MICHIGAN
TAX LAWYER

Volume XXXIX
Issue 2
Summer 2013

SBM State Bar of Michigan | TAXATION SECTION

CONTENTS

Tax Section Matters

Section Committee Reports

International Tax Update

Michigan Tax Legislation Update

SBM Pro Bono Initiative

Student Tax Note

The Michigan Tax Lawyer is a publication of the Taxation Section of the State Bar of Michigan that is designed to be a practical and useful resource for the tax practitioner. The Michigan Tax Lawyer is published three times each year —September (Fall), January (Winter), and May (Summer). Features include the Section's Committee Reports, news of Section events, feature articles, and Student Tax Notes.

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 Jackie J. Cook, Schiff Hardin LLP, 350 South Main Street, Suite 210 Ann Arbor, MI 48104, jcook@schiffhardin.com, or (734) 222-1529.

Subscription Information
Any member of the State Bar of Michigan may become a member of the Section and receive the Michigan Tax Lawyer by sending a membership request and annual dues of $30 to the Taxation Section, State Bar of Michigan, 306 Townsend Street, Lansing, MI 48933. In addition, any person who is not eligible to become a member of the State Bar of Michigan, and any institution, may obtain an annual subscription to the Michigan Tax Lawyer by sending a request and a $33 annual fee to the Taxation Section at the aforementioned address.

Change of Address
Individual subscribers should send notification in writing to: Michigan Tax Lawyer, Membership Records, Taxation Section, State Bar of Michigan, 306 Townsend Street, Lansing, MI 48933.

Citation Form
The Michigan Tax Lawyer may be cited as follows: (Vol.) (Issue) MI Tax L. (Page) (Yr.)

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TAXATION SECTION

May 1, 2013

As Summer approaches, the Taxation Section continues to pursue activities for the benefit of its members. Below is a brief summary of some of these activities.

First, preparations for the 26th Annual Tax Conference at The Inn at St. John's in Plymouth are nearly final. This year's conference will provide programming on a broad spectrum of tax topics and will feature National speakers, including Arthur Rosen and Jeffrey Pennell.

Second, policy issues continue to require attention. Recent re-introduction of a Michigan "offer in compromise" bill gives new hope to our long-term efforts to help Michigan move into the mainstream with respect to tax compromise policies. In addition, new policy and position statements on three different Michigan tax issues have recently been adopted: Michigan Corporate Income Tax apportionment, contingent fee audit practices (particularly in the unclaimed property area), and retroactive tax legislation. Policy statements adopted by the Section Council are posted on the website's "Public Policy Developments" page.

Third, the Section has continued its work in connection with amicus brief positions in important Michigan tax litigation matters. In 2013, the Section, with the able leadership of Professor Marjorie Gell, prepared and filed an amicus brief in the Michigan Supreme Court cases *Estate of Wheeler* and *Malpass*. The Section's amicus brief was prepared in response to the Michigan Supreme Court's invitation as the cases involve complex unitary business principle issues. On March 5, 2013, oral argument was held in the Michigan Supreme Court in the two cases.

Fourth, in January we created a seventh standing committee, the Young Tax Lawyers Committee. The Committee's purpose is to attract young lawyers to tax practice and support their development by creating opportunities for education, experience, social networking and coaching from established practitioners. Committee Chair Stephanie Teitsma is busy planning a schedule of events for this dynamic new Committee.

And finally, with respect to our committees, we have a full calendar of committee meetings scheduled for the rest of the year. Each committee generally holds two or three meetings featuring timely presentations on topics of interest to each practice area. See the Section's "Calendar of Events" and "Committee Meetings" website pages for details.

The Section Council is working hard to support you in your tax practice. We hope you'll take advantage of these opportunities, and please contact us with any suggestions or comments.

Sincerely,

Wayne D. Roberts

Wayne D. Roberts
Chairperson

REPORT OF THE BUSINESS ENTITIES COMMITTEE

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Michael Domanski of Honigman will be presenting on "Tax and Structuring Aspects of Captive Insurance Arrangements" on June 13, 2013. The time and location of the presentation are to be determined. Topics will include the use of series limited liability companies and segregated portfolio/cell companies in captive insurance arrangements and cross-border aspects of foreign-domiciled insurance companies. This presentation is being hosted by the Business Entities and International Law committees.

REPORT OF THE ESTATES AND TRUSTS COMMITTEE

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A speaker event was held on April 23, 2013 from 3:00 p.m. to 4:30 p.m. at the offices of Dickinson Wright, 500 Woodward Ave., Ste. 4000, Detroit, MI 48226. The speaker was James P. Spica, Esq. of the law firm of Dickinson Wright. The topic was Tax Aspects of Trust Decanting Under Michigan's New Statutes.

A social event/mixer will be held on June 27, 2013 for persons who are members of the Estates and Trusts Committee and persons who are interested in the Estates and Trusts Committee. Details to follow.

REPORT OF THE EMPLOYEE BENEFITS COMMITTEE

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The Employee Benefits Committee held a half-day seminar on March 21, 2013, at which nationally known speaker Ilene Ferenczy spoke on the topic "Keeping Current – Washington Update." Ms. Ferenczy is an attorney and CPA practicing employee benefits law out of Atlanta, Georgia. The approximately 80 attendees enjoyed her informative and entertaining presentation.

At the 26th Annual Tax Conference, held in Plymouth, Michigan on May 23, the Employee Benefits Committee breakout session featured Brian S. Lakkides, AIF, founder of Fiduciary Firewall Consulting, Inc. who spoke on the topic "Improving ERISA Compliance and Management of Fiduciary Risk." The Committee co-hosted speaker Johana Novak at the joint Employee Benefits and Business Entities Committees break-out session. Ms. Novak, a shareholder at Foster Swift Collins & Smith PC, spoke on health care reform's impact on businesses.

The Employee Benefits Committee is currently working with the Employee Benefits Security Administration ("EBSA," Department of Labor) to schedule a presentation in early this summer on the topic of the EBSA's strategic enforcement plan, audit issues and flags and certain provisions of the Patient Protection and Affordable Care Act. Date and location to be provided soon.

REPORT OF THE INTERNATIONAL TAX COMMITTEE

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Jarrod Wood of PwC presented at the 26th Annual Tax Conference on May 23, 2013 at The Inn at St. John's. Jarrod presentation focused on international legislative updates that have occurred in the past year.

The International Law and Business Entities Committees will be hosting a joint event on June 13, 2013. Michael Domanski of Honigman will be presenting on "Tax and Structuring Aspects of Captive Insurance Arrangements. The time and location of the presentation are to be determined. Topics will include the use of series limited liability companies and segregated portfolio/cell companies in captive insurance arrangements and cross-border aspects of foreign-domiciled insurance companies.

REPORT OF THE STATE AND LOCAL TAX COMMITTEE

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Please mark your calendars for the following upcoming SALT Committee events:

- Tuesday, July 16th: Just Lunch - Tax Meetup (24 Grille, Detroit)
- Thursday, August 22nd: Annual SALT reception (Dykema, Lansing)
- Monday, October 7th: Tax Topics &Tea (Goldish Tea, Royal Oak)

At the Taxation Section's 26th Annual Tax Conference, the SALT Committee hosted several great sessions, including:

- Hot Issues in State and Location Taxation Nationwide, Art Rosen (McDermott, Will & Emery)
- The Latest in Michigan Developments, Joanne Faycurry (Schiff Hardin) & Art Rosen (McDermott, Will & Emery) (afternoon breakout session)
- State Tax Controversies: A View from Many Angles, Marla Carew (Carew Law), Jackie Cook (Schiff Hardin), Paul McCord (Michigan Tax Tribunal), and William Lentine (Dykema) (afternoon breakout session, joint with Practice and Procedure Committee)

There are multiple ways to get involved and contribute your skills and talents to better our SALT committee and profession:

- *Provide your insight.* As SALT committee chair, I am always seeking ways to improve and make this committee valuable to each and every one of you. Therefore, I welcome your comments, feedback and any ideas.
- *Write an article.* The *Michigan Tax Lawyer* is one of the premier tax publications, and our SALT practitioners have historically been significant contributors. Feel free to contact me at any time with recommendations for articles for publication.
- *Host or recommend a panel, roundtable or speaker series.* We all expect this year to be a busy one - with significant state and local tax implications. Let me know if there are any areas of particular interest that you'd like to see technical discussion around.
- *Attend events.* The most important asset of the SALT committee is each of you. Therefore, your attendance at events is critically important to the ability of this committee to be able to provide meaningful resources and networking opportunities to make a significant impact in the profession.

REPORT OF THE YOUNG TAX LAWYERS COMMITTEE

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The Young Lawyers committee is reaching out to its members for suggestions on our next event. Please reach out to Stephanie Teitsma with your idea at stephanie.teitsma@gmail.com.

INTERNATIONAL COMMITTEE'S ANNUAL OVERVIEW OF US INTERNATIONAL TAX—

AN OVERVIEW OF SELECT RECENT POLICY PROPOSALS, LEGISLATIVE ENACTMENTS, AND JUDICIAL DECISIONS

By Andy Lane[1]

Introduction

As the title may suggest, the purpose of this article is to provide a general overview of recent policy proposals, legislative enactments, and judicial decisions. This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties. Furthermore, this article does not and should not be interpreted as expressing a point of view or an attempt to advocate a particular position of a policy related issue, nor does it advocate a review or reform of government policies, regulation, or legislation.

