report, the American Recovery and Reinvestment Act of 2009 was enacted into law. Three of the tax changes contained in the Act should be of particular interest to business entity tax planning. First, the Act generally provides that a taxpayer that reacquires its debt at a discount in 2009 or 2010 can elect to not recognize the resulting cancellation of debt (COD) income in such year, but instead recognize it ratably in each of the five tax years from 2014 to 2018. This is particularly useful for members of an LLC who may be unable to use the insolvency or bankruptcy exclusions for COD income (because such exclusions apply at the member level, not the LLC level).

Second, the Act shortens the 10-year recognition period for built-in gains of an S corporation to 7 years, but only for sales that occur in 2009 or 2010. This may produce some anomalous results. For example, consider a C corporation that elected S status at the start of 2002. At the end of 2008, it will have been an S corporation for seven years, so that it can sell its assets in 2009 or 2010 without being subject to the built-in gains tax. However, if the corporation waits until 2011 to sell its assets, it will again be subject to the built-in gains tax (because it will have been an S corporation for only nine years, and the Act's seven-year rule does not apply to sales that occur in 2011).

Third, the Act increases the exclusion for gain from the sale or exchange of qualified small business stock under Section 1202 of the Internal Revenue Code of 1986, as amended, to 75 percent (from 50 percent), if the stock was acquired between February 17, 2009 and January 1, 2011.

REPORT OF THE EMPLOYEE BENEFITS COMMITTEE

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Recent Activities

At the Committee meeting on March 23, 2009, at the Sheraton Novi, Sue O. Conway and Norbert F. Kugele, both partners in the Grand Rapids office of Warner Norcross & Judd LLP, lead a discussion on welfare plan changes under the Children's Health Insurance Plan Reauthorization Act (CHIPRA) and the American Recovery and Reinvestment Act (ARRA), including the new COBRA premium assistance subsidy for the unemployed and some new HIPAA privacy changes.

At the Annual Tax Conference on April 29, 2009, the Committee held a breakout session. There were two speakers at the breakout session: Andrew Stumpff of Stevenson Keppelman Associates in Ann Arbor, Michigan and Martha Hutzelman of the Law Offices of Martha Hutzelman in New Albany, Ohio. Mr. Stumpff discussed recent cases in employment discrimination that impact employee benefit plans. Ms. Hutzelman spoke on recent cases involving plan claims and also provided an overview of recent statutory and regulatory developments in health and cafeteria plans.

Upcoming Events

To be determined.

REPORT OF THE ESTATES & TRUSTS COMMITTEE

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Recent Activities

The Estates and Trusts Committee hosted Professor Jeffrey Pennell at the Annual Conference of the Tax Section of the State Bar

of Michigan. His lively and energetic presentations were enjoyed by all of the attendees in both the general and break-out sessions. Many have asked if we would have him back again.

REPORT OF THE STATE AND LOCAL TAX COMMITTEE

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Recent Activities

This quarter has seen numerous State Tax Commission and Michigan Department of Treasury actions and releases of authority, and a notable taxpayer use tax victory in the case of *General Motors Corporation v Michigan Department of Treasury*, Court of Claims Docket No: 07-151-MT, in which Judge Rosemarie E. Aquilina of the Court of Claims granted General Motors' motion for summary disposition, ordering a refund of use tax paid and holding 2007 PA 103 unconstitutional as prohibited retroactive legislation.

January

Treasury released the following in an e-mail blast:

> Final Michigan Business Tax (MBT) forms and instructions are now available on Treasury's *MBT website (www.michigan.gov/mbt)*. Businesses registered for MBT and/or the Single Business Tax should receive forms and instructions in the mail by the middle of February. Insurance companies will receive their books in early February.
>
> A complete list of software companies intending to support MBT e-file is available at *www.MIfastfile.org*. As the software is approved for MBT e-file, an "ACCEPTED" notation is added to the list.
>
> The deadline for filing an insurance company return is March 1, 2009. For all other taxpayers, including fiscal-year filers with a fiscal year ending in 2008, the filing deadline has been extended to April 30, 2009, for this first year of filing MBT returns.
>
> Several resources are available on the MBT website, in addition to final MBT forms and instructions. Informational webcasts, explaining each form in detail, are available for viewing, and more than 300 frequently asked questions have been answered and posted by category.

February

MBT e-file information became available on Treasury's MBT website and at *http://www.michigan.gov/taxes/0,1607,7-238-44070-155635--,00.html*.

The Michigan Chamber released details regarding proposed revenue enhancements to close the State's 2010 budget gap.

The STC released an end-of-year legislative summary for assessors and equalization directors. The January 1, 2007 effective date of HB 6122/PA 473 of 2008 was noted—certainly an effective date that will generate much future discussion.

Resources are available at *www.michigan.gov/propertytaxestimator* and *http://www.michigan.gov/treasury/0,1607,7-121-1751---,00.html*

Or go to *www.michigan.gov/treasury* and select Local Government Services

http://www.michigan.gov/taxes/0,1607,7-238-43535---,00.html
Or go to *www.michigan.gov/taxes* and select Property Taxes
for property tax estimation and to unravel the effect of US CPI on Michigan CPL (or, why is taxable value increasing when the economy is in the dumps?)

March

On March 18, 2009, the STC released a memorandum regarding changes of personal property classifications from industrial to commercial containing a cryptic reference to an Oakland County Circuit Court case believed to be *Naftaly v Hino Motors Mfg USA*.

April

Treasury released RAB 2009-2, regarding Tobacco Products Tax and Secondary Wholesaler Licensure. The STC released Bulletins 3 and 4 of 2009 regarding Millage Rollbacks and Changes to the Manual on Right-of-Way Easements, and a memorandum on classification of wind energy property. The STC also released information regarding Treasurer Kleine's request that the STC review real property classified as industrial real, and the direction to assessors to submit lists of such property to the STC by June.

April 29, 2009 marked the Tax Section's 22nd Annual Tax Conference, with great SALT-related speakers such as Richard Pomp of the University of Connecticut Law School and Eric Coffill of Morrison Foerster, Sacramento.

May

On May 4, 2009, RAB 2009-4 was released, establishing new interest rates and superseding RAB 2008-5.

International Update

INTERNATIONAL TAX OF MYSTERY: THE NEXUS OF WITHHOLDING RULES FOR FOREIGN PERSONS AND ESTATE PLANNING

By Timothy E. Harden, Esq.

It is a fairly safe assumption that most estate planners are not experts on the international tax rules. In fact, the thought that international tax rules might apply to an estate plan or estate administration probably would leave most estate planners with an uncomfortable feeling ranging from a vague sense of unease to borderline panic. The standard reaction would likely be to attempt to avoid the situation; however, this is not always possible. For instance, in a common situation, the estate planner's trustee client may need to make a distribution to a beneficiary located abroad. This may be a child who relocated overseas or a charity located in another country. Whatever the details of the situation, though, it is clear that the trustee has to do something. This article discusses what to do.

Withholding Rules for Payments to Foreign Persons

The question that the trustee, for example, must answer in this type of situation is whether he must withhold any money from the payment to the payee, because foreign persons are subject to tax on their U.S. source income. The rules applying to this situation can be found in Treasury Regulation 26 CFR 1.1441-1 and following regulations and in IRS Publication 515. The rules are fairly lengthy, but this is mainly because of the broad spectrum of potential foreign payee entities and the resulting need for rules to apply to each. The purpose of this article is to provide an overview of the main issues that need to be considered for the application of the rules and to provide a roadmap for the analysis of a situation. A detailed examination of the rules applying to every possible foreign payee entity would be counter-productive for these purposes. All of the information contained below can be found in the above cited treasury regulation and IRS publication.

Therefore, the following issues need to be considered. First, just because a payee is not located in the United States does not necessarily mean that the payee is a "foreign person" for the purposes of withholding. So the threshold consideration is whether the payee is a "U.S. person" or a "foreign person." If the payee is a foreign person, then the trustee will need to withhold from the payment to the payee. This leads to questions about the amount of the withholding, the reporting requirements with regard to the withholding, and any potential liability related to the withholding.

Terminology

First, some basic terminology that the IRS uses in this arena needs to be defined to provide the language for the analysis of the rules. The term "NRA Withholding" refers to the regime that requires money to be withheld from payments to foreign persons. According to the IRS, you are a "withholding agent" if you are a U.S. or foreign person who has control of or pays any money that is subject to withholding to a foreign person. So in the above example, the trustee paying to a beneficiary would be a withholding agent if that beneficiary were a foreign person. The definition of a "foreign person" is important, because only payments to foreign persons are subject to NRA withholding. A foreign person includes nonresident alien individuals, foreign corporations, foreign partnerships, foreign trusts, foreign estates, and also foreign branches of U.S. financial institutions. In addition, there are specific guidelines for determining whether an entity is U.S. or foreign, as is shown in the next section.

U.S. Person or Foreign Person

NRA withholding only applies if the person is a foreign person, and, alternatively, it does not apply if the payment is to a U.S. person. The following are, in brief, the rules for the above categories of foreign persons. A nonresident alien is someone who is not a U.S. citizen or a resident alien. Nonresident aliens married to U.S. citizens or resident aliens are a special case, in that payments to them are still subject to NRA withholding, but with an exception for wages paid to them. Residents of U.S. possessions are treated as nonresident aliens for these rules, provided they are not U.S. citizens.

A foreign corporation is one that was not organized under the laws of the United States, any of its states, or the District of Columbia. The rule for foreign partnerships is the same, although in practice there will be less of a bright line because of the often more informal nature of partnerships. A foreign private foundation is one that was created or organized under the laws of a foreign country, although the NRA withholding rate for such a founda-

tion is only 4 percent, which is lower than the standard rate described below.

Organizations that were formed under foreign law but are qualified as exempt from income tax under IRC section 501(a) present a special case. Generally, NRA withholding does not apply to them unless the IRS has determined that they are foreign private foundations. However, any payments made to them must still be reported in the manner described below, even if there is no money withheld from the payment.

Finally, payments made to a U.S. branch of a foreign person generally are considered payments to a foreign person. The exception to this rule is for payments to U.S. branches of foreign banks and insurance companies, provided that they are subject to U.S. regulatory supervision, the prospective payor agrees to treat them as U.S. persons, and this agreement is recorded on a withholding certificate, Form W-8IMY.

These are the general rules for whether a payee is a U.S. or foreign person, but the question of what information the payor is allowed to rely on in making its determination remains. As mentioned above, a payment is not subject to NRA withholding if it is to a U.S. person. The first form that a payor can rely on is Form W-9. This form can only be used by a U.S. person and contains the payee's taxpayer identification number. Additionally, if there is more than one owner of a person, such as a partnership, the payment is not subject to NRA withholding if any one of the owners provides a W-9.

The other possible piece of documentation is Form W-8. This would be provided by a foreign person, who would therefore be subject to NRA withholding. However, the W-8 would show the payor that the foreign person is the beneficial owner of income and is entitled to a reduced rate of NRA withholding.

Mechanics of Withholding

Once the payor determines that its payment is going to a foreign person, it must determine how much to withhold, when to withhold, and how to report the withholding. Most of the time the amount of the withholding is going to be 30 percent of the gross amount subject to withholding. One exception, as discussed above, is for withholding from payments to foreign private foundations, the rate for which is 4 percent. Another major exception is if the foreign person is claiming treating tax treaty benefits. To do that, the foreign person must provide a Form W-8BEN claiming the reduced rate of withholding. The payee must also provide a U.S. taxpayer identification number and certify that: (1) it is a resident of a treaty country; (2) it is the beneficial owner of the income; (3) if an entity it derives the income within the meaning of section 894 of the Internal Revenue Code (it is not fiscally transparent); and (4) it meets any limitation on benefits provision, if any, contained in the treaty. There are two exceptions to the requirement of providing a United States taxpayer identification number. These are that providing the number is not required if the income is from marketable securities or if the income is an unexpected payment to an individual.

The question of timing is usually simple: the amount must be withheld at the time the payor makes a payment subject to withholding. However, there are some twists. One is that a payment for the benefit of a foreign person is considered made to that person. So if a payor makes a payment to a foreign person's creditor, the payment is considered made to the foreign person. A United States partnership is generally required to withhold when distributions of amounts subject to withholding are made. However, if a foreign person has a distributive share of income that the partnership does not actually distribute, then the partnership must withhold on that distributive share at the earlier of the due date for the Schedule K-1 or the date it is actually provided. Finally, a United States trust operates under similar rules, in that it must withhold on the amount includible in the gross income of a foreign beneficiary to the extent the trust's distributable net income consists of an amount subject to withholding.

