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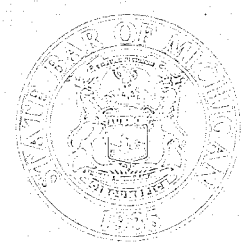

TABLE OF CONTENTS

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

Input from members of the Taxation Section is most welcome. Our publication is aimed toward involving you in Section activities and assisting you in your practice. If you have suggestions or an article you wish to have considered for publication, please contact Patricia A. Calore, 313 South Washington Square, Lansing, Michigan 48933, (517) 371-8277.

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TAXATION SECTION

STATE BAR  OF MICHIGAN

April 7, 1992

Dear Taxation Section Member:

In the last issue of the Michigan Tax Lawyer, I summarized the principal established programs of the Tax Council and also summarized several new activities in which the Tax Council was exploring involvement. This letter provides a detailed update on one established program and one new activity.

First, the Fifth Annual Summer Tax Conference will be held at the Grand Traverse Resort near Traverse City on July 9-11, 1992. The title of the Conference is "Tax Strategies for the '90's". Conference Chairperson, Reg Nizol, has scheduled an absolutely outstanding group of national speakers including:

a. Jerry August who is the current Chairperson of the S Corporation Committee of the Taxation Section of the American Bar Association. He is one of the preeminent national authorities on S corporations and is from West Palm Beach, Florida. Jerry's topic is "Pass Through Entities: Sub S Corporations, Partnerships, and Limited Liability Companies."

b. Bernard Bress who is an attorney who works in the office of Associate Chief Counsel (International) at the IRS in Washington, D.C. His topic is an "Introduction to International Acquisitions and Joint Ventures."

c. Andy Katzenstein who is from Los Angeles. Andy is an extraordinarily interesting speaker who has spoken at two previous Summer Conferences and is returning by popular request. His topic is "Selected Estate Planning Topics: GRITS, GRATS, GRUTS and GST Planning."

d. Roger Siske who is from the Chicago law firm of Sonnenschein Nath & Rosenthal and one of the principal national experts on employee benefit matters. His topic is "Executive Compensation and Non-Qualified Deferred Compensation - Strategies for the '90's."

e. Jerry Wolfe who is Chairperson of the Tax Department of the Detroit office of Coopers & Lybrand and one of the preeminent tax professionals in Michigan. Jerry's topic is "Tax Strategies for the Individual."

The Conference is always a great opportunity to meet and socialize with other tax professionals and to exercise your recreational and relaxation skills. The Grand Traverse Resort represents one of the outstanding Michigan locations for these activities regardless of the weather. In addition, the Conference program includes activities and special arrangements for children and families.

Second, Alan Valade and Dick Daguanno, together with the help of our excellent professional coordinator - Karen Nizol, are compiling the Michigan Tax Directory. The Directory is scheduled to be published in April 1992 and will include the names and business addresses and telephone numbers of virtually all of (a) the Michigan representatives of the Internal Revenue Service, (b) the Lansing-based tax representatives of the Michigan Department of Treasury and the Michigan Attorney General's Office and (c) the members of the Taxation Section. Other useful information will also be included in the Directory. I suspect that you may find the Directory to be even more useful than the "Code." As always, Alan Valade, Dick Daguanno and Karen Nizol have done an outstanding job.

The Tax Council is pursuing many other established programs and new activities. The following pages of this issue of the Michigan Tax Lawyer will provide you with an update on these programs and activities and the names and telephone numbers of the person or persons who you may contact if you are interested in participating.

Best regards.

Sincerely,

Roger Cook
Chairperson

RC/mes
B1619H

Report of the Corporation Committee

Michael A. Indenbaum, Chairperson
150 West Jefferson, Suite 2500
Detroit, Michigan 48226
(313)496-7679

1. Chairperson's Message.
Although the membership roster continues to grow, we are always soliciting new members. If you or anyone you know is involved in issues dealing with federal tax aspects of corporate taxation, please call or write me and I will include your name on our roster.

2. Recent Activities.
The most recent meeting of the Corporation Committee was held on Thursday, November 14, 1991 at the offices of Kemp, Klein, Umphrey & Endelman, P.C. in Troy, Michigan. At that meeting, Mr. Gary Schwarcz of Barris, Sott, Denn & Driker and Bill Acker of Kemp, Klein spoke on Limited Liability Companies and I spoke on new Code Section 382.

3. Future Schedule.
The next meeting of the Corporation Committee will be held on Wednesday, February 26, 1992 at 3:30 p.m. at the offices of Kemp, Klein, Umphrey & Endelman, P.C., located at 201 West Big Beaver Road, Suite 600, Troy, Michigan. This meeting will be a joint meeting of the Corporate Tax Committee, Partnership Committee and the Committee on Federal Tax Aspects of Real Estate Transactions. At this meeting we will discuss the recently proposed Limited Liability Company Act, which may form the basis for the new Michigan legislation. Another meeting will follow on Thursday, April 9, 1992 at 3:30 p.m. at the offices of Kemp, Klein, Umphrey & Endelman, P.C., in Troy, Michigan. Mr. Gary Schwarcz will discuss the recently proposed regulations under Code Sections 704 and 752. In addition, it is anticipated that Richard Soble will discuss his article which was published in the January 1992 Journal of Taxation regarding self-employed health insurance issues.

4. Important Developments.
The Internal Revenue Service recently proposed regulations concerning the de minimis exception to the so-called stock for debt exception to cancellation of indebtedness income set forth in Code Section 108(e)(10). Moreover, proposed regulations relating mainly to Code Section 269 have been finalized with some changes. Specifically, Prop. Reg. Section 1.269-7 has been adopted without change, thereby allowing the application of Code Sections 382 and 269 in tandem. In addition, the final regulations retain, in a slightly relaxed form, the controversial "tax avoidance purpose" presumption relating to ownership changes where Code Section 382(1)(5) applies. These final regulations were generally effective as of January 6, 1992.

Report of the Employee Benefits Committee

Janet G. Witkowski, Chairperson
One Woodward Avenue, Suite 2400
Detroit, MI 48226
(313) 961-8380

1. Chairperson's Message.
My continued thanks to our active membership for contributing ideas and volunteering to help. I would like to hear from many more of you as to your preferences for meeting location and format, topics you would like to have addressed, or ways in which you would like to participate. We now have more than 300 members on our roster. I encourage anyone involved in the area of employee benefits law

who has not yet joined us to contact me so that I may include them on our mailing list.

2. Recent Activities.
On February 10, 1992, the committee met at the Grand Manor at Fairlane in Dearborn. Ms. Lyssa Hall, from the Office of Exemptions, United States Department of Labor gave an informative presentation on identifying prohibited transactions and the procedures to follow for obtaining class or individual exemptions, as well as the policies and considerations that the Office of Exemptions employs in deciding whether to grant a particular exemption.

3. Future Schedule.
The next meeting of the Committee will be held at noon on Friday, May 15, 1992 at the Dearborn Inn in Dearborn. This meeting will feature our annual "talent show," which has become a popular tradition. Several members of the Committee will give short presentations on specific problems and issues which they have encountered in their practices. The Committee will meet again on Wednesday, September 16, 1992 at 2:00 p.m. at the State Bar Building in Lansing. This meeting will be held in conjunction with the State Bar Annual Meeting, and will feature representatives from the IRS in Cincinnati, who will update us on new developments.

Report of the Estates & Trusts Committee

George W. Gregory, Chairperson
625 Purdy Street
Birmingham, MI 48009-1738
(313) 646-4200

1. Chairperson's Message.
Joseph Bonventre, William H. Volz and I wrote an article that should appear in this issue. It reflects three things. First, we interviewed tax administrators and tax attorneys in other states. Second, we reviewed death taxes in a variety of states. Third, we summarized the highlights of the survey of committee members.

Committee member Gerry Kline informs me that in a recent announcement, Thomas Hoatlin, Michigan's Commissioner of Revenue, said that for 1992 the State of Michigan will not require one to base estimated tax payments on 1992 Michigan income. This is different from the new federal rules discussed at the last Committee meeting.

Floyd Schmitzer is now the Manager of Income Taxes and Inheritance Taxes for the State of Michigan. David Horvath, the Michigan Inheritance Tax Examiner in Oakland County was the part time Acting Manager of Michigan Inheritance Taxes. Diane Weaver is the Manager of Intangibles Taxes for the State of Michigan.

2. Recent Activities.
For the third year in a row the first Committee meeting of the calendar year was "Income Taxation of Estates and Trusts: What Is New and Exciting?"