This article is sponsored by the International Committee, a sub-committee of the State Bar of Michigan, Taxation Section. The International Committee has resolved to provide to its section members an annual international tax legislative overview, this being the inaugural overview. If you are interested in joining the International Committee or would like to be included in the International Committee's activities, please email Hassan Jaafar at *hjaafar17@gmail.com*.

Policy Proposals

Tax policy surrounding the US federal income taxation of cross-border activity continues to be at the forefront of several proposed tax plans. Proposals have ranged from changes to existing code provisions to a complete overhaul of the international tax regime calling for a change from a "world-wide" tax regime to a "territorial" tax regime. Following is a summary of some of the key proposals.

Obama Administration FY14 Budget[2]

President Obama's 2014 budget repeated several provisions of the president's prior international tax proposals. However, one key omission from the 2014 budget was an extension of the "look-through" and "active finance" exceptions to the code's anti-deferral regime ("subpart F income"). Other key proposals included in the FY14 budget are noted below:

- Defer deduction of interest expense related to deferred income;
- Reform the foreign tax credit: utilize a pooling basis to determine the foreign tax credit ("FTC");
- Tax currently excess returns associated with transfers of intangibles offshore;
- Limit shifting of income through intangible property transfers;
- Disallow the deduction for excess non taxed reinsurance premiums paid to affiliates;
- Limit earnings stripping by expatriated entities;
- Modify tax rules for dual capacity taxpayers;
- Tax gain from the sale of a partnership interest on a look-through basis;
- Prevent use of leveraged distributions from related foreign corporations to avoid dividend treatment;
- Extend Internal Revenue Code ("IRC") Section 338(h)(16) to certain asset acquisitions; and
- Remove foreign taxes from a "902" corporation's foreign tax pool when earnings are eliminated

Chairman Camp's International Tax Reform Discussion Draft[3]

Dave Camp (R-MI) is the current chair of the House Committee on Ways and Means. As part of a comprehensive US federal income tax overhaul, Chairman Camp released his plan for international tax reform in late 2011. Most notably his discussion draft called for a reduction to the corporate US federal income tax rate from 35% to 25% and a complete change to the landscape of international tax from a world-wide tax regime to a territorial tax regime. Under the current US federal income tax world-wide regime a US taxpayer is generally

International Update

subject to US federal income tax on its worldwide income regardless of whether the income is US or foreign sourced.[4] Under the worldwide US federal income tax regime, relief from double taxation may be granted by way of the foreign tax credit.[5] Under a territorial tax regime, generally a US taxpayer would be subject to tax only on its US source income while its foreign source income would be (assuming that no subpart F provisions of the IRC are applicable) taxable only in the foreign country. Chairman Camp's proposal discusses other international tax items and provides detail on how the change from a world-wide regime to a territorial regime would be effectuated. A summary of some key points included in his discussion are set forth below:

- Reduce US federal corporate income tax rate to 25%
- Repeal the worldwide tax regime
- Implement a territorial tax regime
  - 95% dividends received deduction for post-effective date dividends
  - Toll charge to the pre-effective date earnings and profits (this toll charge is softened by a 85% dividend received deduction and foreign tax credits are permitted to offset the 15% which is subject to US federal income tax; the total amount of the toll charge can be paid over 8 years)
  - 95% dividends received deduction when distributed for pre-effective date earnings and profits
  - US owned branches will be treated as a controlled foreign corporation – 95% dividend received deduction
- Subpart F Income (IRC's Anti-Deferral Regime)
  - Foreign source royalties will be taxed currently – but possibly lower than the proposed 25% corporate federal income tax rate
  - Foreign Personal Holding Company Income – not addressed in the draft
  - Foreign Base Company Sales Income – not addressed in the draft
  - The draft contains three base broadening alternatives to subpart F income
  - Exceptions to subpart F Income - Controlled foreign corporation "look-through" and "active financing" were not addressed in the draft
- Gain on the sale of qualified foreign corporation stock is 95% exempt from federal US income tax
- Foreign tax credit
  - Foreign tax credit carryforwards may be carried forward to post-effective years
  - Foreign to foreign dividends are 95% exempt from US federal income tax
  - IRC Section 902 repealed
  - IRC Section 909 repealed
- IRC Section 956 repealed
- IRC Section 959 repealed

Senator Enzi Tax Plan[6]

Shortly after Chairman Camp released his draft, Senator Michael Enzi (R-WY) introduced the *United States Job Creation and International Reform Act of 2012*. This bill had many similarities to Chairman Camp's discussion draft, namely both drafts call for a territorial tax regime. In contrast to Chairman Camp's discussion draft, Senator Enzi's bill did not call for a reduction to the US federal corporate income tax rate. A summary of the international tax components of Senator Enzi's bill is set forth below:

- Repeal the worldwide tax regime
- Implement a territorial tax regime
  - 95% dividend received deduction for qualified foreign source dividends paid from earnings and profits post enactment
    - Shareholder must own 10% of stock to receive the dividend received deduction
    - Controlled foreign corporation stock must be held for at least 1 year
    - Foreign tax credits would not be allowed to offset the 5% which is subject to US federal income tax
    - Hybrid dividends would be disqualified
  - Earnings and profits accumulated prior to enactment would be taxed under current existing tax law
    - No toll charge on accumulated earnings and profit at time of enactment
    - May allow for a one-time 70% dividend received deduction on dividends paid from earnings and profits which were previously accumulated
    - Earnings would be deemed to be distributed on a first in, first out basis
- Subpart F Income
  - Foreign base company sales and services income repealed
  - "Active finance" and "CFC look-through" exceptions permanently extended
  - Create an additional subpart F category whereby all controlled foreign corporation's income will be subject to US federal income tax unless the effective tax rate of the controlled foreign corporation exceeds

one-half of the maximum US federal income tax rate (an active trade or business exception may apply to this category)

- IRC Section 956 – unchanged by the Enzi bill
- IRC Section 959 – unchanged by the Enzi bill
- Foreign Tax Credit
    - IRC Section 902 repealed
    - IRC Section 909 repealed
    - IRC Section 920 unchanged by the Enzi bill
    - Create an intangible income basket in addition to the current general and passive baskets

Senator Levin Letter & Bill[7]

Senator Carl Levin (D-MI) is the Chairman of the Permanent Subcommittee on Investigations ("PSI") which over the past ten years has examined what Senator Levin referred to as "offshore tax abuses."[8] As a result of this review, PSI has identified ten specific international "tax loopholes" that Senator Levin's letter to congress and his subsequent bill addresses. In October 2012, Senator Levin sent a letter to congressional and administration leaders on the need to address the offshore tax abuses as part of a deficit-reduction package. This letter was followed by the introduction of a bill in February 2013. The bill addresses most of the items contained in Senator Levin's letter. Both the letter and the bill seek to prevent:

- US multinational corporations from shifting profits offshore through abusive transfer pricing arrangements;
- US multinationals from pretending to keep profits offshore, while actually returning offshore cash tax-free to the US through serial loans;
- US multinationals from pretending to keep profits offshore while using offshore subsidiaries to place the offshore cash in US banks and investments;
- US entities from operating and managing out of the US to incorporate offshore, claim foreign status, and dodge substantial US taxes;
- US financial firms from treating swap payments received from the US as nontaxable foreign source income;
- US multinationals from making an offshore subsidiary invisible for tax purposes and avoid taxation of passive offshore income under the "check-the-box" and "CFC look-through" rules;
- US multinationals from deducting the costs of moving jobs and operations offshore;
- Mutual funds from dodging limits and taxes on commodity speculation by routing their commodity activities through offshore shell corporations;
- Barriers to US tax enforcement because of inadequate tools to combat taxpayers hiding assets in secret tax haven bank accounts; and
- US taxpayers from hiding assets in US bank accounts opened in the name of offshore entities.

Senator Sanders Bill[9]

Senator Bernie Sanders (I-VT) released his bill that took aim at international tax reform. Senator Sanders' bill does not call for a complete overhaul of the existing US international tax regime. Instead, Senator Sanders calls for specific changes which can likely be executed by amendments to existing code provisions. Set forth below are the four items which are at the center of Senator Sanders' bill:

- Eliminate deferral for the active income of controlled foreign corporation's by making all income earned by a controlled foreign corporation in a foreign country subpart F income under the current IRC Section 952;
- Amend IRC Section 904 to reinstate the per-country FTC regime that was previously in place;
- Treat foreign companies managed and controlled in the US as US companies under IRC Section 7701; and
- Limit FTC claims under IRC Section 901 for dual capacity taxpayers that are "large integrated oil companies."

RECENT ENACTMENTS

2013 Extenders Package

In January 2013, President Obama signed into law a provision which extends to December 31, 2013 for calendar year taxpayers and for fiscal years ending in 2014 for fiscal taxpayers the controlled foreign corporation "look-through"[10] and the "active finance"[11] exceptions to subpart F income.[12] The extension included a retroactive application to January 1, 2012. These extensions are not permanent and, as discussed above, are often a hot topic for discussion (whether the exceptions are addressed or not) in the various international tax proposals.

Final Regulations to IRC Sections 367(a)(5) and 1248(f)

In March of this year, the Internal Revenue Service and the Treasury Department released regulations (final, temporary, and proposed) related to outbound tax-free reorganizations. The final regulations related to IRC Sections 367(a) and 1248(f) were the headliners to these regulations.