After making the payment to the foreign person, the payor is required to report the payment. The payor does this by reporting it on Form 1042-S and filing a tax return on Form 1042.

Liability

The final major question for a potential payor to a foreign person is the extent of the liability to which the payor could be subject for failing to follow the withholding rules. As with many liabilities related to making distributions, a withholding agent is personally liable for any tax required to be withheld. Further, this liability is independent of the liability of the foreign person who

Are You an Author?

The Michigan Tax Lawyer is solicitating articles for the Fall 2009 and Winter 2010 editions. If you have suggestions or an article you wish to have considered for publication, please contact Lynn A. Gandhi, lgandhi@honigman.com; 660 Woodward Avenue, Detroit, MI 48226-3506.

receives the payment. This presents a fairly high risk of exposure for a payor, because only one of the parties will be located in the United States, and it will not be the payee.

Conclusion

This article shows that while the withholding rules for payments to foreign persons can get somewhat complicated when applied to particular fact situations, the basic outline of how to follow them is not that difficult. First, the potential payor has to determine whether the payment it is required to make will be to a foreign or United States person. This will be based solely on the documentation provided to the payor by the payee. If the payment is to a United States person, then the analysis stops and no withholding is required. If the payment is to a foreign person, then the payor must determine the rate of the withholding, which with some exceptions will most of the time be 30 percent of the gross amount of the payment. Finally, the payor has to both report the payment and file a tax return reflecting the payment. Backing all this up is the threat of personal liability of the payor for the tax. Thus, in the end, it really is not a mystery at all.

About the Author

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BE AFRAID; BE VERY AFRAID!

By John B. Payne, Esq.

As of February 8, 2006, Congress made startling and drastic changes to Medicaid. Eligibility for the program is radically curtailed under the Deficit Reduction Act of 2005 due to punitive new rules for transfers for less than full and fair consideration. In implementing these harsh changes, Michigan Department of Human Services has adopted draconian, even diabolical, rules that affect estate and financial planning for anyone of retirement age. They are found in the Program Eligibility Manual, on DHS's website: www.michigan.gov/dhs. Any attorney, CPA, financial planner, or tax advisor must be aware of the danger to anyone over 65 who provides funding for college for a child or grandchild, gives money for the down payment for a home, makes a substantial donation to a charity, or gives more than a pittance to a candidate or cause. Every transfer of money or property is subject to review by the Department of Human Services if the transferor needs Medicaid within five years.

Gifts

The legislation changes the treatment of gifts made by persons who apply for Medicaid. Any gift made on or after the date of enactment of this law will be subject to a five-year look-back. 42 USCA § 1396p(c)(1)(A). Furthermore, a gift results in a Medicaid penalty that begins when the person who made the gift is otherwise eligible for Medicaid. 42 USCA § 1396p(c)(1)(D)(ii).

This is a drastic and restrictive limitation on the ability of elder citizens to dispose of their property. To see how this works, let's assume that Rosco, a widower, is in good health when he gives his grandson $25,000 for college. After the gift, he still has $75,000 in savings. Two years after he made this gift, he suffers a stroke and enters a nursing home. His cost of care as a private-pay patient is $6,500 per month and his income is $1,200, so he has to withdraw $5,300 per month to pay for his care. Three years and three months after the gift, he runs out of money. Under the new rules, he cannot get assistance with his nursing home bill for a number of months computed by dividing the $25,000 gift by a number that represents the average cost of private-pay care in a nursing home. In 2009, DHS calculates the penalty using $6,362 as the average cost of private-pay nursing, so he is ineligible for 3.93 months, or three months and 27 days.

This penalty provision applies without regard to the reason for a gift. Donations to one's church, one's alma mater, or one's younger, opposite-sex caregiver are all penalized. It would be the same whether Rosco gave his daughter money because she wheedled it out of him or because she needed help paying for a liver transplant.

Under this new rule, the penalty for a gift cannot start until the applicant has made an application for Medicaid and been determined to be eligible, based on the applicant's assets. Then, unless there is another period of ineligibility running, the penalty is applied. What is Rosco to do if he is penalized *after he has run out of money?* More to the point, what is Rosco's nursing home to do when Rosco cannot pay? The nursing home can discharge him for not paying his bill, but only if they can find another appropriate placement. How likely is that, if he is broke and Medicaid will not pay the bill?

Many people put their children's names on the homes, bank accounts, stock portfolios, annuities, and other investments to avoid probate on their death. These changes may cause problems in the Medicaid application process. The inability to qualify for Medicaid for nursing care could subject donees to clawback by the nursing home under such theories as fraudulent transfer and unjust enrichment. Even without gratuitous transfers, family members are often sued by nursing homes under filial responsibility law or because the family member signed the contract as "guarantor" or "responsible party." Any estate plan where the net worth is less than $2 million must consider the potential need for Medicaid, and the client must be warned that any gift could come back to haunt the donor and the donee up to five years later.

No Safe Harbor, Minimum Gift, and No Maximum Penalty

All gifts are required to be lumped together to establish a penalty period, even if the gifts consist of small amounts in successive months. 42 USCA § 1396p(c)(1)(E)(i). The state does not round down or disregard fractional months. Furthermore, there is no maximum penalty. If Rosco gave away $500,000, the penalty would be 80 months. A $500 gift could make him ineligible for 24 days. The Program Eligibility Manual makes the point brutally clear. It says, "There is no minimum amount of resource transfer be-

fore incurring a penalty; determine a penalty on any amount of resources that are transferred and meet the definition of a divestment even if the penalty is for one day. Divestment is a type of transfer, NOT an amount of transfer." Program Eligibility Manual (PEM) Item 405(9) (January 1, 2009).

No Partial Cure

The penalty can only be cured if *all* of the divested property is returned to the applicant. The policy manual states as follows:

> Cancel a divestment penalty if either of the following occurs before the penalty is in effect:
> - All the transferred resources are returned and retained by the individual.
> - Fair market value is paid for the resources.
>
> Recalculate the penalty period if either of the following occurs while the penalty is in effect:
> - All the transferred resources are returned.
> - Full compensation is paid for the resources.

Once a divestment penalty is in effect, return of, or payment for, resources cannot eliminate any portion of the penalty period already past. However, you must recalculate the penalty period. The divestment penalty ends on the later of the following:

- The end date of the new penalty period.
- The date the client notified you that the resources were returned or paid for. PEM Item 405(11)-(12).

The extreme unfairness of these rules is easy to see. What happens if Rosco gave a block of stock to his nephew and the stock tanked? Only if the nephew can return the same shares of stock to Rosco, or can pay the full value of the shares *as of the date of the gift* can the divestment be cured. Gifts to several people can only be cured if all of the gifts are returned. Making matters worse, these oppressive new rules apply to gifts made before the policy was created!

The rules have the potential to create other impossible situations. Assume that Hazel gave $150,000 out of countable assets of $350,000 to her children shortly before her husband, Chester, entered long-term care. She applied for Medicaid and was denied. She must hope that Chester will expire soon because the penalty will not start until the countable assets are below $109,560. Because the penalty is based on a greater amount than remains to her, Chester will not receive long-term care Medicaid until several months after Hazel is totally broke.

Michigan Department of Human Services also puts a particularly punitive spin on how the penalty period is calculated. The policy reads:

> Apply the total penalty months and days. Apply a penalty even if the total amount of the penalty is for only a partial month.
>
> The penalty is applied to the months (or days) an individual is eligible for Medicaid and actually in LTC, Home Health, Home Help, or the MI Choice Waiver.[1] The divestment penalty period cannot be applied to a period when the individual is not eligible for Medicaid for any reason (e.g., the case closes for ANY reason) or is eligible for Medicaid but is NOT in LTC, Home Help, Home Health, or the MI Choice Waiver. Restart the penalty when the individual is again eligible for Medicaid and in LTC, Home Help, Home Health, MI Choice Waiver.
>
> A group 2 deductible eligible individual is not eligible for Medicaid until the deductible is met. Apply the penalty only to the days of the month after the deductible is met. PEM Item 405(10) (January 1, 2009).

To comply with the "otherwise eligible" condition required to trigger the running of the divestment penalty where gifts have been made, elder law attorneys have been prescribing short-term annuities or promissory notes that comply with the DRA to create eligibility and pay for care during the resultant penalty. It sounds as if the deductible in the new policy is the patient pay amount. If that is the case, and Maude has $1,500 in Social Security and $4,500 from a short-term immediate annuity or DRA-compliant promissory note to cover a $6,200 per month nursing home bill, the patient pay amount would be $5,940. Only the last day or two of each month will count against the penalty!

If that is the case, there may be no remedy where gifts have taken place. There will be many nursing home residents who innocently made gifts—or were manipulated into doing so—who will never be able to get past the Medicaid penalty.

This start-stop approach to divestment penalties is not only unreasonably punitive, it is contrary to instructions from the federal Center for Medicare and Medicaid Services (CMS). In a memorandum, the Center for Medicaid and State Operations instructs, "Once the penalty period is imposed, it will not be tolled (i.e., will not be interrupted or temporarily suspended), but will continue to run even if the individual subsequently stops receiving institutional level care." *New Medicaid Transfer of Asset Rules Under the Deficit Reduction Act of 2005,* Sections 6011 & 6016, at 3 (July 26, 2006); http://www.cms.hhs.gov/smdl/downloads/TOAEnclosure.pdf.

No Undue Hardship

Congress requires the states to create reasonable undue hardship waivers for divestment penalties. Here is the undue hardship policy adopted by Michigan DHS:

> Waive the penalty if it creates undue hardship. Assume there is no undue hardship unless you have evidence to the contrary.

> Undue hardship exists when the client's physician (M.D. or D.O.) says:
> - Necessary medical care is not being provided, and
> - The client needs treatment for an emergency condition.
>
> A medical emergency exists when a delay in treatment may result in the person's death or permanent impairment of the person's health.
>
> A psychiatric emergency exists when immediate treatment is required to prevent serious injury to the person or others. PEM Item 405(12).

DHS might have said, "There is no such thing as undue hardship." If the person meets the test for medical emergency, a hospital would be obligated to treat the person. The test for psychiatric emergency is the same as that for judicial commitment. Neither test addresses the situation where the resident of a nursing home has no money and Medicaid is denied, based on a divestment.

Conclusion

As the discussion above explains, there will be dramatic changes in Medicaid for nursing home residents. Before purchasing an annuity or making a gift, anyone over 60 should be carefully advised regarding the possible Medicaid consequences in case the person or the person's spouse ever needs care in a nursing home.

About the Author

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Endnotes

1 "Waiver" refers to the Home & Community-Based Services waiver, or MI Choice Waiver Program. This waiver, or exception from limitation of long-term care services to nursing facilities, provides home- and community-based services for aged and disabled persons who, if they did not receive such services, would require care in a nursing home. Services under this waiver program must be less costly for MA than the cost of nursing home services for the total number of waiver clients, not per person. PEM Item 106(1) (July 1, 2008). Since it is providing long-term care services, waiver applicants are subject to the same penalties as those in nursing facilities.

FIFTY YEARS OF PRACTICE REVERSED BY NEW RULES ON POST-DEATH EVENTS

By William E. Sigler, Esq.

Introduction

Section 2053 of the Internal Revenue Code of 1986, as amended (the "Code"), provides that the value of a decedent's taxable estate is to be determined by deducting claims from the value of the gross estate.[1] The Regulations under Code section 2053 are almost 50 years old. New rules proposed by the Internal Revenue Service and Treasury Department would permit a deduction only for the amount paid by an estate with respect to a claim, instead of for the value of those claims as of the date of death.[2] Similar rules would apply to deducting expenses, indebtedness, and taxes. They would require practitioners to file protective claims with almost every estate tax return.

Background

Code section 2001 imposes a tax on the transfer of the taxable estate of every decedent, citizen, or resident of the United States. Code section 2031(a) defines the value of a decedent's gross estate as the value at the time of the decedent's death of all property, real or personal, tangible or intangible, wherever situated. After determining the decedent's gross estate, Section 2051 then provides for the decedent's taxable estate to be determined by deducting various items provided for in Code sections 2051 through 2058.