The meeting was held on January 22, 1992, at 3:00 p.m., at the Radisson Plaza Hotel, Southfield, Michigan. Michael Obloy, Vice President and Senior Trust Officer in Charge of Estate and Tax Administration in the

Personal Trust Division of Manufacturers National Bank of Detroit was the speaker. He focused on return preparation for the coming filing season and changes in fiduciary income taxation. His main topics were the new estimated fiduciary income taxes and multiple state taxation of trusts when there is an asset, a trustee, or a beneficiary located in a state other than Michigan.

Sue Swanson, C.P.A., Internal Revenue Service, Revenue Agent Group Manager in Pontiac, Michigan discussed several topics. These included some interesting aspects of the rules of practice before the Internal Revenue Service as they apply to tax attorneys and technological changes at the I.R.S. One moral of the story: file your individual tax returns timely. Someone at the local I.R.S. office can obtain the line item amounts on an individual tax return from a computer terminal. A surprising leap in I.R.S. technology.

Lorraine F. New, Internal Revenue Service Estate and Gift Tax Attorney, presented some areas of concern to the Internal Revenue Service in the fiduciary income tax area. She based her presentation on recent rulings, court cases and an occasional war story.

Thirty eight people attended.

3. Future Schedule.
On May 14, 1992, David Horvath will roll out (1) a rough first draft of a proposed Michigan Inheritance Extension form and (2) a proposed Michigan Inheritance Tax Return. He chairs a committee made up of Oakland County Bar Association members Rob Labe, Paul McKenney, David Radner, and George Gregory. They are drafting.

On September 22, 1992, Austin A. Kanter, CLU, ChFC, of American Benefits Group will present the income tax and other nonestate tax aspects of life insurance for estate planners. In addition to transfer for value rules and other income tax aspects, he will address how to read and analyze a proposal for life insurance.

Report of the Partnership Committee

Gary Schwarz
211 West Fort Street, Fifteenth Floor
Detroit, MI 48226
(313)965-9725

1. Chairperson's Message.
On November 14, 1991, the Partnership Committee, the Real Estate Sections Committee on Federal Income Tax Aspects of Real Estate Transactions and the Corporation Committee held a joint meeting to discuss the *Campbell* case, limited liability companies and the new Code Section 382 regulations. The same committees met on February 26, 1992 to discuss the ABA proposed limited liability company act.

2. Future Schedule.
The Partnership Committee will meet on April 9th at 3:30 p.m. at the offices of Kemp, Klein, Umphrey & Endelman, P.C. in Troy. We will discuss the new regulations under Code Section 704 and Code Section 752.

3. Important Developments.
Final Treasury Regulations on Code Sections 752 were published on December 23, 1991. These regulations simplify the allocation of partnership liabilities and debts among partners. Final Treasury Regulations on Code Section 704 were published on December 27, 1991. The final regulations deviate from the temporary regulations when dealing with the minimum gain chargeback, among other changes. The final regulations will be discussed in detail, as mentioned above, at our April meeting.

Report of the Practice and Procedure Committee

Thomas G. Mies, Chairperson
32900 Five Mile Road
Suite 4
Livonia, Michigan 48154
(313) 421-5055

1. Chairperson's Message.
I am happy to report that our membership has continued to grow. The members in attendance at our meetings appear to appreciate the timely topics being discussed, along with the opportunity to engage in informative dialogue with the various speakers and the other members of the Committee, who are always willing to share their experience and knowledge.

2. Recent Activities.
At the Committee's meeting on January 23, 1992, Phillip J. Shefferly, of the firm Shefferly and Silverman, P.C., gave a very informative talk pertaining to various aspects of bankruptcy which are of concern to tax practitioners. Some of the issues which Mr. Shefferly addressed were prompt audits, priorities, assessment of the 100% penalty, payment plans under Bankruptcy Section 1129(A)(9)(c) and discharge of tax liabilities, with primary focus on Chapters XI and VII. The members in attendance were, without exception, impressed with Mr. Shefferly's knowledge of the area and his ability to concisely present information that is very useful to each and every one of the members in their everyday practice.

3. Future Schedule.
Committee meetings will be held on April 23, 1992 and June 25, 1992 at the offices of Couzens, Lansky, Fealk, Ellis and Roeder, 33533 W. Twelve Mile Road, Suite 150, Farmington Hills, Michigan. The meetings are scheduled to be held from 3:00-5:00 p.m. The final meeting of the year will be held in connection with the State Bar annual meeting.

Report of the State and Local Tax Committee

Thomas D. Hammerschmidt, Jr., Chairperson
800 First National Building
Detroit, Michigan 48226
(313)223-3536

1. Chairperson's Message.
The dust seems to have settled for awhile in the world of state and local taxes. All is quiet on the *Caterpillar* front after oral argument before the Michigan Supreme Court was held in early December of 1991. Hopefully, we will see a decision in the near future, possibly even before this report reaches publication. With the exception of the enactment of 1991 Public Act 128 in late October, which fine-tunes the capital acquisition deduction and recapture provisions of the 1991 Public Act 77 amendments to the SBT, and some late December legislation affecting automobile dealer floor plan interest under the SBT, there has not bee a lot of legislative activity. Because of the slowdown in the need to identify and analyze recent developments in state and local taxation, the Committee has been able to devote some attention at Committee meetings to significant ongoing issues affecting state and local tax practice. Our last two Committee meetings have contained some in-depth presentations in this regard which have been very well received by participants. Educational opportunities are one of the primary benefits that attendance at Committee meetings afford to tax lawyers. As always, I strongly urge attorneys with an interest in state and local taxes to join the Committee and to actively

participate in our quarterly meetings. The presentations and the ability to "network" with many attorneys recognized for their experience in the state and local tax field is a significant benefit.

2. Recent Activities.
The Committee last met on January 8, 1992 in combination with the State and Local Tax Committee of the Real Property Section. Each Committee presented an overview of procedural issues affecting tax disputes of both property and non-property taxes in Michigan. The presentations were especially valuable to those practitioners who do not devote their full-time practice to one of these areas but who still need to know some of the basics in order to be responsive to client inquiries. As mentioned in my last report, at our September 25, 1991 meeting we heard a presentation on transferee and successor liability issues, including the tax clearance provisions and applicable procedures under Michigan's Revenue Act. Under the Revenue Act the potential for successor liability for a purchaser of a business or its assets affects virtually every business transaction in Michigan.

3. Recent Developments.
As most of you know, there are a number of property tax proposals which are being considered by the legislature and which may end up on the November 1992 ballot. Some of the proposals for funding property tax relief involve changes to the SBT, such as eliminating the so-called capital acquisition deduction "loophole." Many of the State Bar Sections and their Committees are monitoring these developments.

We understand that Representative Rick Bandstra is preparing to introduce a number of bills representing another attempt at a Michigan "Taxpayer Bill of Rights." Some of you may remember the efforts of this Committee two years ago in analyzing legislation which had been introduced for that same purpose. Even the Department of Treasury revenue officials acknowledge that there are areas where changes would be welcome in the administration of Michigan taxes. Your input in this process would be welcome and extremely helpful in shaping rules which we will all have to live with in the future if legislative changes are made.

The Department's "Quarterly Tax Advisor" has been discontinued as a regular publication due to budget problems. Revenue Commissioner Tom Hoatlin has stated that the Department was very proud of the "Quarterly Tax Advisor" and hopes to resume publication when circumstances permit.

Finally, Dave Kirvan, the administrator of the SBT, announced earlier this year that he expected the long-awaited SBT Rules to come out sometime this summer. There may be some further slippage in that schedule as the legislative services bureau has not yet completed its review of the rules. A release later in the year is a possibility.

4. Future Schedule.
The next meeting of the Committee is scheduled for April 21, 1992. Meeting announcements will be sent to Committee members with the details of the meeting. Those of you who are interested in being added to the Committee mailing list should feel free to call me or Karen Nizol, the Taxation Section Coordinator, at (313)953-0088. Please also mark your calendar for September 16, 1992, at 2:00 p.m., for a Committee meeting to be held in Lansing in conjunction with the State Bar's annual meeting. Similar to our meeting last September, we hope to have a Department of

Treasury official who will speak on state and local tax policy issues and what might be in store for the future.

Simplifying Michigan's Death Tax: Senate Bill 1 proposes a State Pick-up of the Federal Estate Tax Credit

By: George W. Gregory
Joseph A. Bonventre
William H. Volz

Michigan's inheritance tax law is nearly one hundred years old. As with the neighboring states of Ohio, Indiana, Illinois, Wisconsin and Minnesota, the state of Michigan can trace its beginnings to the Northwest Ordinances of 1785 and 1787. Throughout the Nineteenth Century, the states that emerged from the Northwest Territories looked to New York for guidance in the development of their laws. When New York adopted an inheritance tax law in 1895, all of our neighboring states moved to copy it. Michigan adopted the language of the New York code in 1899. Michigan often looks to New York's courts for guidance on how to interpret the inheritance tax statute.

Seniors who have acquired significant wealth are often key investors in any state's economic plans.