IRC Section 367(a)(5) Final Regulations Overview[13]

Generally, IRC Section 367(a)(1) requires a US person to recognize gain on the transfer of property to a foreign corporation even if the transfer otherwise would be treated as a tax-free transaction under IRC Sections 332, 351, 354, 356, or 361. An exception to the general rule of IRC Section 367(a)(1) is the active foreign trade or business exception under 367(a)(3) which applies to asset transfers. A similar exception applies to outbound stock transfers under Treasury Regulations Sections 1.367(a)-3 & -8. However, IRC Section 367(a)(5) generally prevents the application of these exceptions to a US target under a transfer of assets in an IRC Section 361 exchange (outbound reorganization). IRC Section 367(a)(5) does provide some leniency, subject to basis adjustments and other conditions if the US target is controlled by five or less domestic corporations. The exceptions in IRC Section 367(a)(3) and Treas Regs Sections 1.367(a)-3 & -8, noted above, may be applicable.

The final regulations allow for an elective exception to IRC Section 367(a)(5). The election allows the US target to avail itself to the active foreign trade or business exception in an outbound asset reorganization if five requirements are met:

- The US target is controlled by five or fewer domestic corporations
    - S-Corps, Real Estate Investment Trusts, and Regulated Investment Companies are not permitted
    - This determination takes place immediately prior to reorganization
    - Members of an affiliated group are treated as one corporation
    - Direct ownership only
- The US target recognizes gain to the extent of its inside gain attributable to non-control group member, or a control group member cannot preserve share of inside gain
- Control group members adjust allocable target foreign stock basis to preserve share of US target's inside gain
- US target agrees to recognize gain if the target foreign corporation disposes of a significant part of assets received in reorganization
    - Significant means 40% or more of asset value
    - Disposition must be made with a principal purpose of tax avoidance
    - Disposition must take place within 5 years of asset transfer date
    - If the disposition satisfies the principles of the triggering event exception in the GRA rules, this requirement (4) will be deemed satisfied
    - Ordinary course of business disposition is acceptable
- The US target and each control group member must timely file an election statement

IRC Section 1248(f) Final Regulations Overview[14]

An IRC Section "1248 Shareholder" is defined under IRC Section 1248(a)(2) as a US person that owned a 10% combined voting power of a foreign corporation, which is the target of a foreign stock sale, and the foreign corporation was a controlled foreign corporation at any time during the five-year period ending on the date of the sale of foreign stock. The general rule of IRC Section 1248(f) is that distributions of foreign stock by a 1248 Shareholder through transfers described in IRC Sections 337, 355, or 361(c) may give rise to gain that is currently includible in the gross income of the 1248 Shareholder. The 1248 Shareholder should recognize an amount equal to the excess of the fair market value of such stock over its adjusted basis in the hands of the domestic distributor corporation. The gain should be characterized as a dividend to the extent of the earnings and profits of the foreign corporation which is the subject of the stock sale. There is however an exception to the general rule of IRC Section 1248(f) and it is found in IRC Section 1248(f)(2). The exception is applicable if the distribution under IRC Sections 337, 355, or 361(c) is made to a domestic corporation that is 1.) treated as holding the distributed stock for a period that at least equals the holding period of the distributing corporation, and 2.) the distributee corporation is a Section 1248 Shareholder immediately after the distribution.

The final regulations provide guidance on the IRC Section 1248(f)(2) exception. The final regulations first address the requirements which must be satisfied to qualify for the exception to general recognition requirements of 1248(f):

- The 80% distributee (IRC Section 337 has an 80% ownership requirement) must be a Section 1248 Shareholder immediately after the IRC Section 337 distribution
- The 80% distributee is treated as holding the stock of the foreign distributed corporation received in the IRC Section 337 distribution for the period during which the stock was held by the domestic distributing corporation
- The 80% distributee's basis in the stock of the foreign distributed corporation received in the IRC Section 337 distribution does not exceed the domestic distributing corporation's basis in such stock at the time of the IRC Section 337 distribution.

The final regulations also provide for an additional elective exception if the above enumerated requirements are not satisfied. The election allows taxpayers to make elective basis and holding period adjustments to avoid an IRC Section 1248(f) inclusion.

The elective exceptions for IRC Sections 355 and 361(c)(1) distributions are available if adjustments are made to each section 1248 Shareholder's IRC Section 358 basis and to the amount of earnings and profits attributable to the stock received to preserve the IRC Section 1248 amount attributable such stock. If the combined IRC Section 367(a)(5) and IRC Section 1248(f) income recognized and basis adjustments exceed the built-in-gain in the property transferred by the US target, the amount subject to IRC Section 1248(f) is reduced to account for the amounts subject to Section 367(a)(5). Additionally, the final regulations contain rules applicable when multiple classes of a CFC's stock are distributed in a IRC Section 361(c)(1) distribution.

Judicial Decisions

Bank of New York Mellon v. Commissioner[15]

The *Bank of New York Mellon* featured a Structured Trust Advantaged Repackaged Securities transaction ("STARS transaction") executed by Bank of New York Mellon ("BONY"). Under the STARS transaction, BONY obtained financing from a UK bank at a below market cost. Further under the STARS transaction, BONY transferred income producing assets to a trust with a UK trustee. The trust was taxable in the UK. BONY claimed foreign tax credits and certain deductions related to the STARS transaction. The income earned from the assets held in trust was characterized as foreign source.

The Internal Revenue Service disallowed BONY's foreign tax credits, the deductions, and the characterization of the asset income as foreign source alleging that the STARS transaction lacked economic substance. BONY petitioned the Tax Court for review. At issue was whether BONY was entitled to the tax benefits related to the STARS transaction which were disallowed by the IRS.

The tax court held that the STARS transaction is disregarded for US federal income tax purposes because it lacked economic substance. Consequently, BONY was not entitled to the claimed foreign tax credits or deductions related to the STARS transaction. Furthermore, the income produced by the trust assets was not foreign source income.

PPL Corp v. Commissioner[16]

The underlying issue in *PPL Corp* is related to IRC Section 901 which allows a credit for foreign taxes that have the predominant character of an income tax. PPL determined that the amount of tax paid by a foreign subsidiary to the UK government under a windfall tax regime is similar to a US income tax. Therefore, PPL claimed a foreign tax credit ("FTC") related to the tax paid to the UK government for the windfall tax. The IRS disallowed the foreign tax credit related to the UK windfall tax. The IRS reasoned that the UK windfall tax regime taxes imputed profit making value, and therefore does not meet the 901 requirements. PPL Corp petitioned the Tax Court for review.

The Tax Court[17] concluded that the UK windfall tax was creditable reasoning that its predominant character was that of a US income tax in the US. The Third Circuit[18] reversed the tax court concluding that the statutory language of the foreign tax law was definitive in determining character. A companion case in the Fifth Circuit[19] agreed with the court's reasoning. The fifth circuit interpreted IRC Section 901 as requiring the foreign tax to be evaluated on the basis of the intent and effect of the foreign tax. The US Supreme Court granted certiorari. The US Supreme Court, resolving the split among the third and fifth circuits, concluded that taxpayer could claim a US foreign tax credit for the UK windfall tax.[20]

Endnotes

1 Andy Lane practices in the area of international taxation. He is a member of the State Bar of Michigan and its Taxation Section. Mr. Lane holds both a JD and an LLM in taxation from Thomas M. Cooley Law School. Andy Lane has noted that any views, opinions, or other statements expressed in this article are solely his own and may not express the views or opinions of his employer.

2 Fiscal Year 2014 Budget of the US Government, *available at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/budget.pdf.

3 Chairman Dave Camp's International Tax Reform Discussion Draft (October 2011), *available at* http://waysandmeans.house.gov/uploadedfiles/discussion_draft.pdf.

4 I.R.C. § 61.

5 I.R.C. § 901.

6 United States Job Creation and International Tax Reform Act of 2012, S. 2091,112th Cong. (2012).

7 Letter from Senator Carl Levin, Chairman of the Permanent Subcommittee on Investigations, to US Congress (October 5, 2012), *available at* http://www.levin.senate.gov/newsroom/press/release/levin-writes-to-bi-partisan-leaders-on-closing-offshore-loopholes-avoiding-fiscal-cliff/; and Cut Unjustified Tax Loopholes Act, S. 268, 113th Cong. (2013).

8 Letter from Senator Carl Levin, Chairman of the Permanent Subcommittee on Investigations, to US Congress (October 5, 2012),

9 Corporate Tax Dodging Prevention Act, S.250, 113th Cong. (2013).

10 I.R.C. 954(c)(6).

11 I.R.C. 954(h)(10).

12 American Taxpayer Relief Act of 2012, H.R. 8, 112th Cong. (2013).

13 T.D. 9614, 2013-17 I.R.B. 947.

14 T.D. 9614, 2013-17 I.R.B. 947.

15 *Bank of New York Mellon Corporation v. Commissioner,* 140 T.C. 2 (2013).

16 *PPL Corp. et al v. Commissioner*, No. 12-43 (U.S. MAY 20, 2013).

17 *PPL Corp. and Subsidiaries v. Commissioner*, 135 T.C. 304 (2010).

18 *PPL Corp. and Subsidiaries v. Commissioner,* 665 F.3d 60 (2011).

19 *Entergy Corp. and Affiliated Subsidiaries v. Commissioner*, 683 F.3d 233 (2012).

20 *PPL Corp. et al v. Commissioner,* No. 12-43 (U.S. MAY 20, 2013).