Code section 2053(a) allows a deduction for funeral and administration expenses, claims against the estate, and unpaid mortgages and other indebtedness relating to the value of property included in the decedent's gross estate. The purpose of these deductions is to exclude from estate taxation those portions of the gross estate that are expended in paying claims and expenses of the estate. Since these amounts are not being transferred to the decedent's legatees, beneficiaries, or heirs, the rationale is that they should not be subject to estate taxation under Code section 2001.

Valuing claims, expenses, indebtedness, and taxes as of the date of the decedent's death is not always easy. What is the value of threatened or pending litigation against the decedent at the date of death? Numerous cases have dealt with the deductibility of claims against the estate where the amount of the estate's liability is uncertain as of the date of death. The courts have tended to fall into one of two different camps.

The first line of cases follows the decision in *Ithaca Trust v Commissioner*.[3] In this case, the Supreme Court held that the estate tax charitable deduction for a charitable remainder interest was to be determined as of the date of death. The courts following *Ithaca Trust* generally do not consider post-death events in valuing claims. However, they have recognized exceptions.[4] One example would be where a claim is not presented for payment. Another example would be for a claim that becomes unenforceable after the decedent's death. On the other hand, several courts have held that the amount actually paid on a claim following the decedent's death is not even admissible into evidence in determining the date of death value of the claim.[5]

The other line of cases follows *Jacobs v Commissioner*.[6] The Court in *Jacobs* rejected the date of death valuation approach in determining the deductible amount of a claim against the estate. The Court distinguished *Ithaca Trust*, stating that "…the claims which Congress intended to be deducted were actual claims, not theoretical ones." Other cases in the First, Second, Fifth, and Eighth Circuits have considered post-death events in valuing claims.[7]

The proposed regulations essentially reject *Ithaca Trust* and adopt the reasoning in *Jacobs*. The decision to adopt *Jacobs* is based on Code section 2053(a) which, unlike Code section 2031, does not contain a specific directive to value a deductible claim at its date-of-death value. Furthermore, the Internal Revenue Service and Treasury Department believe that the date-of-death valuation approach exemplified by *Ithaca Trust* has required an inefficient use of resources for taxpayers, the IRS, and the courts.

The underlying rationale of the Internal Revenue Service and Treasury Department has been subject to controversy, because Code section 2053(a)(3) allows a deduction for claims against the estate. In other words, the deduction is not limited to amounts paid by the estate. The proposed regulations would appear to require claims by an estate to be included in the gross estate, but they would deny a deduction for claims against the estate until those claims are paid. Claims that were formerly susceptible to an actuarial valuation would no longer be deductible until paid. There are rules in the proposed regulations that mitigate some of these adverse results. For example, there are provisions for deducting "estimated amounts," but it remains to be seen how useful those provisions will be. For example, in order to deduct the estimated amount of a claim against the estate, the proposed regulations require that the amount is "ascertainable with reasonable certainty, and will be paid."[8]

Some of these concerns may yet be addressed before the proposed regulations are finalized. In addition to the proposed regulations, the Priority Guidance Plan lists two additional projects under Code section 2053. The first relates to procedures for filing and perfecting protective refund claims for amounts deductible under Code section 2053. The second relates to personal guarantees and the application of present value concepts in determining the deductible amount of the administration expenses and claims against the estate.

Amount Actually Paid

Court Decree

Under the proposed regulations, deductions for claims, expenses, indebtedness, and taxes would be "limited to the total amount actually paid."[9] However, simply paying the claim, expense, indebtedness, or tax is not enough. The proposed regulations refer to the court having appropriate jurisdiction over the administration of the estate, and say that if certain conditions are met, the executor may rely on the final judicial decision of the court if the court actually reviews the expenditures for funeral expenses, administration expenses, claims against the estate, and/or unpaid mortgages and approves them as being allowable as estate expenditures under local law. The conditions which must be met include the following:

- The expenditures are otherwise deductible under Code section 2053 and the corresponding regulations;
- The expenditures have been paid by the estate or meet the requirements for estimated expenses (discussed below);
- The court reviewed the facts relating to the expenditures; and
- The court's decision is consistent with local law.[10]

The proposed regulations provide an example where a local court decree approving an allowance made to an executor in excess of the amount or limit prescribed by statute may not be relied upon to establish the amount deductible under Code section 2053.[11] Most probate cases are unsupervised, and many estates are administered without any probate at all. In that case, the proposed regulations provide that an estate will not be denied an otherwise allowable deduction under Code section 2053 solely because a local court decree has not been entered with respect to that amount, if the amount would be allowable under local law and if no court decree is required under applicable law for payment.[12]

Consent Decrees

The proposed regulations further provide that an executor may rely on a local court decree rendered by consent to establish the amount deductible under section 2053 if two conditions are satisfied.[13] First, the consent decree must be a *bona fide* recognition of the validity of the claim.[14] Second, it must have been accepted by the court as satisfactory evidence upon the merits.[15] A consent given by all parties having interests adverse to that of the claimant is presumed to be recognition of the claim's validity.[16] However, there are more stringent rules for determining the amount deductible for claims by the decedent's family members, related entities, or beneficiaries of the decedent's estate or revocable trust. These are discussed below.

Settlements

There is a different set of rules for settlements. An executor may rely on a settlement to establish the amount deductible under Code section 2053 if the following conditions are satisfied:

- The settlement resolves a *bona fide* issue in an active and genuine contest;
- The settlement is the product of arms-length negotiations by parties having adverse interests with respect to the claim; and
- The settlement is within the range of reasonable outcomes under applicable state law governing the issues resolved by the settlement.[17]

A settlement is viewed as being within the range of reasonable outcomes if it results in a compromise between the positions of adverse parties and reflects the parties' assessments of the relative strengths of their respective positions.[18] Notwithstanding the foregoing, a deduction for amounts paid in settlement of a claim against the decedent's estate will not be allowed if the terms of the settlement are inconsistent with applicable local law.[19] In addition, no deduction will be allowed for amounts paid in settlement of an unenforceable claim.[20]

The reason for the difference in the requirements between a consent decree and a settlement is not clear. In fact, the difference between a consent decree and a settlement is not entirely clear. For example, if the parties to a settlement agreement have the court enter an order approving the settlement, does it become a consent decree? If the court did not specifically make a determination on the validity of the claim, is it still a consent decree, or is it now just a settlement? Would it ever be possible for the court to make a determination on the validity of the claim without an actual court hearing? Must the court hearing be a formal evidentiary hearing? The relatively straightforward and inexpensive process of getting a settlement approved by the court may now involve a more complicated analysis, and potentially be a lot more time-consuming and expensive.

Estimated Amounts

There are several exceptions to the general rule that an amount must be paid in order to be deductible. The biggest of these exceptions is for estimated amounts. A deduction will be allowed for a claim that "satisfies all applicable requirements" even though

the exact amount is not known, provided that the following two requirements are met:

- The amount must be ascertainable with reasonable certainty; and
- The amount will be paid.[21]

Thus, no deduction may be taken on the basis of a "vague or uncertain estimate."[22] Moreover, the proposed regulations impose a duty on the executor to notify the commissioner, and pay any applicable tax and interest, if a deduction was allowed in advance of payment and the payment is subsequently waived or otherwise not made.[23]

The proposed regulations provide an example where state law specifies that the executor is entitled to receive compensation equal to 2.5 percent of the value of the probate estate. In that case, the executor may claim a deduction on the decedent's estate tax return for estimated fees equal to 2.5 percent of the value of the probate estate. However, the deduction will be disallowed if the fees have not been paid as of the time of the examination of the return, unless the executor can establish that the amount is ascertainable with reasonable certainty and will be paid. It is not clear from the example how the executor's fees could fail to satisfy those requirements given the facts outlined in the example. However, the example indicates that the executor may file a protective claim and then later file for a refund once the amount has been paid or the executor satisfies the conditions for deducting an estimated amount. On the other hand, if the deduction is allowed in advance of payment and the payment is thereafter waived or otherwise not made, then the executor must notify the commissioner and pay the tax and interest due.[24]

Another example involves a decedent who is sued in a tort proceeding and responds by asserting affirmative defenses. The estate tax return is due before a final judgment is entered in the case. In that situation, the executor may not take a deduction because the deductible amount cannot be ascertained with reasonable certainty. Instead, the executor must file a protective claim before the expiration of the period of limitations.[25]

Reimbursements

Under the proposed regulations, a deduction is not allowed to the extent that the expense or claim "is or could be compensated for by insurance or otherwise reimbursed."[26] Presumably, this would include a situation where the executor pays a claim against the decedent based on a guaranty. If the decedent fails to pursue a claim for contribution under state law against a co-guarantor, or fails to seek reimbursement from the primary obligor, then presumably the deduction on the estate tax return for the claim would be disallowed.

Administration Expenses

Executor's Commissions

An executor may deduct executor's commissions to the extent they have been actually paid or in an amount which at the time of filing the estate tax return may reasonably be expected to be paid.[27] No deduction may be taken if no commissions are to be paid.[28] If the amount of the commissions has not been fixed by the court, then a deduction will be allowed on the examination of the return only if all three of the following conditions are met:

- The commissioner is reasonably satisfied that the commissions claimed will be paid;
- The amount claimed as a deduction is within the amount allowable by the laws of the jurisdiction in which the estate is being administered; and
- It is in accordance with the usually accepted practice in the jurisdiction to allow such an amount in estates of similar size and character.[29]

If the foregoing conditions are not met, then a protective claim for refund may be filed before the expiration of the period of limitations in order to preserve the estate's right to claim a refund for future amounts paid or estimated to be paid.[30] If the deduction is disallowed in whole or in part on the examination of the return and a protective claim was timely filed, then the disallowance will be subject to modification once the requirements for deductibility are met.[31] If the deduction is allowed in advance of payment and payment is thereafter waived or otherwise not made, then the executor must notify the commissioner and pay any additional tax and interest.[32]

Attorney's Fees

As with executor's commissions, the executor may deduct attorney's fees that have been actually paid or which at the time of filing may reasonably be expected to be paid.[33] If on the examination of the return the fees claimed "have not been awarded by the proper court and paid," then a deduction will nevertheless be allowed if the following conditions are met:

- The commissioner is reasonably satisfied that the amount claimed will be paid; and
- The fees claimed do not exceed a reasonable remuneration for the services rendered, "taking into account the size and character of the estate and the local law and practice."[34]

If the executor is unable to satisfy these requirements, then a protective claim for refund must be filed before the expiration of the period of limitations in order to preserve the estate's right to claim a refund for future amounts estimated to be paid.[35] If the deduction is disallowed in whole or in part on the examination

of the return and a protective claim is timely filed, then the disallowance will be modified once the requirements for deductibility are met. Besides the size and character of the estate and the local law and practice, there is no reference in the proposed regulations to other factors such as the expertise of the attorneys involved.

Expenses incurred in defending the estate against claims are deductible even if the estate is ultimately not victorious.[36] "Expenses incurred in defending the estate against claims" include costs relating to arbitration and mediation, and costs associated with reaching a negotiated settlement of the issues.[37] However, expenses incurred merely for the purpose of unreasonably extending the time for payment, or incurred other than in good faith, are not deductible.[38] Given the nature of litigation, it is not clear as to what would need to be demonstrated in order to resolve a controversy over whether expenses of litigation were incurred "merely for the purpose of unreasonably extending the time for payment" or "other than in good faith."

Claims Against the Estate

General

Claims are liabilities imposed by law or arising out of contract or tort. Claims are deductible if they meet the requirements set forth in Regulation § 20.2053-1. Once those requirements are met, then the amount of those claims which may be deducted under the proposed regulations is limited to amounts for "legitimate and *bona fide* claims" that:

- Represent personal obligations of the decedent existing at the time of the decedent's death;
- Are enforceable against the decedent's estate at the time of payment; and
- Are actually paid by the estate in settlement of the claim.[39]

The proposed regulations specifically provide for events occurring after the date of a decedent's death to be considered when determining the amount that is deductible.[40] Amounts that are unmatured on the date of the decedent's death and that later mature and are paid are deductible. However, no deduction may be taken for a potential or unmatured claim. In that case, the executor must file a claim for refund when the claim matures. A protective claim for refund may be filed before the expiration of the period of limitations for claims for refund. If the requirements may be met, the claim may also be estimated by applying the rules outlined above. Although the protective claim may not state a specific dollar amount, it must identify the outstanding liability or claim that would have been deductible had it already been paid, and the reasons why actual payment has been delayed.[41]

These rules are essentially the opposite of the approach which views the estate tax return as a "snapshot" as of the date of death. Note the inconsistency in the treatment between claims by an estate and claims against an estate. Claims by an estate are an asset. They are valued as of the date of death using the "snapshot" approach. On the other hand, claims against the estate are a deduction. In order to be deductible, they must actually be paid utilizing a "look-back" approach. Does this mean that the full amount of a claim by the estate against a third party must be included in the decedent's gross estate, while a counter-claim by the third party against the estate may not be taken into account until a judgment is entered or a settlement is reached? The answer is not clear.