The National Trend to a "Pick-Up" Tax

A contrasting model sprang up in Florida and Nevada. These states consciously sought to attract the wealth of America's retirees by projecting an image of low tax cost to their citizens. These "retirement" states often established state constitutional prohibitions against death taxes and other taxes as well. When Congress, with the Revenue Act of 1926, created a federal estate tax credit for state death taxes paid, Florida challenged the constitutionally of the Act. Florida argued that the federal statute was constitutionally flawed because it allowed a credit for state death taxes and Florida's state constitution prohibited such taxes. The U.S. Supreme Court disagreed and found the new federal tax applied uniformly to the states. Therefore, Florida's constitutional restriction did not exempt its residents from the federal estate tax, but the taxpayer could take a federal credit for death taxes paid to a state for obligations under the state's inheritance tax or its estate tax. It made no sense at all for a state to forego the revenues it could receive under the federal estate tax credit. Consequently, three years later, Florida amended its constitution to allow its legislature to pass a death tax. The amount of Florida's new tax would not exceed the state death tax credit allowed in computing the tax liability under the federal government's estate tax or any other states' death taxes. Florida would simply "pick up" the tax revenues designated by the federal credit. Since 1930, Florida has pointed to the presence of this modest "pick-up" tax as a central part of selling itself as a retirement mecca. With Fiscal Year 1991 death tax revenues of over $300 million, it is clear that Florida's marketing strategy has been enormously successful.

Not surprisingly, other states have followed Florida's lead in attempting to attract and retain citizens in the later years of their lives. Seniors who have acquired significant wealth are often key investors in any state's economic plans. In 1977, seven states adopted the "pick-up" only tax. This increased to eleven states by 1981 and to twenty-five states in 1986. Presently, more than twenty-eight states and the District of Columbia limit their state death tax obligation to the "pick-up" tax. All six states from the old Northwest Ordinances adopted the Nineteenth Century New York inheritance tax law. Only two still retain it — Indiana and Michigan. Illinois, Wisconsin and Minnesota now have the "pick-up" only tax.

Ohio has a state estate tax modeled on the 1976 Federal Estate Tax.

Senate Bill 1 is a Pick-Up Tax for Michigan

Michigan's present inheritance tax is computed by focusing on the amount of property each beneficiary receives and the relationship of the beneficiary to the decedent. Senate Bill 1 would begin phasing out the inheritance tax this year. Eventually, our inheritance tax would be replaced with an estate tax. As with the other state "pick up" taxes, the tax liability on a Michigan estate would be equal to the maximum federal estate tax credit that could be claimed for state death taxes. The "pick-up" tax owed in Michigan would equal the federal credit allocable to Michigan. Senate Bill 1 proposes that Michigan adopt a "pick-up" tax quite similar to what is now the law in over half of the states.

Projections of Tax Revenues

Especially during tough economic times, a principal argument against the lower tax rate of a "pick up" only death tax is the projection of lost tax revenues. The Michigan Senate Fiscal Agency projected that under Senate Bill 1, Michigan's death tax revenues would drop from $112 million (about 1.5% of Michigan's General Fund/General Purpose Revenues) in 1990 to an estimated $75 million in 1995. Proponents of the lower "pick up" tax rate argue that the projections of revenue losses do not account for the lower rate's capacity to stem the out-migration of the state's wealthy senior citizens. The Senate Fiscal Agency could not find evidence to show whether people changed their residency because of their sensitivity to lower death taxes. Our study indicates that Michigan has a very significant group of tax sensitive senior citizens.

Tax Sensitive Seniors

Senator Nick Smith, the draftsman of Senate Bill 1, emphasized the importance of lower tax rates to Michigan's economic future when he told us:

> It is easy for some in the legislature to be short sighted during these tight budget times and resist giving up any revenue. However, most other states have decided that going to a "pick up" tax is going to be a long term advantage for citizens, and Michigan needs to look at these long term benefits.

In a pilot study, the Estates and Trusts Committee of the State Bar of Michigan surveyed twenty persons attending a Tax Council meeting. They were queried about their clients who were being counselled on retirement and estate planning. These initial respondents noted that a state's tax climate was a determinative factor for those clients who changed residence to another state. The Tax Council respondents painted a healthy financial profile of those that left the state. They estimated that these tax sensitive seniors would have paid an average of $8,000 in Michigan income taxes and $6,000 in Michigan intangibles taxes each year.

After refining the questionnaire tested on the Tax Council, the Estates and Trusts Committee surveyed its 120 members. Forty-eight responded. Only five felt that taxes never resolved the question of a person's residence, but two of these five noted that the state's tax climate was still a "strong factor." The remaining respondents indicated that nearly half of their clients, who chose to live in another state, did so for tax reasons. The financial profile of these tax sensitive seniors was certainly healthy, perhaps even glowing. The estate and trust attorneys estimated that the average taxpayer who had chosen not to live in Michigan because of taxes would have paid $22,200 a year in state income taxes as well as $7,500 in intangibles taxes. Had this

As with the other state "pick up" taxes, the tax liability on a Michigan estate would be equal to the maximum federal estate tax credit that could be claimed for state death taxes.

average person died in Michigan, they would have paid $193,000 in inheritance taxes. Consequently, the study indicated those clients of the Estates and Trusts Committee, who left Michigan for a better tax climate, took with them more than $71 million in annual state tax revenues ($58 million in income taxes and $13 million in intangibles taxes). Consequently, the Senate Fiscal Agency analysis overlooks a significant positive tax impact of adopting the "pick up" tax.

Michigan's analysts are not alone in overestimating the reduction in state inheritance tax revenues. Wisconsin's analysts projected a dramatic drop in revenues as the state began a five year phase-in of their new "pick up" tax in 1988. Yet, in fact, the revenue loss was delayed and more modest.

Fiscal Year	1987 Projections of Revenue	Actual Revenue
1988	$89.0	$94.3
1989	84.0	93.8
1990	87.0	85.3
1991	70.0	71.5

A Smooth Transition

Interviews with government administrators and attorneys practicing in the area of state death taxation recorded very positive reviews for Wisconsin's transition to its new "pick up" tax. Further interviews with attorneys and government officials in Illinois, Ohio, Florida, Arizona and California highlighted five central findings.

1. The Florida approach to state death taxes, now in place for over sixty years, is practical and workable. In part to neutralize the tax advantages of other states, a healthy majority of states now have a "pick up" tax.
2. An orderly change to a "pick-up" tax should include an extended phase-in period so that government officials can write and the public can appreciate the detailed rules that are essential for a smooth transition. The five year periods employed in Wisconsin and in Senate Bill 1 should ease the short-term reduction in revenues, allow for the conclusion of outstanding litigation involving the Michigan inheritance tax and assure high quality training for the affected state administrators.
3. The legislative approach is a much better way to enact the "pick-up" tax than to promote it through a referendum for a constitutional amendment. California is still muddling through much litigation and a host of difficult questions that arose from a successful referendum enacting a very peculiar model of a "pick up" tax with much too brief a period of transition.
4. State auditors will accord great weight to the Form 706 asset valuations accepted by the federal government. Yet the state should reserve a capacity of its own to monitor the valuations of the assets in the estates of its citizens.
5. We live in an increasingly mobile society, and Michigan is a popular "vacation home" state. We should anticipate that different states will use conflicting rules in apportioning the assets of our most mobile citizens. Officials from several states recommended strongly that it is critical to enlist the talents of (often reluctant) government administrators in creating detailed apportionment rules.

A New Tax Policy

The "pick up" tax focuses on the decedent's estate and not the characteristics of those who would inherit the assets in the estate. However, this distinction draws little ire.

It is the lower effective tax rate and the projections of the loss of state revenues that brings controversy to Senate Bill 1. The inheritance tax brings in only about 1.5% of Michigan's General Fund/General Purpose revenues. The lower death tax rate will be very attractive to senior citizens, farmers wishing to transfer their land to the family's next generation and closely held businesses that are concerned about both high asset valuations and taxes upon an owner's death.

In return for a modest, short term loss in revenues, the state can send a strong signal to its older investors that we very much would like them to remain citizens of Michigan for the rest of their lives. The much simpler forms used in calculating the "pick up" tax coupled with the lower effective tax rate should strengthen Michigan's image as a "tax friendly" state.

George W. Gregory is a tax lawyer and a shareholder in Lee & Gregory, P.C., with offices in Birmingham and Brighton, Michigan, and currently serves as Chair of the Estates and Trusts Committee of the Tax Section.

Joseph A. Bonventre is a tax lawyer affiliated with the Detroit office of Clark, Klein & Beaumont.

William H. Volz is the Dean of the Wayne State University School of Business Administration and a Professor of Business Law at the School of Business Administration.