Save the Date for Upcoming SBM Tax Section Events

September 26, 2013, 3-5 p.m.
Council Meeting, Annual Meeting of the Taxation Section, and Past Chair Dinner

May 22, 2014
SBM Annual Tax Conference
at the Inn at St. Johns in Plymouth

NOTABLE PENDING LEGISLATION IMPACTING MICHIGAN TAX ADMINISTRATION

By William C. Lentine and Jackie J. Cook [1]

A good tax system is a transparent tax system.[2] The Michigan Legislature has recently taken note of the importance of the manner and mode in which taxes are administered. Voluntary compliance is foundational to the administration of any good tax system. Recently, the Legislature recognized that taxpayers are more likely to comply with a voluntary compliance tax system when that system is perceived to be "balanced, fair, and effective," as opposed to "oppressive, unfair, or otherwise biased."[3]

The importance of the fair administration of state taxes has been noted in mainstream media as well:

> Perception is a powerful tool when it comes to a state's business climate. Making Michigan attractive for new investment – and encouraging businesses already located here to stay put – is a deliberative and dynamic process. Michigan's recent positive steps to improve its business climate are creating a positive international impression after a decade of bad press and negative perceptions.[4]

With Michigan's tax administration practices under a microscope, the Department of Treasury (the "Department") recently pledged to members of the Michigan Legislature to undertake the following six specific initiatives related to its administration of state taxes:

1. To address concerns about the "rebuttal process" used at informal conference, the Department issued Internal Policy Directive 2013-2, requiring the Department's rebuttal of an informal conference referee's recommendation to be approved by the Deputy Treasurer before issuance.

2. To address concerns expressed about the objectivity of the Taxpayer Advocate, the Advocate now reports to the Chief Deputy Treasurer.

3. To address concerns about the timeliness of responses to questions, the Department is investigating ways to facilitate addressing in real time questions submitted through the Tax Practitioner Hotline.

4. "Treasury pledged to support a limited offer in compromise program."

5. "Treasury pledged to develop a recommendation that would streamline the tax appeal process for both property and non-property taxes by the end of 2013."

6. "Treasury agreed to work in good faith to evaluate a formal review/appeal process for unclaimed property" and is reviewing HB 4703.[5]

Notably, changes to the Department's administrative practices are coming on the heels of significant simplification of Michigan's business taxes. In 2011, Michigan implemented a straightforward Corporate Income Tax[6] after decades of levying complicated taxes under the Single Business Tax Act ("SBTA")[7] and later the Michigan Business Tax Act ("MBTA").[8] Michigan also significantly reduced property taxes on industrial and commercial personal property in 2012.[9]

According to one national think tank, the substantive changes have improved Michigan's tax climate.[10] However, some taxpayers perceive that the administration of taxes in Michigan has increasingly become more onerous through Department practices that include overly-aggressive enforcement and a lack of responsiveness from the Department, leading many taxpayers and practitioners to conclude that more reform through legislation is needed. Michigan can continue to improve the negative perception of its current tax climate through the passage of a series of bills currently pending before the Michigan Legislature which are aimed at improving Michigan's administration of taxes. These various bills include: providing audit guidance to taxpayers and auditors; establishing an offer in compromise program; reforming corporate officer liability; implementing a finite duration on audits and for processing refund claims; and expediting successor liability clearance requests. Briefly, this article will outline selected bills.

PROVIDING AUDIT GUIDANCE FOR TAXPAYERS AND AUDITORS

A package of five House Bills recently introduced would collectively lend transparency to the Department's audit procedures and would limit the use of indirect audit procedures. House Bills 4288 through 4292 would codify standards for conducting tax audits and provide public guidance and transparency with the purported goal of treating taxpayers under audit more fairly. Clearer statutory guidance would also be provided to the Department's auditors for conducting audits. In a similar vein, SB 327 would prohibit the Department from using collection goals, budgets, or quotas in conducting audits and issuing assessments, including unclaimed property audits and assessments.

Limiting the use of indirect audit procedures

Currently, there is no clear statutory guidance as to when an indirect audit procedure may be used. House Bill 4288 (amending the Sales Tax Act[11]) and House Bill 4292 (amending the Use Tax Act[12]) would restrict "the use of 'indirect methods,' or sampling during the course of an audit by the Department of Treasury to determine a taxpayer's income and expenses and, ultimately, a tax liability." House Bill 4289 (amending the Uniform Unclaimed Property Act[13]) would also restrict the use of indirect methods or sampling "to determine a reporting entity's unclaimed property liability."[14] The adoption of these bills would offset the belief of some taxpayers that their audits are too often based on the use of indirect methods or projection sampling (extrapolation) despite the availability of accurate and complete business records maintained in the ordinary course of business.

House Bills 4288 and 4292 would codify two sets of standards for sales and use tax audits. First, for taxpayers who have filed returns and kept accurate and complete records, the bills would prohibit the Department from using any "indirect audit procedure" (a procedure defined in the bills as using circumstantial evidence) unless the Department has documented reason to believe that any records or returns filed are inaccurate or incomplete. Second, for taxpayers who have not filed returns or have not kept accurate and complete records, the bills would allow the Department to use an indirect audit procedure in order to complete the assessment.

Further, HBs 4288 and 4292 attempt to eliminate "arbitrary" audits by codifying that an "indirect" audit would have to contain the following five elements:

1. A review of the taxpayer's books and records. (The department could use an indirect method to determine the accuracy of the taxpayer's books and records.)
2. A tax deficiency determination or an assessment could not be based on a projection from a sample without the written approval of the taxpayer.
3. Both the credibility of the evidence and the reasonableness of the conclusion must be evaluated before any determination of tax liability is made.
4. The department could use any method to reconstruct income, deductions, or expenses that is reasonable under the circumstances, including the use of third party records.
5. The department must investigate all reasonable evidence presented by the taxpayer refuting the computation.[15]

House Bill 4289 would establish a statutory procedure for conducting an unclaimed property tax audit. Audits would be required to be performed using the U.S. Government Accountability Office's *Government Auditing Standards.*[16] For entities that have complete records of transactions, the Department may not "determine liability based on a 'reasonable' statistical sample or other sampling techniques", unless the entity gives written approval. The Department's audit must contain the following:

1. A review of the reporting entity's books and records.
2. Not be based on a determination of any indirect audit procedure.
3. Not extrapolate a determination based on any indirect audit procedure.[17]

Under HB 4289, when the Department uses an indirect audit procedure, the audit must contain the following:

1. The department (or agents) could use any method to establish the audit determination.
2. The department (or agents) could not be arbitrary in the use of authority.
3. An indirect method could be used to test the accuracy of the reporting entity's books and records.
4. The department (or agents) would have to investigate all reasonable evidence presented by the taxpayer refuting the computation.
5. The department (or agents) could use third-party records.[18]

Audit procedure transparency

Under HB 4290, the Revenue Act would be amended to require the Department to "publish and make available to the public in printed and electronic formats the department's internal policy directives, audit standards, sampling manual, cash basis sales and use tax manual, industrial processing sales and use tax manual, contractors sales and use tax manual and other deductions sales and use tax manual." The publication of such guidance would help taxpayers understand the Department's interpretation of applicable law.

Additionally, under HB 4291, the Revenue Act would be amended to require the Department to provide a taxpayer with a copy of the Department's audit file, including a complete copy of audit work papers, report findings, and correspondence and other documentation that were used to form the basis for an audit determination.

Prohibition against collection goals, budgets or quotas.

Under SB 327, the Department, including its consultants, contractors, agents, and employees, would be subject to the following through the administration, collection, or auditing of taxes and other money or fees, including unclaimed property:

- They would be prohibited from using collection goals, budgets, or quotas in actions or decisions relating to the administration, audit, assessment, or collection of money or fees administered by the Department.
- They would have to be independent and carry out their duties and responsibilities without bias as to the application of the governing statutes and rules.
- They would have to apply all statutes and rules fairly and equally to all taxpayers.[19]

SB 327 would also allow an award of costs and attorney fees against the Department if the taxpayer incurs such expenses contesting an action by the Department prohibited under SB 327.[20] Additionally, a Department employee, consultant, contractor, or agent could be subject to disciplinary actions.[21]

Establishign an Offer-In-Compromise Program

Although the IRS and over 40 states provide an "Offer-in-Compromise" program, Michigan does not.[22] HB 4003 proposes a codified, uniform and transparent process for taxpayers who cannot pay their taxes to voluntarily come forward in order to become compliant and make payments on, at minimum, a portion of their outstanding tax liabilities. HB 4003 was purportedly modeled in part after the federal "Offer-in-Compromise" Program.[23]

Unlike tax amnesty programs, the Offer-in-Compromise Program under HB 4003 would benefit those who truly cannot pay due to circumstances like bankruptcy, medical expenses or loss of job. Tax amnesty programs, on the other hand, are generally limited in duration when used to collect delinquent taxes. Typically those types of programs are available to delinquent taxpayers fully capable of paying and available to delinquent taxpayers that indisputably owe the amount of tax at issue. An Offer-in-Compromise Program could promote compliance by taxpayers through encouraging partial payment of deficiencies thereby alleviating a barrier to prospective compliance.

> "Under this program, the State Treasurer (or an authorized representative) could compromise all or any part of any payment of a tax, unpaid account, or amount due the state or any of its departments, institutions, or agencies that are subject to administration under the Revenue Act, including any related penalties and interest, if one or more of the following grounds exist:
>
> 1. A doubt exists as to liability.
> 2. A doubt exists as to collectibility.
> 3. A substantial probability exists that a compromise would further the fair and efficient administration of the tax.[24]

HB 4003 provides that a taxpayer's participation in the federal Offer-in-Compromise Program is *prima facie* evidence that the taxpayer is entitled to compromise a "similar or comparable Michigan tax liability that exists, at least in a proportional amount, for the tax year in which the federal compromise was granted."