Contested Claims

No deduction may be taken on an estate tax return for a claim against the decedent's estate to the extent the estate is contesting the decedent's liability.[42] However, the proposed regulations refer to the rules on estimating amounts, so if those rules can be satisfied, then presumably a deduction would be allowed.[43] On the other hand, there is no reference in this section of the proposed regulations to filing a protective claim, and it is not certain as to whether that is meant to imply that a protective claim may not be made where a claim against the decedent's estate is being contested. There is a reference to filing protective claims in the section of the proposed regulations dealing with estimating amounts, which is cross-referenced in this section, so an argument can be made that it should be permissible.

Claims Against Multiple Parties

If the decedent's estate is one of two or more parties against whom a claim is being asserted, then the estate may only deduct the portion of the total claim due from, and paid by, the estate, reduced by the total of any reimbursement received from another party, insurance, or otherwise.[44] Furthermore, the amount deductible by the estate will be reduced by the amount the estate could have collected from another party or an insurer, but which the estate declines or fails to attempt to collect.[45] There is an exception where the estate establishes that the burden of collecting would outweigh the benefit.[46] Similarly, if the estate establishes that the party from whom a potential reimbursement could be collected would only be able to pay a portion of the potential reimbursement, then the amount deductible by the estate will be reduced only by the portion that could reasonably be expected to be collected.[47]

It would not be unusual for an estate to have a claim for reimbursement against a co-guarantor or primary obligor in connection with a guaranty transaction. In many cases, the co-guarantor or primary obligor is likely to be a family member. The estate may not want to pursue a claim for reimbursement against the family member due to the embarrassment to the decedent's family and the ill-will that are likely to result. In those circumstances, making the necessary adjustments to the amount of the claim that is deductible is likely to be difficult.

Claims By Related Parties

Claims by family members, related entities, or beneficiaries are viewed with particular skepticism under the proposed regulations. The "potential for collusion in asserting invalid or exaggerated claims in order to reduce the decedent's taxable estate" is specifically referenced.[48] Thus, the proposed regulations create a "rebuttable presumption" that claims by a family member of the decedent, a related entity, or a beneficiary of the decedent's estate or revocable trust are "not legitimate and *bona fide*" and are therefore not deductible.[49]

Only a hint is provided as to how this presumption may be rebutted. The proposed regulations provide that evidence sufficient to rebut the presumption may include evidence that the claim arises from circumstances that would reasonably support a similar claim by unrelated persons or non-beneficiaries.[50] On the other hand, an actual settlement between a decedent's estate or revocable trust and a family member, related entity, or beneficiary of the decedent's estate or revocable trust will be presumed not to be deductible absent evidence of the legitimacy and *bona fide* nature of the claim.[51]

The definition of "family members" is particularly expansive. It includes the spouse, grandparents, parents, siblings, and lineal descendants of either the decedent or the decedent's spouse.[52] It also includes the spouse and lineal descendants of any such grandparent, parent, or sibling.[53] In addition, it includes adopted individuals.

"Related entity" is also defined very broadly. It includes any entity in which the decedent, either directly or indirectly, had a beneficial ownership interest at the time of the decedent's death or at any time during the three-year period ending on the date of the decedent's death.[54] However, it does not include a publicly-traded entity.[55] It also does not include a closely-held entity in which the combined beneficial interest, either directly or indirectly, of the decedent and the decedent's family members, collectively, is less than 30 percent of the voting or non-voting beneficial ownership interests.[56]

Code section 7491 generally provides that the government has the burden of proof after the taxpayer produces credible evidence about a factual dispute, and the "rebuttable presumption" standard in this section of the proposed regulations, and perhaps some of the standards elsewhere in the proposed regulations, arguably violate this statute. There are other inconsistencies with prior guidance as well. For example, the aggregation of family members in determining the beneficial ownership in a closely-held entity runs counter to Revenue Ruling 93-12.[57]

Finally, the proposed regulations create a lot of practical problems and potential unfairness. For example, suppose that prior to death the decedent received care from both a child and an independent caregiver. The child would be required to present more evidence substantiating the deductibility of payments made for his or her services than required of the independent caregiver.

Unenforceable Claims

Claims that are unenforceable prior to or at the time of the decedent's death are not deductible, even if they are actually paid.[58] Claims that become unenforceable during the administration of the estate are not deductible to the extent they are paid after they become unenforceable.[59]

Claims Founded Upon a Promise

A claim founded upon a promise or agreement is deductible only to the extent that the promise or agreement was *bona fide* and in exchange for adequate and full consideration in money or money's worth.[60] The promise or agreement must have been in good faith, and the price must have been an "adequate and full equivalent reducible to a money value."[61] The only exceptions to these rules are for pledges or subscriptions.

The guarantee of a child's or other person's debt would presumably not be deductible under these rules, assuming that no fee was paid for the guarantee. On the other hand, if the executor can demonstrate that adequate and full consideration was paid for the guarantee, then the deduction would still have to be reduced by the amount recoverable against the child or other person whose debt was guaranteed by the decedent. An interesting question arises as to whether the amount the child is entitled to receive from the estate as a beneficiary should be taken into account in determining the amount recoverable by the estate. Arguably, those amounts should not be taken into account.[62]

Recurring Payments

The proposed regulations cover three situations involving recurring payments. The first situation is where the decedent is obligated to make recurring payments on an "enforceable and certain claim" that is not subject to a contingency, and the payments will continue for a period extending beyond the date on which a final determination of estate tax liability is made. In that case, the obligation may be deducted as an estimated amount.[63] However, the amount deductible is only the present value of the payments as of the date of the decedent's death.[64]

The second situation is where the decedent has a recurring obligation to pay an "enforceable and certain claim," but the decedent's obligation is subject to a contingency. This scenario also includes the situation where the decedent has a non-contingent obligation to make recurring payments, but there is a "reasonable likelihood that full satisfaction of the liability will not be made."[65] In these cases, the estate's deduction is limited to the amount actually paid.[66]

The third situation is where the decedent has a recurring obligation to pay an "enforceable and certain claim" and the estate purchases a commercial annuity from an "unrelated dealer in commercial annuities in an arm's-length transaction" to satisfy the obligation. In this case, it does not matter whether the recurring obligation is contingent or non-contingent. The deduction will be the sum of the amount paid for the commercial annuity, plus the amount actually paid to the claimant by the estate prior to the purchase of the commercial annuity.[67]

All three situations involving recurring payments refer to obligations of the "decedent," and it is not clear whether the same rules would apply to a claim that is resolved after the decedent's death. There are three examples in the proposed regulations, but they all apply to the situation involving a decedent's divorce. In the first example, the estate is allowed a deduction for fixed payments to be made over a fixed period of time.[68] In the second example, a deduction is denied in a similar situation involving fixed payments over a fixed period of time, because the payments cease upon the death or remarriage of the spouse.[69] Thus, a protective claim for refund would need to be filed in order to preserve the estate's right to claim a refund as the payments are made. In the last example, a deduction is permitted for the full cost of an annuity purchased to satisfy an installment obligation under a property settlement agreement incident to a divorce.[70]

Thus, it is not clear whether the result would be different where the estate incurs an installment liability after the decedent's death in connection with the resolution of a claim. For example, if the amount is fixed and non-contingent, would the full amount be deductible, or would just the present value be deductible?

The interest on a deductible claim is itself deductible as a claim, but only to the extent of the amount of the interest accrued at the date of the decedent's death and actually paid.[71] The same rule would apply even if the executor elects the alternate valuation method under Code section 2032.[72] Parenthetically, the proposed regulations recognize that post-death accrued interest may be deductible in appropriate circumstances either as an estate tax administration expense under Code section 2053 or as an income tax deduction.

Taxes

Post-death adjustments increasing a tax liability will increase the amount of the deduction taken under Code section 2053(a)(3) for that tax liability.[73] Similarly, a refund will reduce the amount of the deduction taken for that tax liability.[74] Expenses associated with defending the estate against the increase in tax liability or with obtaining a refund are also deductible.[75] However, in order to preserve the estate's right to claim a refund, a protective claim must be filed before the expiration of the period of limitations.

The proposed regulations include an example where an estate spends $30x defending an asserted $100x deficiency in connection with a gift tax return filed in the year before the decedent's death. The final determination of deficiency is in the amount of $90x. The estate is permitted to deduct both the deficiency in the amount of $90x and the $30x incurred in defending against the increased deficiency. However, the example specifically references the $30x being incurred in connection with the "non-frivolous defense" against the increased deficiency, leaving open the possibility of the deduction for the deficiency being determined according to one standard and the deduction for the legal and accounting fees incurred in defending against the increased deficiency being determined according to another standard.[76]

A second example in the proposed regulations involves a situation where an estate receives a refund for taxes paid in connection with the decedent's final income tax return. If the estate previously received a deduction for the full amount shown on the decedent's income tax return, then the executor has a duty to notify the commissioner of the refund and to pay the additional estate tax and any related interest.[77]

Protective Claims

Under the proposed regulations, it is likely to become more the rule than the exception to file protective claims in connection with estate tax returns. However, there are a variety of substantive and practical problems that are likely to be encountered.

One area of difficulty concerns the interrelationship between claims that do not become deductible until after the expiration of the period of limitations and other deductions, such as the marital and charitable deductions. For example, suppose that the gross estate is $100x, the residue is $30x, and that there is a claim against the estate for $10x. Suppose further that the residue qualifies for the marital deduction. Can the executor claim a charitable deduction for $30x, or must the executor reduce the marital deduction by the $10x protective claim?

Another question involves whether a protective claim is always available. For example, the proposed regulations do not specifically refer to the availability of a protective claim in the context of a contested claim.[78] On the other hand, there is a reference to the ability to file a protective claim in the context of potential and unmatured claims, and a contested claim is essentially a form of potential or unmatured claim.[79] In addition, the proposed regulations indicate that a contested claim can be estimated.[80] The section of the proposed regulations dealing with estimated amounts indicates that a protective claim may be filed if the rules for deducting an estimated amount cannot be satisfied.[81] By referring to the section of the proposed regulations on estimated claims, does that mean that a protected claim can be filed for any uncontested claim that cannot be estimated?

The proposed regulations provide relatively little guidance in terms of what needs to be included in a protective claim. The only discussion about the content of a protective claim is in the section of the proposed regulations dealing with estimated amounts.[82] This section indicates that a protective claim does not have to state a particular dollar amount or demand an immediate refund. However, a protective claim must identify the outstanding liability or claim that would have been deductible had it already been paid. It must also describe the reason for delaying the determination of the liability or the actual payment of the claim.

In matters involving claims against the estate, the executor must be careful to avoid including information in a protective claim that would prejudice the estate's position with respect to that claim. Presumably, referring to the parties, the amount of their respective claims and counter-claims, the current status of the proceedings, and the applicable section of the regulations pursuant to which a deduction is sought should be sufficient. Similarly, on the estate tax return, practitioners should be careful to list the amount of any claim as "undetermined" in order to avoid an argument by the opposing party that the filing of the return is an admission with respect to the claim.

A protective claim for refund is filed on IRS Form 843. It does not have to be filed with the estate tax return, as long as it is filed before the expiration of the period of limitations for claims for refund. However, as a practical matter, it makes sense to file it at the same time that the estate tax return is filed. This will help to avoid overlooking it and missing the deadline later on.

Once the deduction becomes allowable, then another Form 843 must be filed. Note that under the proposed regulations, this can occur when the claim is paid, when the claim is capable of being estimated, or when an annuity is purchased in the case of an installment obligation. Consideration should also be given at that time to filing an amended estate tax return. For example, the amended estate tax return may be helpful in showing the calculation of the adjustment for the claim.

Conclusion

The proposed regulations are not effective until they are finalized. However, many practitioners are likely to begin filing protective claims with estate tax returns even before the proposed regulations are finalized.