FOOTNOTES

1. Mich. P.A. 1899, No. 188.
2. *In re Cress's Estate,* 335 Mich. 551, 56 N.W.2nd 380 (1953): *In re Atherton's Estate,* 333 Mich. 193, 52 N.W.2nd 660 (1952): *In re Rackham's Estate,* 329 Mich. 493, 45 N.W.2nd 329 (1951).
3. *Florida v. Mellon,* 205 U.S. 12 (1927).
4. Florida Constitution Article 7, Section 5.
5. BDO Seidman Tax Letter, 1990.
6. October 23, 1991 letter from Economist Dennis Collier, Wisconsin Bureau of State Tax Policy. However, he attributes the difference to estates growing faster than projected due to the run up in the stock market in the late 1980s.

Partnership Liability Allocations Under the Final 752 Regulations

By: Alan C. Roeder

I. Introduction. Final Regulations have been published regarding the allocation of a partnership's liabilities among its partners.[1] This allocation has a direct impact upon a partner's basis in the partnership ("outside basis") which affects each partner's deductions and gains. This article summarizes the Final Regulations.

Essentially, a partner's outside basis is the sum of money contributed to the partnership as well as the contributor's adjusted basis in any property contributed.[2] A partner's basis is subsequently increased by any additional contributions and by his distributive share of "income items". His basis will be decreased by cash distributed to him, the basis of property distributed to him and other specific items.

Essentially, a partner's outside basis is the sum of money contributed to the partnership as well as the contributor's adjusted basis in any property contributed.

The partner's basis will also be adjusted by a change in his share of partnership liabilities, any partnership liabilities he assumes and any of his liabilities assumed by the partnership.[3] These adjustments are the subject of this article.

A. Old Regulations. The original Regulations concerning liability sharing were promulgated in 1956 and consisted of two paragraphs.[4]

Basically the regulations provide that (i) partners in a general partnership allocate all recourse liabilities in the same ratios used to share losses and all nonrecourse liabilities in the same ratios used to share profits,[5] and (ii) partners in a limited partnership allocate nonrecourse liabilities in accordance with their profit ratios. A limited partner's share of recourse liabilities will equal the lesser of the additional contributions he is obligated to make or that portion of the partnership's recourse liabilities multiplied by his loss-sharing percentage. Remaining recourse liabilities of the partnership are allocated to the general partner(s).

B. The *Raphan* Case and Congressional Response. In *Raphan v. United States,*[6] the Claims Court considered a debt which was secured by partnership assets and which imposed no liability on the partnership or the partners other than the ability to recover the assets. The general partner had personally guaranteed the debt. The Court determined that the guarantee did not cause the debt to become recourse and, therefore, the limited partners could include it in their basis.

Congress then directed that §752 should be applied without regard to the Claim Court's determination and that the Regulations should be amended to consider the effects of "guarantees, assumptions, indemnity agreements and similar arrangements."[7]

C. Temporary, Proposed and Final Regulations. Lengthy and complex Temporary Regulations were filed on December 29, 1988, in an effort to address the Congressional mandate.[8] On July 31, 1991, Proposed Regulations were issued to simplify the Temporary Regulations and to address some of the comments which had been submitted.[9] Final Regulations were published on December 23, 1991.

II. Treatment of Partnership Liabilities under the Final Regulations. The Final Regulations provide that a partnership liability is a recourse/nonrecourse liability to the extent that any/no partner or related person[10] bears the economic risk of loss for that liability under Treas. Reg. §1.752-2.[11] If one or more partners bears the economic risk of loss as to part, but not all, of a partnership liability represented by a single contractual obligation, that liability is treated as two or more separate liabilities, some of which may be recourse and some of which may be nonrecourse.[12]

Any increase in a partner's share of partnership liabilities, or any increase in a partner's individual liabilities by reason of the partner's assumption of partnership liabilities, is treated as a contribution of money by the partner to the partnership and the converse is treated as a distribution of money by the partnership to the partner.[13]

Increases and decreases in liabilities resulting from the same transaction are netted.[14]

III. Partner's Share of Recourse Liabilities. Generally, a partner's share of a recourse liability equals that portion of the liability, if any, for which the partner or related person bears the economic risk of loss.[15]

A. Obligation to Make a Payment. A partner's economic risk of loss includes the amount the partner or related person would be obligated to pay or contribute, without reimbursement, upon the constructive liquidation of the partnership when all of the liabilities become due in full, all of the assets have a value of zero, all property is sold in a taxable transaction for an amount equal only to the nonrecourse liabilities secured by that property, all items of partnership income, gain, loss, deduction and credit ("Tax Items") are allocated among the partners and the partnership is liquidated.[16] Treas. Reg. §1.752-2(b)(2) attempts to clarify the method of computing gain or loss for these purposes.[17]

All statutory and contractual obligations are taken into account based upon the facts and circumstances at the time. These include obligations such as guarantees, indemnifications, reimbursement agreements, obligations running directly to others, obligations imposed by the partnership agreement (including capital contributions and deficit capital account restoration upon liquidation) and obligations imposed by the partnership agreement (including capital contributions and deficit capital account restoration upon liquidation) and obligations imposed by state law (including the state partnership statute.)[18] Absent a devious plan, each obligor is deemed to fulfill his obligations regardless of his actual net worth.[19] Contingent obligations unlikely to be paid are disregarded.[20]

B. Partner as Lender. A partner also bears the economic risk of loss with respect to a nonrecourse loan made by the partner or related person to the partnership (or a lender's interest in such a loan is acquired by him) if no other partner bears the risk of loss for that loan.[21]

C. Special Rule for Nonrecourse Liability with Interest Guaranteed by a Partner. The Final Regulations liberalize the Temporary Regulations by providing that if one or more partners or related persons have guaranteed more than 25% of the total interest that

will accrue on a nonrecourse liability over its remaining term, the liability will be treated as two separate debts and the guarantors will be deemed to bear the economic risk of loss of such debt to the extent of the present value[22] of the guaranteed future interest payments. This rule only applies if it is reasonable to expect that they will be required to pay substantially all of the amount they've guaranteed if the partnership fails to do so,[23] and does not apply at all if the guarantee is for a period not in excess of the lesser of five years or one-third of the term of the debt.[24]

D. De minimis Exceptions. A De minimis Partner or Related Person does not bear the risk of economic loss with respect to Qualified Financing provided by him to the partnership.[25] The purpose of this exception is to permit a person who is in the business of lending money and whose relationship to the partnership is primarily that of a lender to own a small equity interest in the partnership without diminishing the basis of the other partners.[26] Furthermore, a De minimis Partner or Related Person does not bear the economic risk of loss with respect to guaranteed future interest payments if the related loan constitutes Qualified Financing.[27] The Final Regulations expand these exceptions to provide that a De minimis Partner or Related Person[28] does not bear the economic risk with respect to a liability he guarantees if such loan would have been Qualified Financing[29] if the guarantor had made the loan to the partnership.[30]

E. Time-Value-of-Money Considerations. If a payment obligation is not required to be satisfied within a reasonable time after the liability becomes due and payable, or if the obligation to make a contribution is not required to be satisfied before the later of: (1) the end of the year in which the partner's interest is liquidated, or (2) 90 days after the liquidation, the obligation is recognized only to the extent of the value of the obligation.[31] The value of such obligation is the entire principal balance of the obligation only if the obligation bears interest at a rate equal to or greater than the AFR under Code Section 1274 at the time of valuation commencing on the due date of the liability or the date of the liquidation of the partner's interest, whichever is applicable. Otherwise, the value of the obligation is discounted to the imputed principal amount pursuant to Code Section 1274,[32] and the balance of the obligation is allocated to the other partner(s)[33]. An obligation is not satisfied by the transfer to the obligee of a promissory note by the partner or related person unless it is readily tradeable on an established securities market.[34]

F. Partner or Related Person's Separate Property as Security for a Partnership Debt. A partner bears the economic risk of loss for a partnership liability to the extent of the value[35] of any of the partner's or related person's separate property (other than a direct or indirect interest in the partnership) pledged as security for the debt,[36] or any of the partner's or related person's separate property (other than the partner's or related person's promissory note unless it is readily tradeable on an established securities market[37]) which is

contributed to the partnership solely for the purpose of securing[38] such liability.

G Tiered Partnership. If a partnership ("upper-tier partnership") owns an interest in another partnership ("lower-tier partnership"), the liabilities of the lower-tier partnership are allocated to the upper-tier partnership in an amount equal to the sum of: (1) the amount of economic risk of loss the upper-tier partnership bears with respect to such liabilities, and (2) any other amount of the liabilities with respect to which the partners of the upper-tier partnership bear the economic risk of loss.[39] The sum is then treated as a liability of the upper-tier partnership for purposes of applying the Code and Regulations to its partners.[40]

H. Anti-Abuse Rules. Treas. Regs. §1.752-2(j) provides that any or all of the foregoing will be disregarded if the facts and circumstances indicate that the substance is other than what seems obvious from the form. Transactions may be more likely to be found abusive under the Final Regulations than under the Temporary Regulations.