Corporate Officer Liability Reform

Michigan law currently provides that business officers, members, managers or partners (collectively, referred to as "officers") are subject to personal liability for a business's failure to file tax returns or pay taxes due if the Department determines that the individual(s) has control of or responsibility for making the tax returns or paying taxes.[25]

Michigan's current law has been applied by the Department to pursue individuals who were not corporate officers during the time the taxes at issue accrued,[26] to individuals who were not employed by the business during the time the business became delinquent for taxes,[27] and to individuals who had no authority or ability to file or make tax returns and to make the tax payments at issue.[28] Some officer liability assessments have been made after a company in distress went out of business or went through a bankruptcy proceeding and final notices of tax assessment were sent to the business address when a receiver was in place.[29]

When an uncontested final assessment becomes final 90 days after it is issued to a business, the taxes became an uncontestable liability. Because Michigan lacks an Offer-in-Compromise program, those taxes can never be compromised by the Department under any circumstances. In contrast to many other states, the taxes included in the officer liability assessments include not only taxes that the business collected and is required to hold in trust for the Department, i.e., sales and use taxes, but also include ordinary business taxes, such as the Single Business Tax, Michigan Business Tax, and Michigan Corporate Income Tax. Corporate officer liability assessments have included such things as: inaccurately-estimated assessments that grossly overstate the actual tax liability owed; denying an officer an opportunity to contest the amount of an assessment to ensure that, even if the officer is liable, that the correct amount of tax is paid; not permitting the officer to contest the tax even if he or she did not receive notice of the business entity's assessment; and assessing officers for debts that arose after the officer no longer worked for the business.[30]

SB 64 purportedly will amend the corporate officer liability provision to do the following:

- Limit personal liability to situations in which a business failed to pay tax collected from another person [i.e., "trust fund" taxes].
- Limit personal liability to a person who had been responsible for collecting the tax or filing returns during the time period of default, and willfully failed to pay the collected tax.
- Limit the liability of a responsible person to his or her proportionate share of the tax assessed, if there were more than one responsible person.
- Allow a responsible person to recover the excess from another person, if the responsible person paid more than his or her share of tax assessed.
- Require the Department of Treasury to assess a purchaser of a business before assessing a responsible person, if both were liable.
- Require the Department to disclose the name of any other liable person or purchaser, and other information, upon the request of a responsible person who was assessed for a business's unpaid collected taxes.
- Prohibit the Department from assessing a responsible person more than four years after an assessment was issued to the business.
- Delete a provision under which the dissolution of a business does not discharge personal liability.[31]

Implementing a Duration on Audits and Refund Claims

Currently, Michigan taxpayers may experience tax audits that can take years to complete. Unlike many states, Michigan's statutes are unique in that they currently allow for an "open-ended" tolling of the period of limitations applicable to assessments.[32] The "open-ended" tolling of the period of limitations may be burdensome on a taxpayer under audit and may delay compliance with other obligations to shareholders and other taxing authorities. HB 337 would "delete a provision that suspends the four-year statute of limitations (for the assessment of a deficiency, interest, or penalty) during the period pending a final determination of tax, including audit, conference, hearing, and litigation of liability for Federal income tax or a tax administered by the Department, and for one year after that period."[33] HB 337 would also "provide that, if the Department initiated an examination of a taxpayer's records to verify returns made, the taxpayer would have to be given written notice and the Department would have to determine the taxpayer's correct tax liability within one year after the 48-month examination period expired (subject to certain exceptions)."[34]

Additionally, taxpayers are experiencing delays regarding refund requests. In some circumstances, delays are exceeding over a year from the date the refund request was filed. Because taxpayers are not permitted to seek a review of a refund request until a denial is issued, delays can increase a taxpayer's burden of allocating precious resources to tracking aging claims. HB 337 would "provide that, if a claim for refund had not been approved within one year after it was received, the claim could be treated as denied, and the taxpayer could appeal the denial to the Tax Tribunal or Court of Claims."[35]

HB 4002 would similarly provide financial incentive for the efficient processing of refund claims by imposing additional interest if a refund has not been paid by (1) May 1 for returns the Department received by March 1 of that year or (2) 60 days from the Department's receipt of a return for returns received after March 1.

Successor Liability

Michigan statutorily imposes successor liability on purchasers of a business's operations or assets.[36] In order to avoid successor liability, purchasers may request a tax clearance from Treasury and should escrow sufficient amounts to cover potential tax liabilities. However, taxpayer's have been reporting that the Department is unable to provide a timely tax "clearance." HB 337 would do the following:

- Set a 30-day deadline for the Department of Treasury to release a business's known tax liability to the purchaser of the business upon the purchaser's request, and make the release mandatory, if the owner waived confidentiality.
- Release the purchaser of a business from liability for its unpaid taxes if the Department failed to provide the tax liability information as required.[37]

Conclusion

In the midst of recent simplification of Michigan's business taxes, and the perception that these changes have improved the tax climate, perhaps now is the time to continue making improvements by implementing legislative changes to the administration of Michigan's taxes. The currently pending proposed legislation, if adopted, may improve Michigan's tax climate by encouraging timely resolution of controversies and providing for clarity in the duration and methodology of tax administration. Perhaps the indirect result of these administrative changes would be an increase in taxpayer's perception of Michigan's tax system as balanced, fair, effective and transparent.

Summary of Notable Pending Bills Affecting State Tax Administration(Status as of June 12,2013)

Topic	Bill	§ Impacted/Added	Primary Sponsor	Introduced	House Activity	Senate Activity
Additional interest on late tax refunds	HB4002	MCL205.30	Shirkey[R]	1/9/2013	4/18/2013- Passed unanimously	5/28/013- Referred out of committee
Offer-in-Compromise program	HB4003	MCL205.28/ 205.23a	Walsh[R]	1/9/2013	Referred to Tax Policy	n/a
Restriction of indirect audit procedures-Sales Tax	HB4288	MCL205.68	Foster[R]	2/20/2013	Referred to Tax Policy	n/a
Restriction of indirect audit procedures- Unclaimed Property	HB4289	MCL567.251	Nesbitt[R]	2/20/2013	5/22/13- Passed unanimously	Referred to Finance
Publication of the Department's audit manuals/guidance	HB4290	MCL205.3	Genetski[R]	2/20/2013	5/2/13- Passed unanimously	Referred to Finance
Availability of audit file to taxpayer	HB4291	MCL205.21	Farrington[R]	2/20/2013	5/2/13- Passed unanimously	Referred to Finance
Restriction of indirect audit procedures-Use Tax	HB4292	MCL205.104a	MacGregor[R]	2/20/2013	Referred to Tax Policy	n/a
Create unclaimed property appeals process	HB4703	MCL567.231a	Farrington[R]	5/7/2013	Referred to Tax Policy	n/a
Requires Department to disclose evidence behind revenue estimates	HB4730	MCL205.28	Foster[R]	5/14/2013	Referred to Gov't Operations	n/a
Corporate officer liability reform	SB64	MCL205.27a	Brandenburg[R]	1/23/2013	Referred to Tax Policy	5/22/13- Passed unanimously
Expand scope of tax return information that may bedisclosed by Dep't	SB316	MCL205.28	Brandenburg[R]	4/16/2013	n/a	Referred to Finance
Prohibition against using assessment collection goals, budgets, or quotas	SB327	MCL205.4	Robertson[R]	4/23/2013	ReferredtoTaxPolicy	5/29/13- Passed unanimously
Audit duration limit; deemed denial of refund claim; successor liability	SB337	MCL205.27a/ 205.30	Brandenburg[R]	5/1/2013	ReferredtoTaxPolicy	5/29/13- Passed unanimously

Endnotes

1 William Lentine is an associate in the Taxation and Estate practice group at Dykema Gossett PLLC in Detroit. Mr. Lentine focuses his practice on tax controversy and tax planning for public companies, private companies and individuals. Jackie Cook is an associate in the Tax group at Schiff Hardin in Ann Arbor. Ms. Cook focuses her practice on litigation and tax planning representing taxpayers in state tax controversy matters and property tax appeals.

2 Legislative Analysis by the House Fiscal Agency to House Bill ("HB") 4290, dated 4/23/2013, available at http://www.legislature.mi.gov/documents/2013-2014/billanalysis/House/pdf/2013-HLA-4290-35ACA445.pdf (last accessed on 6/11/2013).

3 *Id*.

4 *Michigan Treasury's Tax Overkill*, The Detroit News, Charlie Owens, May 7, 2013, available at http://blogs.detroitnews.com/politics/2013/05/07/michigan-department-of-treasurys-tax-overkill/ (last accessed 6/12/2013).

5 Correspondence from State Treasurer Andy Dillon to The Honorable Jack Brandenburg, The Honorable Jeff Farrington, and The Honorable David Robertson, dated May 24, 2013.

6 2011 PA 38 (MCL 206.601-.713), effective January 1, 2012.

7 1975 PA 228 (MCL 208.1-.145), repealed by 2006 PA 325, effective December 31, 2007.

8 2007 Act 36 (MCL 208.1101-.1117), repealed by 2011 PA 39, in effect from January 1, 2008-December 31, 2011.

9 2012 PA 397-403.