It remains to be seen whether these rules will increase or decrease the "inefficient use of resources for taxpayers, the IRS, and the courts."[83] They will certainly complicate the process of filing estate tax returns, and cause them to remain open and unresolved for much longer than before. They are also likely to create many hardships as estates find it necessary to prematurely settle claims or borrow funds to pay estate tax that previously would have been mitigated by deductions that are now not available until some time in the future, or which may not be allowable at all.

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Endnotes

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3 *Ithaca Trust v Commissioner*, 279 U.S. 51 (1929).

4 See, e.g., *Propstra v. U.S.*, 680 F.2d 1248 (9th Cir. 1982) and *Estate of Van Horne v Commissioner*, 78 T.C. 728 (1982), *affirmed*, 720 F.2d 1114 (9th Cir. 1983), *cert. denied*, 466 U.S. 980 (1984).

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10 Prop. Reg. § 20.2053-1(b)(2)(i).

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14 *Id.*

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18 *Id.*
19 *Id.*
20 *Id.*
21 Prop. Reg. § 20.2053-1(b)(4).
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23 *Id.*
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25 Prop. Reg. § 20.2053-1(b)(6), *example 2.*
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27 Prop. Reg. § 20.2053-3(b)(1).
28 *Id.*
29 *Id.*
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31 Prop. Reg. § 20.2053-3(b)(3).
32 *Id.*
33 Prop. Reg. § 20.2053-3(c)(1).
34 *Id.*
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43 *Id.*
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45 *Id.*
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49 *Id.*
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51 *Id.*
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64 *Id.*
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66 Prop. Reg. § 20.2053-4(b)(7)(ii).
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68 Prop. Reg. § 20.2053-4(d), *example 8.*
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70 Prop. Reg. § 20.2053-4(d), *example 10.*
71 Prop. Reg. § 20.2053-4(c).
72 Id.
73 Prop. Reg. § 20.2053-6(g).
74 Id.
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78 Prop. Reg. § 20.2053-4(b)(2).
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83 2007-21 I.R.B. 1293.

PROMOTION OF ALTERNATIVE ENERGY TECHNOLOGIES THROUGH MICHIGAN TAX CREDITS AND INCENTIVES

By Marla S. Carew, Esq.

As this article went to print, Michigan's press coverage of recent tax incentive-driven alternative energy business developments, such as the location of Global Wind Systems, Inc. in Novi, Michigan to take advantage of skilled engineering and manufacturing workers laid off from the auto industry, interest in hiring the same by a Mariah Power/MasTech Manufacturing turbine manufacturing venture located in Manistee, investment of up to $1 billion in the state by polycrystalline silicon (photovoltaic cell component) maker Hemlock Semiconductor, development of a new Livonia facility by hybrid vehicle maker Fisher Coachworks, LLC, and the commitment of A123 Systems, a maker of lithium-ion batteries, to a new location in Michigan, remains vigorous.[1] Since January 2009, Kalamazoo Valley Community College has been offering Michigan's first "windsmith certification" for wind turbine technicians (small, commercial as well as utility-size) based on a German program recognized as an international standard for such training.[2]

In sobering news, in the days before this article was submitted, Chrysler LLC filed for Chapter 11 bankruptcy protection in a New York court, and numerous traditional Michigan automotive supplier creditors will be impacted by the reorganization. With the state's traditional manufacturing economy in the doldrums and the governor proclaiming that the state's "green" focus is all about "jobs,"[3] it is an appropriate time for a review of Michigan's new, and largely untested, tax credits and incentives directed at bringing more alternative energy business and job creation to the state.

The State of Alternative Energy in the State of Michigan Circa 2009

At the present time, whether enacted in connection with the Michigan Business Tax Act ("MBT"), NextEnergy Act, or General Property Tax Act, a number of credits and incentives exist to encourage investment and development of alternative energy businesses in Michigan.

Michigan Business Tax Credits that May Be Available to Alternative Energy Businesses

The following credits against MBT liability are directed at R&D activities, "high technology" companies, or "anchor companies," and may be available to alternative energy companies. However, since these credits, many of which are administered by the Michigan Economic Growth Authority ("MEGA") and realized through MBT filings, are not directly aimed at alternative energy businesses, careful reading of the appropriate statutes and discussion with counsel and state government personnel should be undertaken before any business makes firm plans based on the assumption that it may receive a credit.

The MBT Refundable R&D Credit, MCL 208.1405. For tax years 2009 and later, taxpayers may claim a credit against MBT liability equal to 1.90 percent of the taxpayer's research and development expenses. This credit, when combined with the total compensation and investment credits allowed under MCL 208.1403, may not exceed 65 percent of the taxpayer's total MBT liability. Taxpayers may also take a credit against the MBT equal to 30 percent of the taxpayer's eligible contribution in an eligible R&D business in tax years 2009 and 2010.[4] Taxpayers must apply to the Michigan Economic Growth Authority, or MEGA, and receive a certificate from MEGA in order to claim this credit.

The MBT Refundable Hybrid Technology R&D Credit, MCL 208.1450. For tax years beginning after January 1, 2008 and ending before January 1, 2016, taxpayers engaged in R&D on a hybrid system, the primary purpose of which is propelling a motor vehicle, may claim a credit against MBT liability in the amount of 3.9 percent of the compensation for services, performed in a qualified facility, paid to employees at that facility. However, taxpayers seeking this credit were required to enter into a written agreement with MEGA prior to April 1, 2007, thereby prospectively limiting the availability of this credit.[5]

The MBT High Technology Anchor Company Payroll Credit, MCL 208.1431a, and High Technology Anchor Company Taxable Property Credit, MCL 208.1431c. Both of these credits exist to reward "anchor companies," or "qualified high-technology businesses," that are integral parts of "qualified high-technology activities" and have the potential or ability to influence the business decisions and site locations of "qualified suppliers or customers."[6] MEGA reviews applications by prospective "anchor companies" and may grant "qualified taxpayer" status upon "anchor companies" that influence one or more "qualified suppliers or customers" to open, locate, or expand in Michigan.[7] "Qualified suppliers or customers" are those that open a new location in Michigan, or locate in Michigan, or existing Michigan businesses that expand as a result of an "anchor company" and satisfy certain MEGA requirements.[8]

Effective April 8, 2008, a qualified taxpayer may claim a credit against the MBT in an amount up to 100 percent of a qualified supplier or customer's payroll, attributable to employees performing qualified new jobs (as determined by MEGA), multiplied by the tax rate for the tax year, for a period not to exceed five years. Also effective during this time, a qualified taxpayer may claim a credit against the MBT equal to the sum of up to 5 percent of the taxable value of each qualified supplier or customer's property located within a 10-mile radius of the qualified taxpayer and subject to ad valorem taxes (as determined by MEGA). If this property is subject to industrial facilities tax, then the qualified taxpayer may include only up to 2.5 percent of the taxable value of the property in the credit calculation.[9]

Miscellaneous Energy-Related Credits, MCL 208.1432, 208.1434. A variety of high-technology-directed credits exist in MBT Sections 1432 and 1434, including a credit for polycrystalline silicon manufacturers, parties to written agreements with MEGA, based on their energy consumption costs,[10] a credit for plug-in traction battery pack manufacturers, parties to agreements with MEGA, based on kilowatt hour battery capacity,[11] a credit for "qualified expenses for vehicle engineering" under an agreement with MEGA,[12] a credit for "qualified advanced battery engineering expenses" under an agreement with MEGA,[13] and a credit for capital investment in an integrative cell manufacturing facility, under the terms of an agreement with MEGA.[14] All of these credits are highly specific and limited in scope, and attorneys or taxpayers who believe that they might have applicability to an alternative energy business would be wise to read the statute closely and discuss the proposed activities with experienced counsel and MEGA.

Michigan Tax Credits Directed Specifically at Alternative Energy Businesses

The following credits are directed specifically towards alternative energy businesses, though in some cases availability is limited to a select pool of taxpayers. Businesses, and their counsel, should carefully weigh the benefits of credits and long-term business strategies to ensure that the best overall opportunities for growth in Michigan are seized by alternative energy businesses.

Nonrefundable Business Activity Tax Credit, MCL 208.1429(2). This credit against MBT liability is administered by the Michigan NextEnergy Authority, a "public body corporate and politic" established in 2002, as set forth in MCL 207.821 et seq., and located in the Department of Management and Budget. It allows businesses engaged in alternative energy research, development, and manufacturing to claim a credit equal to the lesser of 1) the amount by which a business's "tax liability attributable to qualified business activity" for the year exceeds the business's "baseline tax liability attributable to qualified business activity" or 2) 10 percent of the amount by which the business's "adjusted qualified business activity" performed in Michigan, outside of a Renaissance Zone, for a tax year exceeds such activity for the 2001 tax year under the former SBT Section37e. "Qualified business activity" is defined in MCL 208.1429(i) to include research, development, or manufacturing of an alternative energy marine propulsion system, an alternative energy system, an alternative energy vehicle, alternative energy technology, or renewable fuel. These "alternative" and "renewable fuel" defined terms are found in MCL 207.822, and among them "alternative energy system" and "alternative energy technology," found at MCL 207.822(c) and (d), are notable for their breadth (encompassing systems and technologies pertaining to fuel cells, wind and solar sources, microturbines, photovoltaic, battery cell, clean fuels, and biomass systems, to name some of the many). It bears mention here, in connection with the mention of a Renaissance Zone, that the NextEnergy Zone was established as one such zone in 2002 at the Wayne State University Research and Technology Park.

Refundable Payroll Tax Credit, MCL 208.1429(5). This refundable credit against MBT liability is administered by the Michigan NextEnergy Authority, and available to taxpayers located in the NextEnergy Zone. The credit is equal to the "qualified payroll amount" (as defined in MCL 208.1429(7)(k)) and, if it exceeds MBT liability for the tax year, the excess may be refunded to the taxpayer. As this refundable credit is available only to "qualified alternative energy entities," defined in MCL 208.1429(7)(h) to be located in an "alternative energy zone," of which currently only the NextEnergy Zone exists at Wayne State University in Detroit, its availability is severely limited compared to the nonrefundable business activity credit discussed above.

Renewable Energy Renaissance Zones, MCL 125.2681 et seq. Under 2006 legislation, expanded in 2008, the State of Michigan may create up to 15 Renewable Energy Renaissance Zones (each a RERZ), each of which may offer 100 percent abatement of MBT, state education tax, personal and real property taxes, and local income taxes for up to 15 years, phased out in increments of 25 percent over the last three years of the term. Counties or communities must submit an application to the Michigan Strategic Fund Board (MSF) in order to have an area designated as an RERZ. Taxpayers that may reap the benefits of location in a RERZ must meet the definition of a "renewable energy facility" as set forth in MCL 125.2683(k), meaning a facility that creates energy directly or fuel from the wind, the sun, trees, grasses, biosolids, algae, agricultural commodities, processed products from agricultural commodities, or residues from agricultural processes, wood or forest processes, food production and processing, the paper products industry, solid biomass, animal wastes, or landfill gases (or focuses on research, development, or manufacturing of systems or components of systems used to create energy or fuel from the items described above).

Alternative Energy Personal Property Tax Exemption, MCL 211.9i. One primary function of the Michigan NextEnergy Authority is the annual certification of alternative energy personal

property that may qualify for tax exemption. Personal property eligible for this tax exemption includes the alternative energy systems, personal property of an alternative energy technology business and the personal property of a business not engaged in alternative energy technology, but instead used solely for researching, developing, or manufacturing alternative energy technologies. Alternative energy systems include fuel cells, solar and wind energy systems, microturbines, and clean fuel systems powered by natural gas, ethanol, hydrogen, biomass and biodiesel, among others (a complete list may be found at MCL 207.822). This tax exemption encourages new alternative energy development in Michigan by limiting its availability to nonresidential technology owners, R&D or manufacturers of such technology, and property new to Michigan (not previously exempted from Michigan tax).

Biomass Gasification and Methane Digester Property Tax Exemption, MCL 211.9(1)(j). This property tax exemption applies to certain energy production-related farm facilities and covers exemption of 100 percent of both real and personal property taxes. Receipt of the exemption requires Michigan Department of Agriculture (MDA) certification and compliance under the Michigan Agricultural Environmental Assistance Program (MAEAP), as well as permitted access to the facility by universities for information collection.

Miscellaneous. The State-offered Biomass Energy Program Grants through the Department of Energy's State Energy Program (through May 2009—query whether this will be extended) and has prepared, and continues to make available, a Model Ordinance for Wind Energy Systems for local governments wishing to develop siting rules for wind turbines.