IV. Partner's Share of Nonrecourse Liabilities.[41] Guidance with respect to a partner's share of nonrecourse liabilities of a partnership can be found by referring to Code Section 704 and the Regulations thereunder.[42]

A. Essentially, a partner's share of nonrecourse liabilities equals the sum of:

1. The partner's share of partnership minimum gain;[43]
2. The amount of taxable gain that would be allocated to the partner under Code Section 704(c)[44] if the partnership disposed of all of its property which was encumbered by nonrecourse liabilities for precisely the amount of the debt; and
3. The partner's share of the balance of nonrecourse liabilities as determined in accordance with his share of partnership profits,[45] or in accordance with the manner in which it is reasonably expected that deductions attributable to those liabilities will be allocated. The method need not be the same each year.

V. Special Rules.

A. Related Parties. The tests for determining related parties for these purposes are found in Code Sections 267(b) and 707(b), but:

1. Substitute "80% or more" for "more than 50% ";
2. Exclude brothers and sisters from the family; and
3. Disregard Code Sections 267(e)(1) and 267(f)(1)(A).

If a person is related to more than one partner, he is related to the partner with the highest percentage of related ownership. If the highest two or more partners have the same percentage of related ownership, the liability is allocated among them equally.[46]

B. No Double-Counting. Each liability is taken into account only once even though a partner may be separately liable in another capacity.[47]

C. Time of Determination. The allocation of liabilities will be determined whenever necessary to properly tax a partner.[48]

VI. Effective Dates.[49] Generally, the Final Regulations govern any liability incurred or assumed by a partnership on or after December 28, 1991.[50] A partnership may elect to have the Final Regulations apply as of the beginning of the first taxable year of the partnership ending on or after December 28, 1991, which means 1991 for calendar year partnerships.[51]

Liabilities are generally governed by the Regulations in effect at the time the liability is incurred or assumed. Therefore, an older partnership will likely have debts allocated among its partners pursuant to the Old Regulations (generally, those incurred prior to January 30, 1989), the Temporary Regulations and the Final Regulations.

ALAN C. ROEDER, is a principal member of the firm of Couzens, Lansky, Fealk, Ellis, Roeder & Lazar, P.C. in Farmington Hills, Michigan. A significant portion of his practice is focused in the areas of taxation and real property. He is a graduate of George Washington University Law School and holds an LL.M. from New York University School of Law.

FOOTNOTES

1. Treas. Regs. §1.752-1 *et.seq.*, TC 8380, also referred to as the "Final Regulations".
2. IRC §722. See IRC §742 if the interest is acquired other than by contribution. Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended, and Treasury Regulations promulgated thereunder.
3. IRC §§7705 and 752.
4. Treas. Regs. §1.752-1 (e), also referred to as the "Old Regulations".
5. See Footnote 45, infra.
6. 3 Cl. Ct. 457 (1983), rev'd on this issue, 759 F2d 879 (Fed. Cir. 1985).
7. §79 of the Deficit Reduction Act of 1984 (the "1984 Act").
8. Temp. Regs. §1.752-1T *et. seq.*, TD 8237, also referred to as the "Temporary Regulations". See Levine, Loffman and Presant, A Practical Guide to the Section 752 Temp. Regs.—Parts I and II, *70 Journal of Taxation*, April 1989, p. 196 and *70 Journal of Taxation*, May 1989, p. 260.
9. Prop. Regs. §1.752 *et. seq.*, Proposed Treasury Decision PS-49-91, also referred to as the "Proposed Regulations."
10. "Related persons" are defined in Section V.A. of this article.
11. Treas. Regs. §1.752-1(a) (1) and (2).
12. Treas. Regs. §1.752-1 (i).
13. Treas. Regs §1.752-1 (b) and (c). The conditions which must be met in order for a partner to be deemed to have assumed a liability are set forth in -1 (d). Upon a contribution of property to or a distribution of property from a partnership, -1 (e) provides that the liability deemed to be assumed will not exceed the fair market value of the property.
14. Treas. Regs. §1.752-1 (f).
15. Treas. Regs. §1.752-2 (a).
16. Treas. Regs. §1.752-2 (b) (1).
17. Note that IRC §704 (c) is now taken into account. See Pickron, "New 752 Prop. Regs. Simplify Rules for Allocating Partnership Liabilities," 75 *Journal of Taxation*, December 1991, p.358.
18. Treas. Regs. §1.752-2 (b) (3). Although this language seems all-inclusive, it is noted that an obligation is deemed to not exist unless it falls within -2 (b) (3). Presumably, "state partnership statute" includes the Michigan Uniform Partnership Act (MCLA §449.1) and the Michigan Revised Uniform Limited Partnership Act (MCLA §449.1101). Pursuant to -2 (b) (5), any obligation is reduced to the extent the obligor is entitled to reimbursement.
19. Treas. Regs. §1.752-2 (b) (6).
20. Treas. Regs. §1.752-2 (b) (4). See also, -2 (f), Example 8, which is helpful in establishing that guarantees regarding certain acts of the partnership and certain conditions of the property will not be considered obligations without facts establishing a reasonable certainty that the guaranteed obligation will arise.
21. Treas. Regs. §1.752-2 (c) (1). Pursuant to -2 (c) (2), the lending partner does not bear the risk of loss to the extent the loan wraps an underlying nonrecourse loan which is payable to another person and secured by partnership property.

FOOTNOTES (continued)

22. Treas. Reg. §1.752-2 (e) (2) provides that the discount rate will be the rate stated in the loan documents or the AFR, compounded semi-annually, if interest is imputed pursuant to §§483 or 1274. Additional details of this computation are set forth in this section.

23. Treas. Reg. §1.752-2 (e) (1). It is reasonable to expect that such payments will be made if the lender can enforce the guaranty without foreclosing on the property and thereby extinguishing the debt.

24. Treas. Reg. §1.752-2 (e) (3).

25. Treas. Reg. §1.752-2 (d) (1).

26. TD 8380, pg. 9.

27. Treas. Reg. §1.752-2 (e) (4). An allocation of interest to the extent paid by the guarantor is not treated as a Tax Item subject to the ≤10% rule.

28. A partner or related person whose interest (directly or indirectly) in each Tax Item for every year that the partner is a partner in the partnership is ≤10%. Although not addressed, a contractual contingency to acquire a greater interest should not be considered if, in fact, the partner's interest does not exceed the limitation.

29. A loan that would otherwise be a nonrecourse loan of the partnership and which would constitute qualified nonrecourse financing pursuant to §465 (b) (6) (without regard to the type of activity financed.)

30. Treas. Reg. §1.752-2 (d) (2).

31. Treas. Reg. §1.752-2 (g) (1).

32. Treas. Reg. §1.752-2 (g) (2).

33. Treas. Reg. §1.752-2 (g) (4).

34. Treas. Reg. §1.752-2 (g) (3).

35. Treas. Reg. §1.752-2 (h) (3). The value is limited to the fair market value of the property. Under the Final Regulations the determination is made at the time the property is pledged or contributed. Under the Temporary Regulations the determination was made whenever necessary to determine the partner's basis, which led to unexpected fluctuations.

36. Treas. Reg. §1.752-2 (h) (1). The inclusion of the related person's separate property is new in the Final Regulations.

37. Treas. Reg. §1.752-2 (h) (4).

38. Treas. Reg. §1.752-2 (h) (2). However, all Tax Items attributable to the contributed property must be allocated to the contributing partner and this allocation is generally greater than the partner's share of other significant Tax Items.

39. Treas. Reg. §1.752-2 (i).

40. Treas. Reg. §1.752-4 (a).

41. Treas. Reg. §1.752-3.

42. Treas. Reg. §1.752-3. Final Treas. Reg. §1.704-2 under IRC §704 (b) were published December 27, 1991, to replace the lengthy and complex Temporary Regulations which were published.

43. Partnership minimum gain is defined in Treas. Reg. §1.704-2 (b) (2) as the amount by which a nonrecourse liability exceeds the adjusted basis of the partnership property it encumbers.

44. IRC §704 (c) seeks, under certain circumstances, to tax a contributing partner on the difference between the fair market value and adjusted basis of property as of the date of the contribution.

45. A partner's share of partnership profits is determined by a facts and circumstances test. The partnership agreement may allocate profits as long as the allocations are reasonably consistent with allocations (that have substantial economic effect under Treas. Reg. §1.704-1 (b) (1) and (2)) of some other significant Tax Item of income or gain.