10 Michigan's overall tax climate improved from 18th in the country to 12th in an annual study conducted by the Tax Policy Center but notably the corporate ranking for tax climate improved from 49th to 7th best. The Tax Policy Center's study is available at: http://taxfoundation.org/sites/taxfoundation.org/files/docs/2013_Index.pdf.

11 1933 Act 167 (MCL 205.51-.78).

12 1937 Act 94 (MCL 205.91-.111).

13 1995 Act 29 (MCL 567.221-.265).

14 See Legislative Analysis of the House Fiscal Agency, dated March 19, 2013, available at: http://www.legislature.mi.gov/documents/2013-2014/billanalysis/House/pdf/2013-HLA-4288-E506EA6C.pdf (website accessed 6/11/2013).

15 See Legislative Analysis of the House Fiscal Agency, dated March 19, 2013, available at: http://www.legislature.mi.gov/documents/2013-2014/billanalysis/House/pdf/2013-HLA-4288-E506EA6C.pdf (website accessed 6/11/2013).

16 *Id*.

17 *Id*.

18 *Id*.

19 Bill Analysis by Senate Fiscal Agency for SB 327, dated 5/23/2013, available at http://www.legislature.mi.gov/documents/2013-2014/billanalysis/Senate/pdf/2013-SFA-0327-F.pdf (last accessed 6/12/2013).

20 *Id*.

21 *Id*.

22 Legislative Analysis by House Fiscal Agency for HB 4003, dated 6/6/2013, available at http://www.legislature.mi.gov/documents/2013-2014/billanalysis/House/pdf/2013-HLA-4003-D0EB29A5.pdf (last accessed 6/11/2013).

23 *Id*.

24 *Id*.

25 MCL 205.27a(5).

26 *Limauro v. Dep't of Treasury*, MTT Docket No. 415784 (2012), on appeal to the Court of Appeals, No. 314176.

27 *Cicurel v. Dep't of Treasury,* MTT Docket Nos. 174091, 175900 and 175901 (1996).

28 *Gibb v. Dep't of Treasury,* MTT Docket Nos. 149191, 149192, 181563 (1993).

29 *Heinz v. Dep't of Treasury*, MTT Docket No. 286501 (2003).

30 See, *Regester v. Dep't of Treasury*, MTT Docket No. 379034 (2011).

31 Senate Fiscal Agency Bill Analysis, Floor Summary to SB 64, completed 5/9/2013, available at http://www.legislature.mi.gov/documents/2013-2014/billanalysis/Senate/pdf/2013-SFA-0064-F.pdf (website accessed 6/11/2013).

32 MCL 205.27a(3)(a) provides that the running of the statute of limitations is suspended for the period pending a final determination of tax, including audit, conference, hearing, and litigation of liability for federal income tax or a tax administered by the department and for 1 year after that period

33 Bill Analysis by the Senate Fiscal Agency for SB 337, dated 5/24/2013, available at http://www.legislature.mi.gov/documents/2013-2014/billanalysis/Senate/pdf/2013-SFA-0337-F.pdf (last accessed 6/11/2013).

34 *Id.*

35 *Id.*

36 MCL § 205.27a(1) currently provides, in pertinent part, that "[i]f the purchaser or succeeding purchasers of a business or its stock of goods fail to comply with the escrow requirements of this subsection, the purchaser is personally liable for the payment of the taxes, interest, and penalties accrued and unpaid by the business of the former owner".

37 Bill Analysis by the Senate Fiscal Agency for SB 337, dated 5/24/2013, available at http://www.legislature.mi.gov/documents/2013-2014/billanalysis/Senate/pdf/2013-SFA-0337-F.pdf (last accessed 6/11/2013).

JOIN THE NEW STATE BAR OF MICHIGAN TAX PRO BONO REFERRAL PANEL

By Nicole Appleberry

INTRODUCTION

Would you like to gain valuable experience representing people who have IRS and Michigan Department of Treasury controversies through administrative advocacy (including audit, appeals, collection due process hearings, etc.) and through litigation? Would you like to do so with specialized training, support, and resources through the State Bar of Michigan Pro Bono Initiative and professors at the Michigan State University College of Law and University of Michigan Law School Low Income Taxpayer Clinics?

If so, sign up for the new Tax Pro Bono Referral Panel, launching this summer as a statewide initiative of the State Bar of Michigan Pro Bono Initiative's Michigan Litigation Assistance Partnership Project (MI-LAPP).

THE CLIENTS AND CASES

Who would you be helping, and with what kinds of cases? Low income clients face some of the same issues that higher income clients do, and the legal work required to help them achieve a satisfactory resolution is very much the same. Their lives and legal situations are, however, affected by their poverty. Some typical clients and issues sound like this (only with much less understanding of their own tax situations):

- "I took care of my sister's kids for a year while she was unable to parent them. The IRS asked me for paperwork showing I did this, but I didn't send anything in -- we never established a formal guardianship, and now I don't even know where she is or how to contact her. The IRS has denied my claim that they were my dependents for the year. What can I do?" (The experience you gain here will help you in any tax controversy case you handle where the client has sparse documentation for a position they've taken.)
- "I am illiterate, physically disabled, and unable to work. I went to a local tax preparer who filed a return claiming I had self-employment income in order to generate a refund. I had no idea! I need to fix this, but don't want to go to jail!" (This experience may be applicable to many clients who filed inaccurate returns.)
- "I used to own a successful business, but when the economy started to tank I got behind on my tax payments. Now I owe money to the IRS and to the Michigan Department of Treasury, but can't come close to being able to afford to pay it. What are my options?" (Many clients can pay you, but not everything they owe to the IRS.)
- "I had no idea my spouse owed student loan money to the federal government. He now has a terminal illness and I am supporting both of us with my job. The IRS took last year's refund to put toward his student loans. We are in foreclosure on our house, have tons of unpaid medical bills, and I just don't know what to do." (Injured spouse issues may be applicable to many clients.)
- "I came here from another country, and day-traded to try to make my savings last. When the brokerage issued the 1099s, they listed only the sales price of the stocks, not the basis, so the IRS thinks I owe thousands of dollars in income taxes. I am terrified and depressed, trying to support my wife and kids on about $15,000 a year. I ignored the IRS's letters as long as I could, but now they're getting serious and I really need some help." (Who wouldn't be interested in working through the wash sale rules? Also handy to know for other, more wealthy clients.)
- "My now ex-husband was abusive toward me and our children. When he went to prison for it, I went to a tax preparer who told me I had to file jointly with him. I tried to explain that we were separated, but she didn't understand because I am profoundly deaf and I didn't have anyone with me that day who could translate my American Sign Language. I don't think I should have to pay the 10% penalty on the money he withdrew to pay his criminal defense attorney, so I filed an innocent spouse petition

SBM PRO BONO INITIATIVE

in Tax Court. Now my husband has intervened, and I have no idea how to present my case at trial." (The facts and dynamics that may justify innocent spouse relief occur at all financial levels.)

- "I want to settle my tax debt for pennies on the dollar, like I've seen on those late-night TV commercials. The internet tells me this is through the IRS's Offer in Compromise program. I want one of those!" (Learning about the IRS's Offer in Compromise program is a staple to any federal tax attorney's practice.)
- "A couple years ago two different credit card companies and my mortgagor cancelled debt I had. Now the IRS has the nerve to tell me that I owe *them* money as a result! How can that possibly be, and is there anything I do about it?" (This is a situation that does also happen to people who can nevertheless scrape together your legal fees.)
- "My brother had me sign that I was vice president of his company, but other than that, I had little to do with the business. Now it turns out that he didn't pay all the taxes, and the IRS is coming after me!" (This is another example of something that happens to people at all income levels.)
- "I claimed the Michigan Homestead Property Tax Credit on my return, and now the Michigan Department of Treasury is questioning it. I have no idea why or what to do about it." (Disputes with Michigan Treasury have their own flavor – any experience you get, working through any tax issue whatsoever, will be helpful to any practice, federal tax and/or state tax.)

The Need

There are many people in the types of situations described above. They're not all low income, but the ones who are can obtain free representation through the Low Income Taxpayer Clinics (LITCs), funded with matching grants through the National Taxpayer Advocate.[1] We have three in Michigan: The Michigan State University College of Law Low Income Taxpayer Clinic in East Lansing, the University of Michigan Law School Low Income Taxpayer Clinic in Ann Arbor, and the Accounting Aid Society in Detroit.

The problem is that these three LITCs cannot possibly help everyone who needs their services. In 2012, approximately 500 cases were calendared for trial before the Tax Court in Detroit. Nationally, about 67% of cases are filed by taxpayers who are not represented by counsel (about 90% of small cases and about 51% of regular cases).[2] The U.S. Census Bureau's 2007-2011 American Community Survey found that 14.5% of people in Michigan have income below the poverty level.[3] People participating in the Tax Pro Bono Referral Panel will represent individuals who earn up to 200% of the federal poverty level – for 2013, that means an annual income of $22,980 plus an extra $8,040 for each additional member of the household. According to the same U.S. Census Bureau survey, that would mean that roughly a quarter of all households would be eligible for Tax Pro Bono Referral Panel services.[4] None of these persons would be able to afford to hire a private tax attorney to represent them in their matters. They tend to be confused about and overwhelmed by their own tax situations, terrified of the IRS or the Michigan Department of Treasury, and extremely grateful for professional assistance.