Federal Credits and Incentives Offer Flexibility

It is worth noting that in addition to Michigan's alternative energy incentives, some of which admittedly are of limited availability (e.g., due to their focus on farm or NextEnergy Zone taxpayers), provisions of the American Recovery and Reinvestment Act of 2009 offer generous and unusually flexible incentives for investment in and development of domestic alternative energy businesses. For example, while the Internal Revenue Code Section 48 Investment Tax Credit or "ITC" (permitting a credit equal to 30 percent, or 10 percent, of certain expenditures), and IRC Section 45 Renewable Electricity Production Tax Credit or "PTC" (permitting a cents-per-kilowatt hour credit) existed and were available to alternative energy businesses prior to 2009, after the enactment of ARRA, taxpayers eligible for the PTC and ITC gained unexpected flexibility in reaping the benefits of these credits. Taxpayers eligible for the PTC may take it, or the ITC, or receive a cash grant from the U.S. Treasury (and taxpayers eligible for the ITC may elect to take it or the Treasury cash grant). ARRA also lifted certain caps and expanded the scope of certain types of alternative energy systems eligible for tax incentives. Any alternative energy business interested in location or expansion in Michigan should carefully investigate the incentives available to it from the federal, as well as state, government in order to maximize the value of strategic business decisions.

Conclusion

Michigan's governor and legislators appear to be serious in their efforts to attract new alternative energy business to the state. Early returns show some successes, such as the commitments of Global Wind Systems, Inc. and A123 Systems, though more time is needed to determine how well the state is able to, for example, bring wind system manufacturing and assembly to Western Michigan or any alternative energy company in need of plentiful automotive-trained skilled labor to metro Detroit. While a number of the MBT/MEGA or NextEnergy Authority administered credits discussed above are narrow in availability (for example, requiring location in the NextEnergy Zone, or one of the state's handful of Renewable Energy Renaissance Zones, or work in a narrow market niche), the state's and federal government's efforts to incentivize alternative energy business development and technological innovation are heartening. This writer hopes that the *Michigan Tax Lawyer* will check back in with this issue in 5 and 10 years, to track progress in changing Michigan's economy one tax credit dollar at a time.

About the Author

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3 'Green' is all about 'jobs' Granholm clarifies shift in economy, The *Ann Arbor News*, March 6, 2009.

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5 MCL 208.1450(1)

6 The terms "Business," "Qualified high-technology activity" and "Qualified high-technology business" are defined in the MEGA Act, MCL 207.803.

7 MCL 208.1431a(5)

8 MCL 208.1431a(5)(f)

9 MCL 208.1431c(1)

10 MCL 208.1432(1)

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THE STIMULUS PACKAGE: SOME TAX CHANGES IN THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

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The American Recovery and Reinvestment Act of 2009 (the Act) was signed into law on February 17, 2009.[1] The legislation is designed to stimulate the economy out of the current deep recession. It represents a massive injection of federal monies into the economy of a size not seen since enactment of the New Deal when then-President Franklin Delano Roosevelt stood at the helm of a country embroiled in an economic crisis and a second World War.[2] The $789 billion package provides a number of tax incentives (in Division B, Title I) for both individuals and businesses.[3] This article discusses a few of those incentives.

Amendment to Section 108[4]

Section 108 allows a taxpayer to exclude cancellation of debt income from gross income in certain circumstances.[5] For 2009 and 2010, the Act amended section 108 by adding subsection (i), a new exclusion for certain businesses that engage in debt restructuring.[6] Under this provision, a taxpayer generally can exclude discharge of debt income equal to the excess of the adjusted issue price of the indebtedness being satisfied over the amount paid to cancel the debt.[7] However, the exclusion is not forever; rather, the taxpayer may defer reporting the income for up to five years.[8]

The new provision is limited to businesses that restructure debt and does not apply to individual taxpayers. For a business to qualify for the deferral, the debt must be reacquisitioned[9] in 2009 or 2010.[10] Additionally, the debt must be used "directly or indirectly by the issuer to reacquire an applicable debt instrument of the issuer."[11] An applicable debt instrument is any debt instrument issued by a C corporation or any other person in connection with the conduct of a trade or business by such person.[12] If only a portion of the proceeds from a debt instrument are used, then the five-year deferment is applied only to the "portion of any original issue discount on the newly issued debt instrument which is equal to the portion of the proceeds from such instrument used to reacquire the outstanding instrument."[13]

Not all taxpayers will want to take advantage of the new provision. To do so, borrowers must forego other section 108 exclusions, such as those that would allow exclusion of 100 percent of the income.[14] The benefit of deferment "may not offset the tax it must pay in the future on the deferred CODI amount."[15]

Inclusion of the deferred income will be accelerated if certain events occur.[16] First, if the taxpayer dies unexpectedly or the business ceases to exist, then any exclusion previously allowed must be taken into account in that taxable year.[17] Second, the acceleration rule applies to the sale, exchange, or redemption of an interest by a partner, shareholder, or other person holding an ownership interest in a partnership, S corporation, or other pass-thru entity that had taken advantage of the deferral provision.[18] However, there is no acceleration of reporting the income where a taxpayer reorganizes and emerges from Chapter 11.[19]

Practitioners currently are awaiting guidance on the new provision. Hopefully, that guidance will address questions regarding characterization of cancellation of debt income for purposes of the qualifying income test of section 7704(e) for larger partnerships,[20] determining whether a corporate taxpayer should be required to increase its earnings and profits during the year the cancellation of debt transaction occurs,[21] and determining what happens when a taxpayer triggers the acceleration clause of section 108(i) by going out of business and transferring its assets to a successor.[22]

First-time Homebuyers[23]

The Housing Assistance Tax Act of 2008 included the First-Time Homebuyer Credit for home purchases after April 9, 2008, and before July 1, 2009.[24] It provided first-time homebuyers with a tax credit of 10 percent of the home purchase price, up to a maximum credit of $7,500.[25] The credit was then recaptured over a 15-year period beginning with the second taxable year after the

purchase.[26] Ultimately, many potential first-time homebuyers were not motivated by the 2008 credit.[27] Consequently, the Act modified the first-time homebuyer credit by increasing the limit from $7,500 to $8,000 for a main residence. It also waived the recapture provision entirely,[28] provided the taxpayer retains the home as the main residence for a period of 36 months.[29] The credit is extended to home purchases occurring before December 1, 2009.[30]

To qualify for the credit, a taxpayer must purchase a home between January 1, 2009, and December 1, 2009, from a seller that is not related to the buyer,[31] and the taxpayer must not have owned a main residence for the previous three years.[32] The taxpayer is entitled to the full credit if he or she earns a modified gross annual income of $75,000 or less ($150,000 for a married couple).[33]

If a qualified taxpayer purchased a main residence on or before April 15, 2009, he could have claimed the credit, at the earliest, on his 2008 income tax return. If the taxpayer closes after April 15, 2009, he can amend his 2008 return or claim the credit on his 2009 return.[34]

The tax credit is a bottom line reduction to the taxpayer's tax liability.[35] It can be split among two or more unmarried individuals using any reasonable method, provided the total amount does not exceed the available credit.[36] However, if married individuals purchase a home and file a joint return, each spouse is treated as having been allowed half of the credit, should repayment be required.[37]

Although this credit is a tremendous benefit for first-time homebuyers, there are many critics who believe that this credit should extend to *all* buyers, and not only to *first-time* homebuyers.[38] However, arguably, the only way to truly stimulate the housing market, and positively impact the housing inventory, is for individuals who currently rent, or are not an active part of the housing market, to purchase new homes.

Some states, such as Missouri, recognize that many prospective buyers do not have the necessary down payment or funds for closing costs and are concerned that the tax credit will have only a minimal impact on the housing slump.[39] Therefore, Missouri is working on an initiative to lend first-time homebuyers the $8,000 credit amount that they will eventually receive. Repayment is required once the credit is obtained, at the latest in the following year.[40]

Credits Related to Electric and Hybrid Cars[41]

The volatility of the oil market and the necessity to reduce our country's carbon emission motivated Congress to enact tax credits to encourage investment in the production and purchasing of energy efficient products, including plug-in electric vehicles. In Michigan, this investment is particularly needed to encourage development of the next generation of automotive companies. Section 30D allows a tax credit for each new qualified plug-in electric drive motor vehicle placed in service by the taxpayer during the taxable year.[42] The credit amount is $417 for any plug-in electric drive motor vehicle with not less than 5 kilowatt hours of capacity and $417 for each kilowatt hour of capacity in excess of five kilowatt hours.[43] The credit cannot exceed $5,000.[44]

Among other requirements,[45] to qualify as a plug-in elective drive motor vehicle the vehicle must be propelled to a significant extent by an electric motor that draws electricity from a battery that has a capacity of not less than four kilowatt hours (kW-hr) and is capable of being recharged from an external source of electricity.[46]

Unfortunately, most hybrid passenger cars that use both an internal combustion engine and battery power would not qualify for the credit because they are not capable of being recharged from an external source of electricity. Vehicles that previously had been in production and would have qualified for this tax credit include the Toyota RAV4 EV, which has a capacity of 27 kW-hr, and General Motors EV1, with a capacity of 26.4 kW-hr. Unfortunately, neither of these vehicles has been in production since 2003.[47] The only vehicle that is currently in production and for sale in the United States and that qualifies for the tax credit is the Tesla Roadster which has a battery capacity of 53 kW-hr. The Tesla Roadster has a list price of $109,000. A tax credit of $4,587 is unlikely to change anyone's ability to afford the Roadster.[48]

Section 30 was amended to allow a credit equal to 10 percent of the cost of any low-speed qualified plug-in electric vehicle, such as an electric golf cart or an electric scooter.[49] This credit is limited to $2,500, down from $4,000 before the section was amended.[50]

Without the development and production of new models of plug-in electric vehicles, the purpose behind section 30D and section 30 is moot. Thus, new section 48C allows a tax credit for 30 percent of the qualified investment for any qualifying advanced energy project.[51] An advanced energy project includes a project that re-equips, expands, or establishes a manufacturing facility for the production of, among other energy projects, new qualified plug-in electric drive motor vehicles and qualified plug-in vehicles. It also applies to the production of components that are designed specifically for use with electric plug-in vehicles.[52]

Section 30B(d) provides a credit for a new qualified hybrid motor vehicle. The credit is equal to the sum of the fuel economy credit[53] and the conservation credit.[54] Considering both credits, the maximum credit a taxpayer could receive for purchasing a new qualified hybrid vehicle is $3,400. The Service's website lists hybrid vehicles that qualify for a tax credit and the amount of the credit for each vehicle as of 2007.[55]

Bonus Depreciation: Sections 179 and 168(k)[56]

The section 179 bonus deprecation 2008 dollar amounts are extended, allowing an expense deduction for $250,000 of the cost of qualifying property[57] acquired and placed in service in the taxable year.[58] However, this provision effectively is limited to small businesses because of the phase-out rule. The expense allowance is reduced dollar-for-dollar where the value of section 179 property placed into service during the taxable year exceeds $800,000.[59]

The Act also extends a special expense allowance of 50 percent of the adjusted basis of qualified property acquired and placed into service before January 1, 2010.[60] Qualified property includes MACRS property with a recovery period of 20 years or less, as well as certain leasehold improvement property.[61]

An election to expense qualified property under section 179 or 168(k) is taken in lieu of depreciation, meaning the basis is reduced by the amount of the expense deduction.[62] For example, assume a taxpayer acquires and places into service $500,000 of five-year MACRS property and elects both provisions. Under section 179, the taxpayer may deduct $250,000, and the basis of the property is reduced to $250,000. Under section 168(k), the taxpayer may deduct $125,000, and the basis of the property is reduced to $125,000. The regular MACRS deprecation is available and results in a depreciation deduction of $25,000. Thus, the taxpayer is entitled to deduct $400,000 of the $500,000 cost of the property, and the property has an adjusted basis of $100,000.

Net Operating Loss Carryback Provision[63]

The Act alters the net operating loss[64] carryback provision and provides an opportunity for a quick refund, within 45 days, to qualified small businesses.[65] A qualified small business[66] may now carry back a net operating loss for three, four, or five years (rather than just two[67] taxable years); the carry forward period is not affected.[68]

Credit for Qualified Wind Energy[69]

In 2008, Congress added to section 48 the business energy credit for a qualified wind energy facility, with certain limitations on how much credit a taxpayer could claim. Now, in the Act, those limitations have been removed.