46. Treas. Reg. §1.752-4 (b). Additional guidance is provided by this section, including a special rule where entities are structured to avoid related person status.

47. Treas. Reg. §1.752-4 (c).

48. Treas. Reg. §1.752-4 (d). See also Treas. Reg. §1.705-1 (a) regarding the timing of basis determination.

49. Treas. Reg. §1.752-5. Liabilities incurred or assumed prior to a §708 (b) (1) (B) termination are not to be treated as incurred or assumed on the date of termination.

50. There is a binding (and unmodified) contract exception.

51. Treas. Reg. §1.752-5 (b). This election is made by filing the prescribed notice with the partnership return filed for such a year.

Recent Cases

Special Assessment - Road Improvements

Kadzban, et al v City of Grandville, unpublished opinion per curiam of the Court of Appeals (8/7/91; Docket No. 114503)

The Michigan Tax Tribunal affirmed special assessments issued by the City of Grandville for certain road improvements, finding that the proofs offered by petitioners were insufficient to establish that no special benefit had been conferred upon the properties. The Court of Appeals concluded that there was adequate support on the record for the creation of the special assessment district, but reversed the Tribunal's decision. The Court determined that the assessments as applied to the contested properties were infirm because the evidentiary presentation at hearing failed to disclose support for an increase in the market values of the properties reasonably correspondent to the amount of the special assessments, as required by the Supreme Court's decision in *Dixon Road Group* v *City of Novi*, 426 Mich 390, 395 NW2d 211 (1986), reh den 428 Mich 201 (1987).

The Court of Appeals concluded that there was adequate support on the record for the creation of the special assessment district, but reversed the Tribunal's decision.

Small Claims Division Valuation Appeal - Michigan Tax Tribunal Affirmed

Kerhoulas v City of New Buffalo, unpublished opinion per curiam of the Court of Appeals (11/20/91; Docket No. 125280)

In this case, the Court of Appeals upheld the valuation determination rendered by the Michigan Tax Tribunal, small claims division, with respect to three older-vintage commercial properties situated in New Buffalo. The Court specifically rejected the Taxpayer's assertion that the imposition of the burden of proof on the Taxpayer is unfair, noting that the placement of the burden of proof is dictated by §37(3) of the Tax Tribunal Act. The Court also disagreed with the Taxpayer's further contention that the Tribunal erred in utilizing revised cost approaches to achieve its true cash value conclusions for the years in question; the Court found that the decisions fulfilled the Tribunal's duty to make independent determinations of true cash value, and that the Taxpayer had failed to present evidence designed to show that an alternative method was superior.

Individual Income Tax - Net Operating Loss Carry Forward

Preston v Dep't of Treasury, 190 Mich App 491, __ NW2d __ (1991)

A Texas resident who, in 1980, sustained net operating losses (NOL's) attributable to Michigan business activities, sought refunds from the Michigan Department of Treasury for subsequent tax years, contending that the losses were properly recognized and carried forward to the later years. The taxpayer's federal return for 1980 reflected no corresponding net operating loss because gains wholly allocable to a state other than Michigan offset the Michigan loss. Rejecting the Michigan Department of Treasury's contentions that the Michigan Income Tax Act neither recognizes the availability of a Michigan net operating loss deduction nor permits such a deduction for a year in which the taxpayer's federal income tax return does not disclose the same loss, the Court of Appeals upheld the determination of the Court of Claims which permitted the taxpayer to carry

forward deductions for the Michigan net operating loss. Specifically, the Court of Appeals ruled that net operating loss deductions for Michigan losses are incorporated within the Michigan Income Tax Act by virtue of the Act's reliance upon the definitions of "taxable income" and "adjusted gross income" found in the Internal Revenue Code. The Court also held that a 1987 amendment to §30(1) of the Income Tax Act which expressly addressed the allowance of NOL deductions is remedial in nature and accordingly has retroactive application. The Court declined to withhold from the taxpayer the benefit of an NOL deduction for losses attributable to Michigan activities solely because those losses had been offset on the taxpayer's federal returns by gains unrelated to activity within this state.

Criteria Governing Issuance of an Industrial Facilities Tax Exemption Certificate

Creative Industries Group, Inc v Dep't of Treasury, 187 Mich App 270, 466 NW2d 311 (1991)

Creative Industries constructed a building and applied for an Industrial Facilities Tax (IFT) Exemption with the City of Auburn Heights. As dictated by statute, IFT exemption applications were required to be filed within six (6) months of the date construction commences. Relying upon erroneous advice given by the City Manager as to the effect of a late application, Creative delayed applying for the exemption until a date beyond the six month statutory period. The State Tax Commission's denial of the taxpayer's application for an IFT certificate was affirmed by the Court of Appeals. In affirming, the Court of Appeals held that, to qualify for an IFT exemption, an applicant must precisely meet all requirements outlined in statute. The Court further determined that the Circuit Court's review of the State Tax Commission's denial of Creative's IFT exemption application is governed by the Administrative Procedures Act, and declined to award the taxpayer equitable relief.

Single Business Tax - Interplay with Severance Tax

Cowen v Dep't of Treasury, ___ MTT ___ (12/10/91; Docket No. 125440)

In *Cowen*, the Michigan Tax Tribunal was confronted with the issue of whether §15 of the Severance Tax Act, MCL 205.315; MSA 7.365, which states that the tax "shall be in lieu of all other taxes, state or local, upon the oil or gas", is to be interpreted to mean that the Single Business Tax Act may not be applied to petitioner, an individual engaged in the business of severing oil and gas from the soil. Petitioner contended that the severance tax, like the single business tax, is imposed upon the privilege of doing business in Michigan, and that §15's reference to all other taxation focuses not only upon the oil and gas products themselves, but also upon the privilege of conducting the business of severing them from the soil. Respondent, on the other hand, asserted that, unlike the single business tax, the severance tax represents a tax upon the oil and gas themselves; because the single business tax is not imposed upon these properties, but instead is intended to reflect the business activities of the taxpayer (see RAB 1989-22), the single business tax is not included within the §15 "in lieu of" clause. The Tribunal agreed with the position advocated by respondent, concluding that the

language of §15, although clear and unambiguous, does not support the petitioner's interpretation of the interplay between the severance and single business taxes. The Tribunal found that the later-enacted Single Business Tax Act does not expressly exempt oil and gas producers from the earlier Severance Tax Act, and that the severance tax was enacted at a time in which a State ad valorem property tax existed, thereby supporting the conceptual divisibility of the severance and single business taxes.

Property Tax - Valuation of Industrial and Vacant Parcels Using an Income Approach

Milwaukee Investment Co v Detroit, ___ MTT ___ (10/15/91; Docket Nos. 150265-67)

At a default hearing which convened before the Michigan Tax Tribunal, petitioner presented the testimony and appraisal report of an MAI appraiser in support of its contentions of true cash value pertinent to an industrial warehouse building used as an automobile body shop, together with land devoted to parking lot purposes, a .36 acre parcel of vacant land, and a building used as warehouse and distribution facility. The appraiser employed the capitalization of income methodology for valuing the improved properties as well as the vacant parcel. Concluding that the uncontroverted evidence supplied by the petitioner rested upon accepted appraisal techniques and identified with the value influences to which the properties were exposed, the Tribunal adopted the net operating incomes and capitalization rates advocated by petitioner.

Individual Income Tax - Davis Refunds

Fonger v Michigan Department of Treasury, __ Mich App __; ___ NW2d ___ (2/4/92; Docket No. 130294)

In *Fonger*, the Court of Appeals considered the issue of whether the 90-day limitations period adopted by the Legislature in 1986 for refund claims grounded in the United States or Michigan Constitutions precluded the taxpayer from prevailing on the refund claims he filed under the United States Supreme Court's decision in *Davis* v *Michigan*, 489 US 803; 109 S Ct 1500; 103 L Ed 2d 891 (1989) for calendar years 1982 through 1987. The Michigan Tax Tribunal, in a decision issued on June 11, 1990, had ruled that Fonger was entitled to a refund of taxes limited not by the 90-day provision of the Revenue Act, but by the four-year limitations period contained in the Michigan Income Tax Act. The Court of Appeals ruled that a statutory amendment added by 1990 PA 285 applied. This provision, which became effective on December 21, 1990, and which also repealed the four-year limitations period contained in the Michigan Income Tax Act, specifically allowed refund claims for 1984 and subsequent years for taxes paid on income received as retirement or pension benefits from a public retirement system of the United States government. The Court of Appeals determined that the U.S. Supreme Court's decision in *Davis* applied retroactively, but that 1990 PA 285 also had retroactive effect in replacing the Michigan Income Tax Act's four-year statute of limitations, and in providing for, as well as limiting, Michigan income tax refund claims for federal pensioners to 1984 and subsequent tax years. The Court of

Appeals therefore reversed the Tax Tribunal and remanded the case for further proceedings consistent with the opinion.