The Opportunity

The State Bar of Michigan Pro Bono Initiative has stepped in to help address this critical need by coordinating a new Tax Pro Bono Referral Panel. In addition to running the Panel administratively, they will provide training on working IRS and Michigan controversy cases (by Professors Michele Halloran at the Michigan State University College of Law and Nicole Appleberry at the University of Michigan School of Law), access to malpractice insurance as necessary, and continuing access to helpful reference materials applicable to this area of practice. Cases will be referred directly from Michigan's Low Income Taxpayer Clinics to the Pro Bono Initiative.

The Training

There was an initial training held on June 8th from 9:00 a.m. to 12:00 noon at the Thomas M. Cooley Law School's Lansing campus and simulcast at their Ann Arbor, Auburn Hills, and Grand Rapids campuses. The training was videotaped and will be available along with other helpful resources on the special website that the Pro Bono Initiative will maintain for Panelists. These other resources will include full access to the book EFFECTIVELY REPRESENTING YOUR CLIENT BEFORE THE IRS: A PRACTICAL MANUAL FOR THE TAX PRACTITIONER WITH SAMPLE CORRESPONDENCE AND FORMS (Keith Fogg, ed., American Bar Association Section of Taxation, 5th ed. 2011), for attorneys that accept a pro bono case referral.

The Commitment

Panelists commit to taking at least one pro bono matter through the Referral Panel within the initial 6 months after taking the training (either the initial training on June 8th or subsequently through the website). Every three months, after taking on a matter, the Panelist will need to provide a brief status report to the Pro Bono Initiative regarding their progress on the matter.

The Plea

Please consider joining the Tax Pro Bono Referral Panel. You'll provide a vitally needed service and gain valuable tax controversy experience.

ABOUT THE AUTHOR

Nicole Appleberry *is a Clinical Assistant Professor and Director of the Low Income Taxpayer Clinic at the University of Michigan Law School and is of counsel at Ferguson & Widmayer, P.C. in Ann Arbor. She is currently Chair of the Practice and Procedure Committee of the Taxation Section of the State Bar of Michigan and can be reached at naberry@umich.edu*

ENDNOTES

1 The Low Income Taxpayer Clinics also educate low-income taxpayers about their rights and responsibilities, conduct outreach and education to taxpayers who speak English as a second language, and identify and advocate for issues that impact low-income taxpayers.

2 Judge Peter J. Panuthos (personal communication, May 16, 2013)

3 U.S. Census Bureau, 2007-2011 American Community Survey

4 *Id.*

Student Tax Notes

MICHIGAN'S NEW CORPORATE INCOME TAX: ITS BENEFICIAL IMPACT ON BUSINESSES, AND ITS PREFERENCE FOR SMALL BUSINESS OVER LARGE BUSINESS

By Sean Patrick Murphy

The most crucial engines of economic growth are businesses, both large and small; however, most tax based policy decisions favor smaller businesses over larger businesses.[1] This is especially true with the recently passed Michigan Corporate Income Tax ("CIT"), as this new business tax law applies only to C-class corporations.[2] The first provision of the CIT states that its chief purpose is "[t]o improve the economic condition of this state, foster continued and diverse economic growth in this state, and enable this state to compete fairly and effectively in the world marketplace for economic development opportunities that will provide for and protect the health, safety, and welfare of the citizens of this state, now and in the future."[3]

This new business tax structure significantly lowers the tax burden for businesses that escape its reach, and it also lowers the burden for businesses within its reach. While Michigan's new CIT should benefit Michigan's economy as intended and benefit companies of all sizes, it favors small businesses over larger businesses when both are crucial engines of economic growth.[4] These characteristics of Michigan's new CIT are explored below.

Michigan's New Corporate Income Tax

The new Michigan CIT is a step in the direction of pro-business, pro-economic growth-oriented tax legislation. The CIT was enacted as Public Act 38 of 2011 under the 96th Legislature of Michigan, and the law went into effect on January 1, 2012.[5] It effectively replaced the Michigan Business Tax ("MBT"), which was only in effect for three years (2008-2011).[6] As stated above, the CIT was enacted with the purpose of stimulating Michigan's economy now and in the future, and its simplified structure and scope are aimed to do just that.

The CIT benefits both large and small businesses, but it is specifically aimed at stimulating the economy through small businesses by eliminating the corporate income tax completely for all pass-through entities.[7] This is a tremendous step toward making Michigan one of the top states to do business in because most businesses are small, pass-through entities.[8] The predecessor of the CIT, the MBT, was a "complicated and unique tax, which was top heavy with specialized incentives and credits."[9] The MBT was a complicated tax, and it applied to businesses of all sizes[10] as long as their gross receipts were above $350,000.[11] This meant that flow through entities, such as partnerships and limited liability corporations faced a double tax, both on the entity and individual income tax level[12] if their gross receipts were more than $350,000. This double taxation on smaller businesses had been a tradition in Michigan since 1976,[13] and this entity tax on top of personal income tax creates a large burden on business and business owners in Michigan.

The CIT eliminated the double tax on smaller businesses by eliminating entity level tax outright, and this elimination of the entity level taxes on business owners was specifically aimed at boosting the business economy of Michigan.[14] The CIT accomplished this elimination of taxes on pass-through entities by defining a "taxpayer" for purposes of the bill as a corporation,[15] and it defines a "corporation" to be a taxpayer that is required to or elects to file as a C-class corporation.[16] This means that taxes on an estimated 95,000 businesses in Michigan will now be exempt from entity level business tax, [17] and they will now only face a single level of taxation at the state level for the first time in over 35 years.[18]

For taxpayers that the CIT applies to, C-class corporations, the taxing system is a flat tax of 6%.[19] This flat tax is a much more simplified system of taxation on businesses than under the MBT, and even though C-class corporations are paying taxes under the CIT, the simplified accounting and bookkeeping is beneficial to these businesses in many ways.[20] Overall, the CIT is a step in the right direction for Michigan's economic present and future by putting businesses first as a way to boost economic growth.

The CIT's Benefits to Michigan Businesses and Consumers

The new Michigan CIT is designed and drafted as a way of boosting Michigan's economy,[21] and therefore, it is designed not only to benefit business owners but also to benefit the state of Michigan as a whole. It aims to accomplish this by easing the burden for businesses to operate, which should result in a more efficiently running economy. The CIT does have benefits to businesses of all sizes, but the businesses that will benefit the most from this system of taxation are small, pass-through entities. Business profits for these pass-through entities will only be subject to personal income tax on the income that flows to members, owners, or partners at a rate of only 4.25% as of January 1, 2013.[22] This is a tremendous benefit to the owners of Michigan pass-through entities because for the 36 years prior to the CIT, most of these businesses were taxed twice on their income, on the individual and entity level.[23]

The larger C-class corporations in Michigan will also benefit from this tax system despite facing less producer surplus than their smaller competitors. The new system allows the larger businesses subject to the tax to pay a much more simplified flat tax or 6%. Flat taxes are said to be the "way of the future."[24] They result in a much easier system of calculation for businesses. Easier computation of taxes results in the reduction of need for legal and accounting services,[25] and this, in return, reduces the cost of doing business for these corporations which ultimately leads to the stimulation of economic growth.

The CIT tax reform also has benefits to Michigan consumers, as a whole, because when Michigan businesses are operating more efficiently, so is the economy of the state. Also, many studies indicate that the burden of corporate income taxes does not fall on the corporate entity itself, but rather, it falls on the individuals who depend on the corporations: investors, workers, and managers.[26] Many studies done both nationally and internationally analyzing who bears the burden of the corporate income tax indicate that the true burden of corporate income taxes falls on the workers and those who depend on the corporations. This is primarily due to the fact that "economic theory suggests that the least mobile factor of production is likely to bear the burden of the tax. In an increasingly global economy, labor is the least mobile [factor] because capital can flow freely across borders."[27] Because of this, a reduction in the tax burden for businesses should directly affect real wages in a positive way.

This was one of the key findings of a study done by the Tax Foundation that was released in 2009 in a special report highlighting the effect that corporate income taxes have on workers wages.[28] This study was done at the state level analyzing data from 1970-2007, and it indicates that "states with higher corporate taxes tend to have lower real wages."[29] Higher wages benefit the economy as a whole because "[w] hen workers have more capital to work with, their labor and productivity rise." Therefore, the elimination of business taxes will benefit both the business itself as well as its workers.

Michigan's New Corporate Income Tax May Not Enough to Keep Michigan Ahead of the Pack in Its Competition with Other States

Michigan's economy has been growing over the last two years, as the Gross Domestic Product ("GDP") of Michigan has outpaced the United States National GDP since 2010.[30] A growing GDP, which Michigan has been steadily attaining, indicates that the economy is, in fact, expanding.[31] The aim of the CIT is to keep this trend moving forward, and there is no indication it will not benefit the economy of Michigan in the long run. The CIT's potential impact on economic growth may not be enough, however, when Michigan's GDP per capita for 2012 was only $37,616.[32] This leaves Michigan ranked forty-second out of the fifty states in GDP per capita.[33] Time will tell whether the CIT will trickle down and impact Michigan residents as well.

Although both large and small businesses benefit from the CIT, there is a clear preference for small businesses as the engine of economic growth. This is because there is a complete elimination of entity level taxes for businesses that are not C-class corporations.[34] A majority of Michigan's economy is made up of small businesses. In fact, small businesses make up almost 99.7% of employer business nationally.[35] Interestingly, the CIT is viewed by some as paid by "wealthy corporations,"[36] but this is typically a common fallacy among both politicians and constituents. "When a government levies a tax on a corporation, the corporation is more like a tax collector than a tax payer. The burden of the tax ultimately falls on the people–the owners, customers, or workers of the corporation."[37] Eliminating taxes on businesses directly affects the consumer and worker in a positive way.