For purposes of the investment credit,[70] qualifying energy property[71] includes qualified small wind energy property, which is property that uses a qualifying small wind turbine to generate electricity.[72] For any qualified property[73] that is part of a qualified investment credit facility,[74] that property can be treated as energy property for purposes of the election to treat qualified facilities as energy property.[75] The energy percentage for that property is 30 percent.[76]

Before the Act, to be a qualified facility, a facility using wind to produce electricity had to be originally placed in service before January 1, 2010.[77] The Act extended the "placed in service" end date from January 1, 2010, to January 1, 2013.[78] The temporary election allows a taxpayer who places qualified wind facilities in service in 2009 through 2012 to claim the investment tax credit instead of the production tax credit.[79] Therefore, under the Act, for those years a taxpayer can place the wind facilities in service and irrevocably elect the 30 percent business energy credit instead of the electricity production credit.

Under the Act, the prior basis reduction rule with subsidized energy financing does not apply to the construction, reconstruction, or erection of small wind energy property completed by the taxpayer to the extent of expenditures made after December 31, 2008, and to acquisition of such property made and placed in service after December 31, 2008.[80] In addition, the $4,000 credit cap applicable to qualified small wind energy property is eliminated for periods after December 31, 2008—allowing an uncapped 30 percent credit to be claimed for such property.[81]

Under section 45, a renewable electricity income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities.[82] Wind is a qualified energy resource.[83] The amount of the credit is equal to the product of 1.5¢ times the kilowatt hours of electricity produced by the taxpayer from qualified wind energy resources, and at a qualified facility during the 10-year period from the date the facility was originally placed in service.[84] Once the taxpayer elects to take the section 48 business energy credit for any qualified investment credit facility, a taxpayer cannot take the section 45 electricity production credit for the qualified investment credit facility.[85]

Work Opportunity Credit[86]

The work opportunity tax credit provides an incentive for employers to hire individuals from certain disadvantaged groups (also called target groups) that have a high unemployment rate.[87] An employer who hires an individual from one of these groups is allowed to file a tax credit with the designated local agency (in Michigan it is the Unemployment Insurance Agency, Work Opportunity Tax Credit Unit).

The Act created two new categories[88] of targeted groups: unemployed veterans[89] and disconnected youth.[90] An employer who hires an individual from one of the targeted groups in 2009 or 2010 may claim a tax credit equal to 40 percent of the first $6,000 of qualified wages paid to an individual during the first year of employment ($12,000 per year in the case of any individual who is a qualified veteran).[91] Qualified first-year wages refers to the service rendered during the one-year period beginning with the day the individual begins work for the employer.[92] However, the credit can be reduced to 25 percent for an employee if the employee works 400 hours or less during the first year of employment.[93]

Earned Income Tax Credit[94]

The Earned Income Tax Credit (EITC), created in 1976, has grown over the past 30 years into the nation's largest program for the so-called "working poor."[95] Before the Act, families with at least three children received the same credit amount as families with two children (around 40 percent of earnings).[96]

Families with three or more children are much more likely to have low incomes than other types of families, even when they are working. In 2000, 28 percent of employed families with three or more children had incomes below 150 percent of poverty, compared to 12 percent of one-child families and 14 percent of two-child families.[97] The research suggests that a larger EITC benefit for families with three or more children would reduce poverty among a group of children and families for which poverty rates remain quite high, while encouraging increased employment among parents in large families and furthering welfare reform goals.[98] Consistent with this research, the Act increases the EITC amount for families with three or more children to up to 45 percent of household income.[99]

The Act also improved the EITC for married couples. Because the EITC is designed to benefit low-income workers, it phases out at a specified income level (about $40,000 for a family with two children). However, if two people who each individually qualify for the EITC get married, their new combined income can reduce or even eliminate their credit. Thus, the Act increases the "phase-out" income for married couples so as to counter this marriage "penalty."[100]

Build America Bonds[101]

As part of the Act, Congress included a tax credit for Build America Bonds until December 31, 2010. The bondholder is allowed a tax credit on 35 percent of the interest paid.[102] To qualify, the bond proceeds must be used for capital expenditures, and the taxpayer must make an irrevocable election for the provision to apply.[103] The issuer, which must be a state or local government, may elect to receive a tax credit of up to 35 percent of the interest paid.[104]

One Item Noticeably Absent From the Act[105]

The estate unified credit exclusion amount is $3.5 million in 2009, $0 in 2010 (due to the repeal),[106] and $1 million in 2011.[107] The highest estate tax rate is 45 percent for 2009, 0 percent for 2010 (due to the repeal), and 55 percent for 2011.[108] Arguably, raising estate tax rates or lowering the exemption amount would encourage the wealthy to spend their money to avoid taxation at their death. Such spending may include giving it to friends, family, or charities, which would lead to the recipient's spending. While this type of spending could fuel the economy, increase job opportunities, redistribute the wealth, and create more opportunities for society as a whole, the Act did not address the estate tax rate or the exemption amount.

About the Authors

This article is a compilation from entries in the Thomas M. Cooley Sixth Annual Tax Writing Competition. Endnotes indicate the primary author of each section. All authors are law students—either in Cooley's graduate tax program or JD students pursuing additional studies in taxation. The piece was edited by Professor Joni Larson of Cooley.

Endnotes

1 American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115.

2 Gregg Hitt and Jonathan Weisman, *Congress Strikes $789 Billion Stimulus Bill*, Wall St. J. Online (last visited April 3, 2009) <http://online.wsj.com/article/SB123436825805373367.html>.

3 American Recovery and Reinvestment Act of 2009, *supra*, note 2.

4 This portion of the article was authored by Amanda York Ellis. Ms. Ellis tied for first place in the Sixth Annual Thomas M. Cooley Tax Writing Competition.

5 See I.R.C. § 108.

6 I.R.C. § 108(i). A business that seeks to take advantage of the new section 108(i) must elect to do so on its tax return. The election is made by including a statement with the tax return for the year the debt buyback occurs. It must clearly identify the instrument and include the amount of income discharged. If a partnership or S corporation wishes to make the election, it must be made by the entity. Once made, the election is irrevocable. I.R.C. § 108(i)(5)(B).

7 I.R.C. § 108(i). A special rule applies for a partnership that takes advantage of the deferral provision. The deferred income is allocated to the partners immediately before the discharge in the same manner as those amounts would have allocated as distributive shares under section 704. If the discharge causes a decrease in a partner's share of partnership liabilities, the decrease is not taken into account for purposes of section 752 at the time of the discharge to the extent it would cause the partner to recognize gain under section 731. Partners who experience a decrease in partnership liabilities take this income into account when income deferred under section 108(i) is recognized. I.R.C. § 108(i)(6).

8 I.R.C. § 108(i). The statute requires that debt be repurchased after December 31, 2008, and before January 1,

2011. Thus, for reacquisitions beginning in 2009, income inclusion is deferred until the fifth taxable year following the taxable year in which the reaquisition occurs. For reaquisitions beginning 2010, income inclusion is deferred until the fourth taxable year following the taxable year in which the reacquisition occurs. I.R.C. § 108(i)(1)(A), (B).

9 Reacquisitioned is "any acquisition of the debt instrument by the debtor which issued the debt instrument or a related person to such debtor." I.R.C. § 108(i)(4)(A)(i), (ii).

10 I.R.C. § 108(i)(1).

11 I.R.C. § 108(i)(2)(B).

12 I.R.C. § 108(i)(2), (B), (i)(3)(A)(i), (ii) The debt instrument issued for reacquiring existing debt is treated as issued for the debt instrument being reacquired. A debt instrument is a "bond, debenture, note, certificate, or any other instrument or contractual arrangement constituting indebtedness (within the meaning of 1275(a)(1))." I.R.C. § 108(i)(3)(B).

13 I.R.C. § 108(i)(2)(B).

14 See I.R.C. § 108(a)(1)(A), (B).

15 Press Release, McGuireWoods LLP, *Stimulus Bill Reduces Tax Burden on Companies that Restructure Debt—But May Complicate Tax Planning* (last visited May 2, 2009) <http://www.mcguirewoods.com/news-resources/news/3733.asp?SearchFor=Stimulus%20Bill%20Reduces>.

16 I.R.C. § 108(i)(5)(D)(i).

17 I.R.C. § 108(i)(5)(D)(i).

18 I.R.C. § 108(i)(5)(D)(ii).

19 H.R. Rep. No. 111-16 at 565.

20 *KPMG Seeks Guidance on Cancellation of Debt Income for Publicly Traded Partnerships*, 2009 Tax Notes Today 60-26 (April 1, 2009).

21 *Treasury To Issue Guidance on Stimulus Cancellation of Debt Provision, Official Says,* 2009 Tax Notes Today 46-2 (March 12, 2009).

22 *Id.*

23 This portion of the article was authored by Catherine McCollum. Ms. McCollum tied for first place in the Sixth Annual Thomas M. Cooley Tax Writing Competition.

24 I.R.C. § 36(h).

25 I.R.C. § 36(a), (b).

26 I.R.C. § 36(f)(1),(7). If the taxpayer disposed of the home, or if a taxpayer no longer used the home as the main residence, the credit balance was recaptured in that taxable year. I.R.C. § 36(f)(2). Notably, if the taxpayer disposed of the home through sale to an unrelated party, acceleration of recapture was limited to the amount of gain obtained in the sale. I.R.C. § 36(f)(3).

27 *[Practitioner] Interoffice Memo on the Enhanced First-Time Homebuyer Credit in the American Recovery and Reinvestment Act of 2009* (RIA) ¶ 1417.

28 I.R.C. § 36(b),(f)(1). This credit is subject to offsets for taxes and other federal debt. See *First-Time Homebuyer Credit Subject to Debt Offsets*, 2009 Tax Notes Today 68-73 (April 13, 2009).

29 I.R.C. § 36(f)(4)(D). A taxpayer that disposes of or ceases to maintain the home as a main residence within 36 months of the date of the home purchase is required to repay the credit in that taxable year. Ceasing to use the home as a main residence includes selling the home, converting the home to business or rental property, or if the home is destroyed, condemned, or disposed of under threat of condemnation. Notably, if the taxpayer's home is involuntarily converted by destruction as a result of theft, seizure, condemnation or threat or imminence thereof, the taxpayer is not required to repay the credit if a new residence is purchased to replace the previous residence within two years. See I.R.S. Form 5405.

30 I.R.C. § 36(h).

31 I.R.C. § 36(c)(3)(a)(*i*),(c)(5). For example, the seller cannot be a parent, grandparent, child, or spouse. A taxpayer who builds a main residence is treated as having purchased that home on the date he or she first occupies the home. I.R.C. § 36(c)(3)(B).

32 I.R.C. § 36(c)(1). The requirement also applies to the taxpayer's spouse.

33 I.R.C. § 36(b)(2). The credit amount is phased out for taxpayers with a modified adjusted gross income between $75,000 and $95,000 and is unavailable for those earning more than $95,000 ($170,000 for married couples). I.R.C. § 36(b)(2).

34 *First-Time Homebuyers Have Several Options to Maximize New Tax Credit* (last visited Mar. 18, 2009) <http://www.irs.treas.gov/newsroom/article/0,,id=205416,00.html>.

35 For example, if the taxpayer is due a refund of $1,000, application of the tax credit will increase the refund amount to $9,000. If the taxpayer owed a tax liability of $10,000 before application of the credit, this liability would be reduced to $2,000. See *Taking the First Time Homebuyer Credit* (last visited Apr. 6, 2009) <http://turbotax.intuit.com/support/kb/tax-content/tax-tips/6360.html>.

36 I.R.S. Form 5405.

37 *Id.*

38 As of the writing of this article, legislation has been proposed to eliminate the first-time homebuyer requirement and to expand the law to all home purchases. *S 740 Would Expand Home Buyer Tax Credit,* 2009 Tax Notes Today 65-21 (March 30, 2009).

39 Bob Tedeschi, *Sweetening the Pot for Home Buyers,* N.Y. Times (last visited Apr. 10, 2009) <http://www.nytimes.com/2009/04/12/realestate/12mort.html>.

40 *Id.*

41 This portion of the article was authored by Drew Genzler.

42 The credit applies to purchases after 2009. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 1141(c), 123 Stat. 115.