Property Tax - Use of Federal Land Bank Sales in Market Technique

Samonek v Columbia Twp and Napoleon Twp, __ MTT __ (10/10/91; Docket Nos. 110939-40)

Petitioners appealed ad valorem real property tax assessments assigned to two contiguous parcels of agricultural land totalling 585 acres situated in Jackson County. At the Michigan Tax Tribunal hearing, both parties presented evidence directed to market activity in the subjects' vicinity; while petitioners relied primarily upon the May, 1986 sale of 615 acres to them from the Federal Land Bank (which sale encompassed the totality of the subjects' acreage), respondents produced an appraisal report which analyzed sales of six similar and fairly proximate properties, together with market data designed to undermine the validity of Federal Lank Bank sales. Noting that petitioners' presentation was deficient in several respects — markedly in its failure to demonstrate that the sales relied upon were "market arm's length transactions" — the Tribunal determined that the market approach set forth in the appraisal report offered by respondents was the most accurate rendition of the subjects' true cash values for the years in question.

Jeopardy Assessment - Illegal Narcotics Sales

Bolton v Dep't of Treasury, ___ MTT ___ (10/7/91; Docket No. 127719)

The Michigan Tax Tribunal sustained a jeopardy sales, single business and individual income tax assessment issued by the Department of Treasury to a taxpayer who admittedly sold controlled substances to police informants, and who failed to produce records demonstrating inaccuracies in the audit methodology used to compute the assessment. In upholding the assessment, the Tribunal also confirmed the validity of a 100% fraud penalty assessed by the Department on the basis of such facts as the taxpayer's involvement in sales of contraband, his failure to file the requisite tax returns, and the absence of records detailing his business activities.

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

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

NEWS ABOUT TAX LAWYERS

The law firm of Warner, Norcross & Judd, P.C. has named **CHARLES E. MCCALLUM** as Managing Partner and Chief Executive Officer, beginning February 1, 1992. Warner, Norcross & Judd, P.C. is a 110-lawyer firm with offices in Grand Rapids, Muskegon, and Holland, Michigan.

J. LEE MURPHY, partner with Miller, Johnson, Snell & Cummiskey, was recently elected Chairman for the 1992 Internal Revenue Service-Bar Liaison Central Region Group Meeting to be held in Cincinnati on November 5-6, 1992. Mr. Murphy was also appointed by Regional Counsel Ed Barnes to be a member of the IRS Central Regional Tax Advisory Group.

THOMAS D. HAMMERSCHMIDT, JR. recently spoke to the Southeastern Chapter of the Independent Accountants Association of Michigan on state and local tax developments. Tom is the Chairperson of the Taxation Section's State and Local Tax Committee. Tom heads the taxation practice group at, Dickinson, Wright, Moon, Van Dusen & Freeman.

Where do we get news? In many cases, the news comes directly from you. Don't be bashful; unless we hear from you, your news won't be told, and you will miss the opportunity to make new acquaintances and become known to your fellow tax practitioners. Also, don't hesitate to send us information about a colleague. Newsworthy items are not limited to legal accomplishments. We also are interested in changes in firm affiliation, marriages and births, lectures or seminars presented, interesting travel, sports awards, or other items. Please send your news to:

Michigan Tax Lawyer
313 South Washington Square
Lansing, Michigan 48933

TAXFILE.PC.

MY PC, MY BONNIE, MY DEAR

By John B. Payne, Jr.

March has been a stressful month for me as a PC owner. On Thursday, March 5, I called my local software retailer and asked the obvious question. The obvious question was not whether they still had a special on joysticks. It was, "What do you have in virus protection?" Remarkably, they were not sold out. Unremarkably, the software they had left was not the highest-rated program.

I try not to put things off to the last minute. I wouldn't have bought anti-virus protection just for March 6. The odds are about 10,000:1 against having a virus and there are other ways of beating Michelangelo. Spending close to $100 for protection is only marginally cost-effective when simply backing up the hard drive regularly avoids serious loss of data. I bought and installed a virus program because all week I had been getting messages like, "Cannot find file CGA80DOA. FON...OK...CANCEL?", and "Pagination error...application terminated". The only reasonable conclusion seemed to be a virus.

There was no virus. The problems were of the inexplicable variety that crop up from time to time. The final diagnosis was "gremlins".

This experience caused me to reflect on my relationship to my PCs. I really cannot think how I would work without a computer. I type faster than I write, so everything is done first on my computer, then generated as hardcopy. On the other hand, I am a lawyer, not a combination systems analyst, programmer and repair technician.

Some attorneys take to computers the way ducks take to horseback riding. If they are in large firms, they simply do their work in long hand and give it to support personnel. They let the "firm" make technical decisions. If they are solo or in small firms, they buy PCs and tell support personnel to learn to use them. I believe that this is a matter of inclination rather than ability. Anyone who can understand *Pennoyer v. Neff* can learn the basics of DOS, WordPerfect® and Lotus 1-2-3®.

I enjoy tinkering with gadgets. I had no PC experience prior to 1987. Since then I have developed a working knowledge of PCs by reading manuals and doing tutorials supplied with programs.

I think it is highly desirable to become proficient in PC maintenance and operation. All that is necessary is two or three ABE courses at the local high school. If it would be too embarrassing to share a public classroom with fifteen or twenty potential clients, numerous computer-training firms provide private or semi-private courses. Many lawyers have teenaged children who would love to teach them computer basics.

I have installed and replaced many components on my PCs. It is remarkably easy. The cover comes off easily. Boards and other components simply plug in. When there is a problem, I try to solve it myself. If I cannot do so, I call technical support personnel for the program or hardware involved. As a last resort, I take the machine to a repair shop.

In some ways, my method is not cost-effective. I bought a FAX board two years ago. Many hours were spent vainly trying to get it to work. I then bought a FAX program for Windows®. It did not work with my board, so I bought a new FAX/Modem. I then found out that program only works with Windows® applications, so I bought WordPerfect® for Windows. The FAX program still does not work. The only way that I can now send a FAX is with a generic program that only sends DOS text. Everything is

on the left margin and there is no underlining, bold or other attributes. Because I have limited time, I haven't been able to get the FAX problems straightened out. By the time the problems are worked out, I will probably have spent three times what it would have cost if I had taken my PC to Inacomp and told them to install a FAX board and software.

Big firms buy Compaq® or IBM® PCs and have full-service on-site maintenance. The small but expensive increase in quality and reliability is offset many times by the increase in efficiency. They can afford in-house technical staff to evaluate software and hardware options and to analyze their systems.

I buy my PCs from mail-order houses. I save $1,000 to $2,500 per machine on selling price, compared to buying from a retailer who would deliver and set up the machine. Working out problems over the phone is expensive in otherwise billable hours. One machine required more than four hours on the phone talking to technical support personnel. I performed two hard-drive replacements before it was decided to replace the entire unit.

The reason that I buy from mail-order houses and do my own troubleshooting is not for front-end economy. I maintain a hands-on relationship with my machines because that way I have the fullest possible understanding of the features and capacities of my PCs. I spend several hours a week reading product reviews and technical articles. I perform the same function as a big firm's in-house technical staff, although at a somewhat lower level.

I train my staff. When not in the office, I can solve many software and hardware problems for them instantly over the phone. I think that is very important for a sole practitioner. I may not be the most knowledgeable computer expert I know, but I am far and away the most reliable. I know that when my staff calls I will be available.

It is difficult for a lawyer in a small firm to gain the expertise to evaluate hardware and software. There is little time to spare and it would seem to be more cost-effective to buy complete systems, set up by the vendor. On the other hand, dependency on the vendor's technical personnel makes the firm very vulnerable to computer problems. They often develop in the evening or on the weekend. I hate to think how long I would have waited for a service technician to become available on March 5. For this reason, I think small-firm practitioners should learn to use and maintain their computers and the software on which their offices rely. They should become "shade-tree" computer technicians. Besides, it can be fun to work on computers.

John B. Payne, Jr. received an LL.M in Taxation in 1988 from Wayne State University. He graduated cum laude from Detroit College of Law in 1986 and received a B.S. from Grand Valley State College in 1976. He has eight years experience administering welfare programs, including Medicaid. He is an experienced lecturer on estate planning for small estates. He practices in Dearborn.

Shortcuts

Ignoring the 15% Estate Tax on Excess Accumulations

By: Kenneth G. Frantz

In all instances the estate experiences a net benefit by leaving the assets in the IRA or Qualified Plan, even after payment of the 15% penalty tax.

Assets held in an IRA or Qualified Plan grow faster than the same assets held outside of these plans because earnings are compounded on a tax deferred basis. This presents the obvious temptation to leave these assets in the IRA or Plan in order to accumulate the maximum estate for one's heirs, while using other assets to cover living expenses during retirement.