Although small businesses make up roughly 99.7% of employer businesses nationally,[38] they attribute only about 46-48% of the nonfarm GDP annually.[39] This demonstrates that larger corporations represent the majority of nonfarm GDP production nationally, and therefore, larger businesses contribute to a large portion of our economy nationally, as well as in Michigan. Also, the share of job creation and economic output by small businesses has been steadily declining in recent years,[40] and this is an indication that smaller businesses are being over emphasized as the fundamental engines of economic growth.

By taxing only larger C-class businesses, the needs of businesses that produce over half of our country's non-farm GDP[41] and most of our GDP in Michigan are being sidelined. "Small business has played, and will continue to play, an important role in the American economy. But the role of big business is equally important."[42] Both big and small businesses should be encouraged, as businesses are more mobile than they ever have been in our state and nations history.[43]

The most common argument for the support of small businesses over larger businesses lies in the belief that small businesses play a unique role in job creation in our economy.[44] Some leading economists have found, however, that this is a common misconception. In 2004, Ben Craig, William Jackson, III, and James Thomson, economists for the Federal Reserve Bank of Cleveland, wrote, "policymakers routinely point to small businesses as important sources of employment growth—even though economic studies find little evidence to support this claim."[45]

The data that is relied on by advocates for small business and by politicians supporting favorable treatment of small businesses is that small firms create more jobs than larger firms. This, however, has been found to be true only during times of economic recession.[46] In 2009, Giuseppe Moscarini and Fabien Postel-Vinay, economists at Yale University and the University of Bristol, respectively, published an article entitled: "Large Employers are more Cyclically Sensitive." In this article, one of their chief findings was "[l]arge employers destroy proportionally more jobs during and after recessions and create proportionally more jobs late in expansions (relative to small employers), both in gross and net terms."[47]

This study was done using both United States national information and international information, and the study observed these same results in several different countries of different sizes and stages of development.[48] The article explains that "[t]he conventional wisdom and oft-heard slogan that 'small businesses are the engine of job creation' finds some empirical support in our data for periods of high unemployment, recessions and their aftermaths, which is presumably when jobs are more needed."[49] The article explains how larger businesses are more sensitive to the business and economic cycles and that the statement that small businesses are leaders in job creation is only true during times of recession, not economic expansion.[50]

Steven J. Davis, from the University of Chicago, John Haltiwanger from the University of Maryland, and Scott Schuh from the Federal Reserve Board examined the data typically relied on for the assertion that small businesses create more jobs and discovered that "[c]onventional wisdom about the job-creating prowess of small businesses rests on misleading interpretations of the data."[51] They note, as one of the leading reasons for misleading interpretations of data is the lack of distinction between net and gross job creation.[52]Gross job increase numbers only take into consideration how many jobs were created, and net job increase numbers look to the difference in jobs after taking into account both jobs created and jobs lost. The study analyzed the years from 1973-1988, and it found that when one looks to gross job creation, small firms do outpace the larger firms.[53] The net job creation, however, is negative because the smaller firms lost more jobs than they created.[54] Using the gross job data instead of the net job data can just as easily be used to state that it is clear that small businesses lose more jobs per year than larger businesses. When netting the job numbers, there is little difference between a whole range of firm sizes, compromising the belief that small businesses have a powerful role as job creators.[55]

Both large businesses and small businesses are fundamental engines of economic growth in our economy, and if the Legislature's goal is to grow our economy for years to come, it should at least consider the needs of the businesses producing the majority of the GDP for the economy in Michigan. Although small businesses vastly outnumber the large businesses, there is little debate that large businesses produce more non-farm goods and services in a given year than all other types of companies.[56] In order to continue encouraging and facilitating economic growth, Michigan should make businesses of all sizes a priority.

About the Author

Sean P. Murphy is a third year law student at the University of Detroit Mercy School of Law. Mr. Murphy wishes to thank Professor Joe Pia for his guidance and help with this article.

Endnotes

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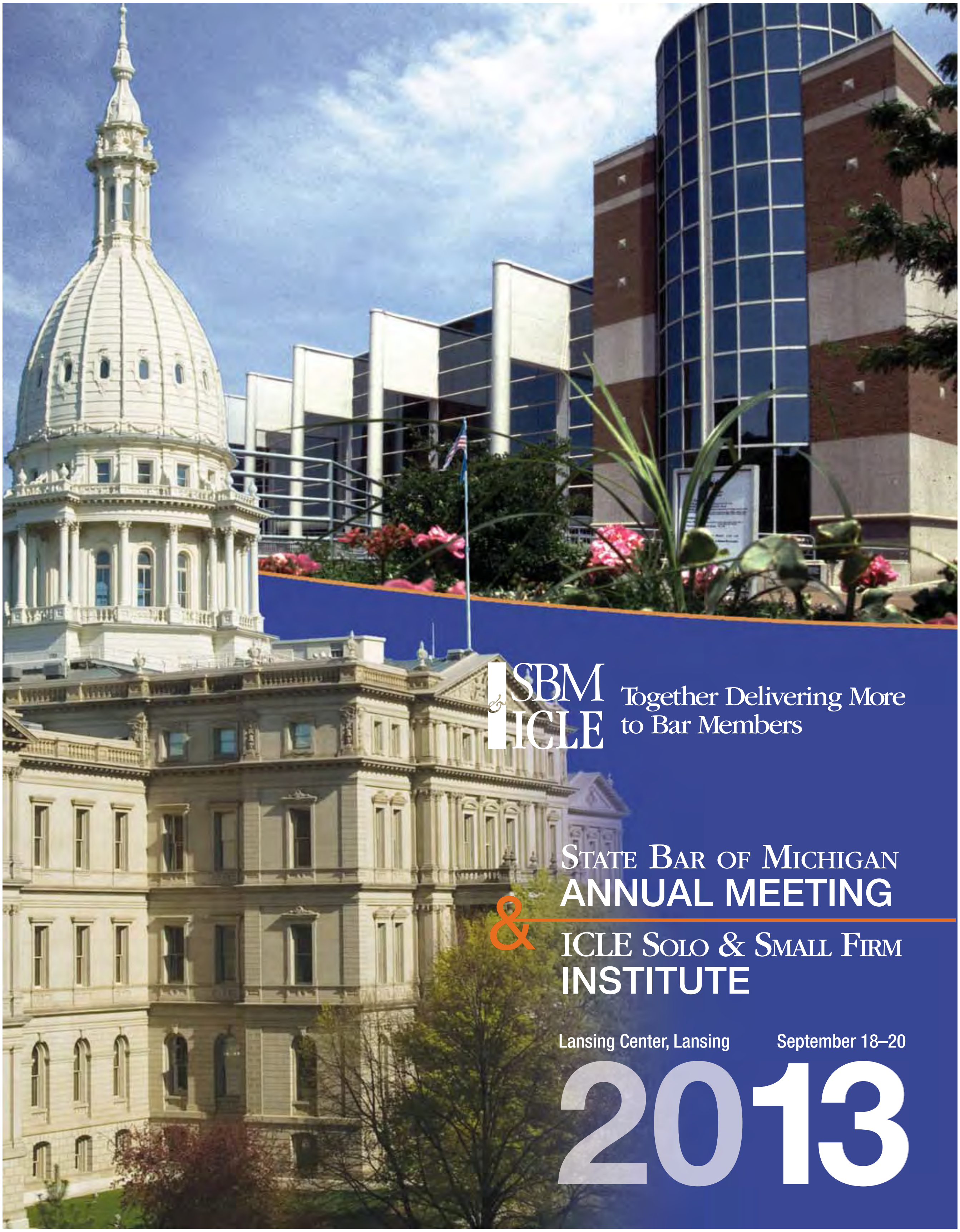
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TRIBUTE TO PROFESSOR MARK SOLOMON

On March 9, 2013, Mark Solomon passed away at the age of 67. Professor Solomon joined Walsh College as an adjunct instructor of taxation in 1976, and became chair of the Taxation and Business Law Department in 1981. In the ensuing years, he strengthened the Master of Science in Taxation (MST) degree's academic rigor, resulting in national recognition among MST alumni and tax professionals. Professor Solomon also took exceptional pride in each MST alumni member's promotion and professional success.

Professor Solomon inspired, encouraged, and awed students with his consummate mastery of tax law. With high classroom standards and attention to detail, he encouraged and inspired students to think like the tax professionals they would ultimately become. At graduation, students sought Professor Solomon out to shake his hand and thank him for setting the bar so high.

In addition to his legacy as a faculty member, Mark was a true student of taxation himself. Mark was the steward of the Walsh College Tax Library, which boasts one of the largest collections of tax-related materials in the Midwest. Mark was also the driving force behind the Tax Portal that provides access to over 600 tax-related Internet links. Finally, Mark created one of the first tax citation manuals to guide tax students and professionals in proper citation to tax authorities.

Mark's sense of humor, vast recommendations of literature and music, and his friendship will be missed by all of those who had the privilege of knowing him. To honor Professor Solomon's teaching excellence, MST alumni created the Mark Solomon Endowed Scholarship in 2012.

Daniel S. Hoops, 2013

MICHIGAN TAX LAWYER
Published by the
TAXATION SECTION
State Bar of Michigan
306 Townsend Street
Lansing, MI 48933-2012