43 Thus, a vehicle with a battery capacity of at least 15 kilowatt hours qualifies for a $4,587 tax credit.

44 I.R.C. § 30D(b)(3).

45 To qualify as a plug-in electric drive motor vehicle, the motor vehicle must have an original use that commences with the taxpayer (the taxpayer would be the leasing company if the vehicle was leased); have been acquired for use or lease by the taxpayer and not for resale; have been made by a manufacturer; be a motor vehicle for purposes of Title II of the Clean Air Act; and have a gross vehicle weight of less than 14,000 pounds. I.R.C. § 30D(d)(1). The term "motor vehicle" under Title II of the Clean Air Act means any self-propelled vehicle designed for transporting persons or property on a street or highway.

46 I.R.C. § 30D(d)(1)(f)(i), (ii).

47 Dennis Simanaitis, *Eclectic Electrics*, Road & Track (March, 2009) <http://roadandtrack.com/assets/download/0309_toyotaRav4EV_techbox.pdf.pdf>.

48 Dennis Simanaitis, *Eclectic Electrics*, Road & Track (March, 2009) <http://roadandtrack.com/assets/download/0309_tesla_techbox.pdf.pdf>.

49 I.R.C. § 30. To constitute a low-speed qualified plug-in electric vehicle, the vehicle must be a specified vehicle that meets the same first three requirements found in section 30D; is manufactured for use on public streets, roads, and highways; and is propelled to a significant extent by an electric motor that draws electricity from a battery that has a capacity of at least 4 kW-hr or 2.5 kW-hrs in the case of a vehicle with two or three wheels. I.R.C. § 30(d)(1). A specified vehicle is any vehicle that is a low-speed vehicle within the meaning of 29 CFR § 571.3 or any vehicle that has two or three wheels and is capable of being recharged from an external source of electricity. A low-speed vehicle is a motor vehicle that is four-wheeled, whose speed attainable in one mile is more than 20 miles per hour and not more than 25 miles per hour on a paved level surface, and whose gross vehicle weight rating is less than 3,000 pounds. Thus, section 30(d) would apply to vehicles such as electric golf carts and electric scooters. I.R.C. § 30(d)(2).

50 I.R.C. § 30(b)(1).

51 I.R.C. § 48C. For a manufacturing project to qualify for the tax credit under section 48C it must be certified by the secretary of the Qualifying Advanced Energy Project Program. If certified, the project has three years from the date of issuance of the certification to place the project in service. I.R.C. § 48C(d)(2)(C).

52 I.R.C. § 48C(a), (c)(1)(A)(i)(VI).

53 The fuel economy amount is determined by a table in the statute. I.R.C. § 30B(c)(2)(A). The fuel economy of the cars is expressed as a percentage based on 2002 model year city fuel economy. It is 45.2 mpg for a vehicle between 1,500 and 1,750 pounds, 39.6 mpg for a vehicle of 2,000 pounds, and 35.2 mpg for a vehicle weighing 2,250 pounds. I.R.C. § 30B(b)(2)(B)(i). For a vehicle that achieves a fuel economy of at least 125 percent but less than 150 percent, the tax credit is $400. The credit increases incrementally as the fuel economy of the vehicle increases. At the upper end, a vehicle that achieves a fuel economy of at least 250 percent provides a credit of $2,400. I.R.C. § 30B(c)(2)(B).

54 The conservation credit amount is determined by a table in the statute. I.R.C. § 30B(c)(2)(A). For a vehicle that achieves a lifetime fuel savings of at least 1,200 gallons of gasoline but less than 1,800 gallons, the credit is $250. The credit amount increases with more gallons saved. At the upper end, a vehicle with lifetime savings of at least 3,000 gallons provides a credit of $1,000. I.R.C. § 30B(d)(2)(A)(i), (ii), (c)(2)(A)(i).

55 <http://www.irs.gov/newsroom/article/0,,id-157557,00.html>. This list includes many different hybrid vehicle models from many different manufacturers, in stark contrast to the almost complete lack of plug-in electric vehicles available to consumers.

56 This portion of the article was authored by Scott Davies.

57 Qualified section 179 property is generally tangible property used in a trade or business that can be depreciated under sections 167 and 168. I.R.C. § 179(d)(1).

58 The dollar limitations apply to taxable years beginning in 2008 or 2009. I.R.C. § 179(b)(1).

59 I.R.C. § 179(b)(2).

60 I.R.C. § 168(k).

61 I.R.C. § 168(k)(1)(B).

62 Treas. Reg. § 179-1(f)(1).

63 This portion of the article was authored by Scott Davies.

64 A net operating loss is generally the amount by which a taxpayer's business deductions exceed its gross income. I.R.C. § 172(c). This amount can be used to offset taxable income in another year where the net operating loss is applied.

65 I.R.C. § 172(b)(1)(H). The five-year carryback period applies to a taxable year beginning or ending in 2008. The Service has advised that small businesses that are not corporations may accelerate a refund using Form 1045, while

corporations may use Form 1139. The Service will work to issue refunds within 45 days or earlier, if possible. These refunds are described as "tentative" because they are subject to review at a later date. IR-News Rel. 2009-26, 2009 IRB LEXIS 132.

66 A qualified small business is one that comes within the meaning of section 172(b)(1)(F)(iii). A corporation or partnership must meet the gross receipts test of section 448(c) for the tax year in which the loss arises. A sole proprietorship qualifies if it would meet the same test if it had been a corporation. The gross receipts test is met for a prior tax year if the average annual gross receipts (reduced by returns and allowances) for the three-year tax period ending in the prior tax year does not exceed $15 million. I.R.C. § 172(b)(1)(H)(iv).

67 I.R.C. § 172(b)(1)(A). Certain losses, including farming and qualified disaster losses, already had been afforded a five-year carryback. I.R.C. § 172(b)(1)(G) (farming losses), 172(b)(1)(J) (qualified disaster losses).

68 I.R.C. § 172 (b)(1)(H).

69 This portion of the article was authored by Szu-Lung Chang.

70 I.R.C. § 46.

71 Qualified energy property generally must be placed in service during the tax year. I.R.C. § 48(a)(1). The property must be constructed, erected, or reconstructed by the taxpayer, or acquired by the taxpayer if the original use of the property begins with the taxpayer. I.R.C. § 48(a)(3)(B). In addition, the property must qualify for depreciation or amortization. I.R.C. § 48(a)(3)(C). Finally, the property must meet performance and quality standards set by the Service (after consultation with the Department of Energy) and that are in effect when the property is acquired. I.R.C. § 48(a)(3)(D).

72 I.R.C. § 48(a)(3)(A)(vi), (c)(4)(A). "Qualifying small wind turbine" is a wind turbine that has a nameplate capacity of not more than 100 kilowatts. I.R.C. § 48(c)(4)(B). The "nameplate capacity" is not defined in the Code, but in the power industry it means the maximum rated output of a generator under specific conditions designated by the manufacturer. Generator nameplate capacity is usually indicated in units of kilovolt-amperes (kVA) and in kilowatts (kW) on a nameplate physically attached to the generator. *Energy Information Administration, Energy Glossary – G* (last visited April 11, 2009) <http://www.eia.doe.gov/glossary/glossary_g.htm>

73 "Qualified property" means property that is (1) tangible personal property, or other tangible property (not including a building or its structural components), but only if that property is used as an integral part of the qualified investment credit facility; and (2) for which depreciation (or amortization) is allowable. I.R.C. § 48(a)(5)(D).

74 "Qualified investment credit facility" means any qualified facility within the meaning of section 45 that is placed in service in 2009 through 2012. I.R.C. § 48(a)(5)(C)(i)-(ii).

75 I.R.C. § 48(a)(5)(A)(i).

76 I.R.C. § 48(a)(5)(A)(ii).

77 H.R. Rep. No. 111-016, at 611.

78 I.R.C. § 48(d)(1).

79 See Committee on Ways and Means, Guide to Certain Renewable Energy Program in the American Recovery and Reinvestment Act of 2009 <http://waysandmeans.house.gov/media/pdf/111/gep.pdf (last visited April 14, 2009)>. To qualify for the election under section 48(a)(5), a taxpayer may make an irrevocable election to treat certain qualified property that is part of a section 45 qualified investment credit wind facility placed in service in 2009 through 2012 as energy property eligible for a 30 percent investment credit. I.R.C. § 48(a)(5).

80 American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, §1103(c)(1), 123 Stat. 115, 212.

81 I.R.C. § 48(c)(4).

82 I.R.C. § 45(a)(2)(A). Qualified facilities include those producing electricity using qualified renewable energy. I.R.C. § 45(d)(1).

83 I.R.C. § 45(c)(1)(A). To be eligible for the renewable electricity product credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person. I.R.C. § 45(a)(2)(B).

84 I.R.C. § 45(a).

85 I.R.C. § 48(a)(5)(B). Nor can the taxpayer later file an amended return to revoke the business energy credit election.

86 This portion of the article was authored by Olivia Michalski.

87 I.R.C. § 51.

88 Before the Act, the target groups were a qualified IV-A recipient, a qualified veteran, a qualified ex-felon, a designated community resident, a vocational rehabilitation referral, a qualified summer youth employee, a qualified supplemental nutrition assistance program benefits recipient, a qualified supplemental security income recipient, or a long-term family assistance recipient. I.R.C. § 51(d).

89 Unemployed veterans include any individuals who are certified by the designated local agency as having served on active duty in the armed forces for more than 180 days or having been discharged or released from active duty in the armed forces for a service-connected disability, having been

discharged or released from active duty in the armed forces at any time during the five-year period ending on the hiring date, and having received unemployment compensation under state or federal law for at least four weeks during the one-year period ending on the hiring date. I.R.C. § 51(d)(14)(B)(i).

90 Disconnected youths include any individuals certified by the designated local agency as having attained age 16, but not age 25, on the hiring date; not regularly attending secondary, technical, or post-secondary school during the six-month period prior to the hiring date; not being regularly employed during the six months prior to the hiring date; and not being readily employable due to lack of sufficient number of basic skills. I.R.C. § 51(d)(14)(B)(ii).

91 I.R.C. § 51(b)(3). To receive the credit, an employer must first apply for (within 28 calendar days after the new hire's start date) and receive certification from the Unemployment Insurance Agency that its new hire is a member of one of the target groups. Once certified, and the minimum required hours worked are met, the employer can claim the tax credit on its federal tax return using Form 5884.

If the employer is related to or rehires an individual, the employer will not be able to claim a tax credit. I.R.C. § 51(i)(2). Nor will an employer qualify to receive a tax credit if an employee from the targeted group works less than 120 hours in the first year of employment. I.R.C. § 51(i)(3)(B). Finally, a tax credit cannot be claimed for federally subsidized on-the-job training; however, the time accumulated during on-the-job training may be used for the employment period. I.R.C. § 51(c)(2)(A).

92 I.R.C. § 51(b)(2).

93 I.R.C. § 51(i)(3)(A).

94 This portion of the article was authored by Shahid Latif.

95 I.R.C. § 32.

96 In 2008, the maximum credit was $4,824 with two or more qualifying children, $2,917 with one qualifying child, $438 with no qualifying children. I.R.C. § 32(b).

97 Alan Berube, David Park, Elizabeth Kneebone, *MetroRaise: Boosting The Earned Income Tax Credit to Help Metropolitan Workers and Family* <http://www.brookings.edu/~/media/Files/rc/reports/2008/05_metro_raise_berube/metroraise_report.pdf>.

98 Robert Greenstein, *Should EITC Benefits Be Enlarged For Families with Three or More Children?* <http://www.cbpp.org/cms/index.cfm?fa=view&id=1215>.

99 I.R.C. § 32(b)(3)(A). In 2009, the maximum credit will be $5,657 with three or more qualifying children, $5,028 with two qualifying children, $3,043 with one qualifying child, and $457 with no qualifying children. I.R.C. § 32(b). A taxpayer can use the EITC Assistant at www.irs.gov/eitc to find out if he or she is eligible for the credit.

100 I.R.C. § 32(b)(3)(B).

101 This portion of the article was authored by Nick Wroblewski.

102 I.R.C. § 54AA(b).

103 I.R.C. § 54AA(g)(2).

104 I.R.C. § 6431(a).

105 This portion of the article was authored by David L. Bindrup.

106 The sunset provision in EGTRRA provides that following 2010, the law reverts back to as it was in 2001. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38.

107 I.R.C. § 2010.

108 I.R.C. § 2001.