In order to discourage "abuse" of these tax advantages in this manner, a 15% additional estate tax is imposed on any "excess accumulations" in the plan at the time of the death of the IRA owner or plan participant.[1] As a compliment to this rule, a 15% excise tax is imposed on "excess distributions" above $150,000 per year.[2] This penalizes large withdrawals during a short period of time, and thereby discourages taxpayers from avoiding the 15% estate tax by using the IRA or Plan to accumulate a large estate, and then withdrawing the money just before death. Together, these taxes encourage the taxpayers to withdraw rather than accumulate IRA or Plan assets during their retirement.

In choosing the best course of action between these two conflicting approaches, a taxpayer's ideal strategy would be to leave the assets in the IRA or Qualified Plan as long as possible to maximize returns, while withdrawing them at just the right times and in the right amounts in order to minimize the taxes. As a practical matter, this would require a computer generated analysis weighing the relative costs and merits of maximizing return versus minimizing taxes. Even then, a truly accurate analysis would require correct presumptions regarding (a) future tax rates, (b) future inflation rates, (c) the taxpayer's date of death, and (d) the investment rate of return on the assets.

These are difficult areas to predict, however, and not everyone is a lucky guesser. As an alternative, it may not be unreasonable to completely ignore these taxes. They were originally intended to approximately offset the advantages of tax-deferred compounding of earnings for individuals in the 28% tax bracket. Because the maximum individual tax rate has now increased to 31%, the 15% estate tax no longer fully offsets the investment advantage of merely leaving the assets in the IRA or Qualified Plan.

The attached chart illustrates this point. It compares the net benefit to the taxpayer's estate of two different courses of action. On the one hand, column g. indicates the net assets included in the estate at death if the assets in the IRA or Qualified Plan are withdrawn at age 65 and, after payment of a 31% income tax, the remaining assets are held in taxable investments. On the other hand, column f. indicates the net assets in the estate at death if they were left in the IRA or Qualified Plan until the taxpayer's death, and then subjected to the 15% estate tax on excess accumulations as well as income tax on income in respect of a decedent.[3]

In all instances the estate experiences a net benefit by leaving the assets in the IRA or Qualified Plan, even after payment of the 15% penalty tax. The advantage becomes greater as the investment rate of return increases, and as the length of time until death increases.[4] In short, the taxpayer is helped a lot if he lives a long time, and is helped a little if he does not.

The likelihood of being helped a lot increases if the taxpayer's spouse is the beneficiary. Unlike other benefi-

ciaries, a spouse may rollover inherited amounts from an IRA[5] or Qualified Plan[6]. This increases the time that the assets can grow on a tax-deferred basis. This would not avoid the 15% estate tax on the taxpayer's estate, however.[7] Alternatively, if the spouse is the sole beneficiary of all retirement funds, (except for a de minimis amount), the 15% estate tax may be deferred until the spouse's death by electing on the taxpayer's federal estate tax return to treat the spouse as the owner of the IRA or Qualified Plan.[8]

As a result, for taxpayers who feel unlucky about making predictions, or who expect that they and their spouses will live long lives, their best approach to this important estate planning decision may be to do nothing.

Kenneth G. Frantz is an attorney with Evans & Luptak in Detroit, Michigan. He is a member of the Employee Benefits Committee of the Taxation Section. He specializes in employee benefits and pensions. He graduated from the University of Michigan, Law School.

FOOTNOTES

1. Code Section 4980A(d)(1). The limit used to determine which part of the plan or IRA assets constitutes an "excess accumulation" is the present value of a hypothetical single life annuity of $150,000 per year (or, if greater, the $112,000 grandfather limit of Code Section 4980A(c)(1)(B)), payable over the taxpayer's hypothetical life expectancy at death, using an interest factor equal to 120% of the Applicable Federal Rate (midterm) for the month of death. This limit will only apply to large balance IRAs and Qualified Plans. For example, the limit for a taxpayer who died in October 1991 at age 65 would be $1,139,833.50.

2. Code Section 4980A.

3. These two examples are extremes used to illustrate a point. They ignore the Minimum Required Distributions which must be taken from the IRA or Qualified Plan each year after 70 1/2, and which would tend to provide an investment result somewhere between the two extremes. See Code Section 401(a)(9).

4. An additional advantage to living a long life is that, given sufficient time, the taxpayer's Minimum Required Distributions may reduce the assets below the excess accumulations limit, thereby eliminating the 15% estate tax entirely. Code Section 401(a)(9).

5. Code Section 408(d)(3)(C)(ii); Prop. Treas. Reg. 1.408-8, A-4(b). This spousal rollover option is an exception to the general rule that inherited IRAs may never be rolled over, (Code Section 408(d)(3)(C)(i)), because the IRA is not classified as an inherited IRA. Code Section 408(a)(3)(C)(ii)(II).

6. Code Sections 402(a)(7) and 408(d)(3)(B).

7. The 15% estate tax is not offset by either the unified credit, (Code Section 4980A(d)(2), or the marital deduction, (Treas. Reg. Section 54.4981A-1T, d-8 and d-11). (The regulations were issued under former Code Section 4981A before it was replaced by 4980A).

8. Code Section 4980A(d)(5)(A),(b); TAMRA Section 1011A(g)(5)(A),(b), P.L. 100-647.

a PERIOD UNTIL DATE(AGE)	b IRA BALANCE AT DEATH	c EXCESS ACCUMULATION LIMIT	d ESTATE TAX ON EXCESS ACCUMULATION	e INCOME TAX ON BALANCE	f NET AMOUNT TO ESTATE	g AFT-TAX BAL. NON-PLAN OR IRA INVESTMT	h NET PLAN OR IRA INVESTMENT ADV.	i PLAN OR IRA PERCENTAGE ADVANTAGE
0 YEARS (65)	1,000,000,	1,110,175	0,	310,000	690,000	690,000	$ 0	0%
	8% ROI							
5 YEARS (70)	1,469,328	1,135,691	50,045	455,492	963,791	902,658	$ 61,133	6.8%
10 YEARS (75)	2,158,925	1,234,549	138,656	669,267	1,351,002	1,180,856	170,146	14.4%
15 YEARS (80)	3,172,169	1,290,515	282,248	983,372	1,906,548	1,544,795	361,753	23.4%
20 YEARS (85)	4,660,957	1,307,608	503,002	1,444,897	2,713,058	2,020,900	692,158	34.2%
	10% ROI							
5 YEARS (70)	1,610,510	1,135,691	71,223	499,258	1,040,029	963,247	$ 76,782	8.0%
10 YEARS (75)	2,593,742	1,234,549	203,879	804,060	1,585,803	1,344,702	241,101	17.9%
15 YEARS (80)	4,177,248	1,290,515	433,010	1,294,947	2,449,291	1,877,218	572,073	30.5%
20 YEARS (85)	6,727,500	1,307,608	812,984	2,085,525	3,828,991	2,620,615	1,208,376	46.1%
	12% ROI							
5 YEARS (70)4	1,762,3424	1,135,6914	93,9984	546,3264	1,122,0184	1,027,0474	$ 94,9714	9.2%
10 YEARS (75)	3,105,848	1,234,549	280,695	962,813	1,862,340	1,528,733	333,607	21.8%
15 YEARS (80)	5,473,566	1,290,515	627,458	1,696,805	3,149,303	2,275,479	873,824	38.4%
20 YEARS (85)	9,646,293	1,307,608	1,250,803	2,990,351	5,405,139	3,386,991	2,018,148	59.6%

Column

c. The excess accumulations limit was computed using Table R(1) of IRS Notice 89-60, and an interest rate of 9.40%, (which is the March, 1991 mid-term rate (compounded annually) published by the IRS as 120% of the Applicable Federal Rate (9.41%) rounded to the nearest two-tenths of one percent). The excess distribution amount used in the calculation was $150,000, which was then adjusted after two years for inflation of 4.5% per year, (anticipating a switch to the "grandfather" variable rate in 1994).

d. The excess accumulation penalty and income tax rates are presumed to be constant over time at 15% and 31%, respectively.

e. The income tax on the IRA or qualified Plan balance refers to income tax that would be owed by the estate as income in respect of a decedent. Code Section 691; Treas. Reg. Section 1.691(a)-2(a).

f. This total is the net amount available under the Plan or IRA which would be subject to estate taxes. No reduction for normal estate taxes is made in this example.

g. This is the amount of assets that would be subject to estate taxes if the entire IRA or Qualified Plan balance had been withdrawn at age 65, income taxes of 31% paid on this amount, and the remaining balance invested in assets having the same return on investment as the assets in the IRA or Qualified Plan. No adjustment was made for the 15% excise tax and excess distributions. Investment returns reflect payment of income taxes at a 31% rate.