MICHIGAN TAX LAWYER

Volume XLIV
Issue 3
Fall 2018

SBM State Bar of Michigan | TAXATION SECTION

CONTENTS

Tax Section Matters

Letter from the Chair 1
Jackie J. Cook, Taxation Section Chair (2018-2019)

Section Committee Reports.. 3

Feature Articles

The Controversy Regarding the Applicable Statute of Limitations for State Tax Assessments and the Court of Appeals' Recent Decision in *Old Orchard Brands LLC v. Dep't of Treasury*................ 4
By Daniel L. Stanley

Avoiding the Risk of Tax Debtor Prisons in the City Income Tax Act 7
By Joshua M. Wease

The End of the End-of-Year Gift? Three Practical Charitable Giving Strategies for Clients to Consider After the 2017 Tax Reform Act 9
By Richard C. Mills

An Interview with the Honorable Michael J. Talbot 12
By Christopher M. Jacobsen

State Fiduciary Income Tax Checkup, Part 2: Trust Nexus In Michigan.................................... 19
By Raj A. Malviya

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 four times each year. 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 Mindi Johnson, Foster Swift Collins & Smith PC, 1700 East Beltline NE, Suite 200, Grand Rapids, MI 49525; mjohnson@fosterswift.com; or (616) 726-2252.

MINDI M. JOHNSON
Editor

State Bar of Michigan Taxation Section Council

JACKIE J. COOK
Chairperson

JAMES H. COMBS
Vice Chairperson

WILLIAM C. LENTINE
Treasurer

ANDREW W. MACLEOD
Secretary

CAROLEE K. SMITH
Ex-Officio

Jon H. Baloch
Sean H. Cook
Andrea D. Crumback
Thomas E.F. Fabbri
Brian T. Gallagher
Mindi M. Johnson
Michael P. Monaghan
Ryan J. Peruski
Joshua M. Wease

Program Facilitator
Mary Owiesny

Probate Section Liaison
George W. Gregory

Area Counsel Liaisons
Robert D. Heitmeyer &
Eric R. Skinner

SBM Commissioner Liaison
Shenique Moss

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 may obtain an annual subscription to the Michigan Tax Lawyer by sending a request and a $30 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.)

Disclaimer

The opinions expressed herein are those of the authors exclusively and do not necessarily reflect those of the Publication Committee, the Taxation Section Council, or the Taxation Section. It is the responsibility of the individual lawyer to determine if advice or comments in an article are appropriate or relevant in a given situation. The Publication Committee, the Taxation Section Council, and the Taxation Section disclaim all liability resulting from statements and opinions contained in the Michigan Tax Lawyer.

p (517) 346-6300
p (800) 968-1442
f (517) 482-6248

306 Townsend Street
Michael Franck Building
Lansing, MI 48933-2012

www.michbar.org

TAXATION SECTION

OFFICERS

CHAIR
Jackie J. Cook
The Mike Cox Law Firm, PLLC
17430 Laurel Park Drive N, Ste. 120E
Livonia, MI 48154
jcook@mikecoxlaw.com

VICE CHAIR
James H. Combs, Detroit

TREASURER
William C. Lentine, Southfield

SECRETARY
Andrew W. MacLeod, Detroit

COUNCIL MEMBERS
Jon H. Baloch, Detroit
Sean H. Cook, Southfield
Andrea D. Crumback, Grand Rapids
Thomas E. F. Fabbri, Birmingham
Brian T. Gallagher, Lansing
Mindi M. Johnson, Grand Rapids
Michael P. Monaghan, Clinton Township
Ryan J. Peruski, Detroit
Joshua M. Wease, East Lansing

EX OFFICIO
Carolee K. Smith, Jackson

COMMITTEE CHAIRS
Eric W. Gregory, Troy
Erick W. Hosner, Royal Oak
Nicholas E. Papasifakis, Birmingham
Rebecca L. Pugliesi, Clinton Township
Daniel L. Stanley, Lansing

PROGRAM FACILITATOR
Mary Owiesny, Detroit

October 1, 2018

Dear Taxation Section Member:

I am honored to serve as Chairperson of the Taxation Section of the State Bar of Michigan for the 2018-2019 fiscal year. Tax Council has been busy planning a number of wonderful events for the upcoming year that I invite you to attend, including:

- The Taxation Section's ***Fundamentals of Taxation Program on October 25, 2018***, in Detroit. Last year, we hosted this annual event for the first time in the fall for attorneys looking for a refresher on essential tax principles as well as newer tax attorneys and law students. The event last year was well attended and received glowing reviews from attendees. Registration information will be sent via email and posted on the Section's webpage. The program will be followed by a mixer event hosted by the Section's Young Tax Lawyers Committee.

- Save the date for the Taxation Section's ***32nd Annual Tax Conference on May 23, 2019***, at the Inn at St. John's in Plymouth. The agenda, with national speakers headlining and four new break-out tracks in the afternoon hosted by the State and Local Tax Committee, Federal Income Tax Committee, Estates & Trusts Committee, and Employee Benefits Committee, will be released later this year. Please join us.

Each Committee will be hosting other events throughout the year focusing on the particular subject matter interests of their unique memberships. The Committees are also responsible for driving content to the Michigan Tax Lawyer on topics within their tax specialties. If you have an interest in getting more involved with a Committee, we invite you to reach out to the Chairs directly:

Employee Benefits – Eric Gregory, EGregory@dickinson-wright.com
Estates & Trusts – Nick Papasifakis, npapasifakis@clarkhill.com
Federal Income Tax – Erick Hosner, ehosner@howardandhoward.com
State & Local Tax – Daniel Stanley, dstanley@honigman.com
Young Tax Lawyers – Rebecca Pugliesi, Rebecca.pugliesi@plantemoran.com

PAST COUNCIL CHAIRS

MICHAEL M. ANTOVSKI
JESS A. BAHS
JOSEPH A. BONVENTRE
RONALD T. CHARLEBOIS
ALLAN J. CLAYPOOL
STEPHEN H. CLINK
JOHN J. COLLINS, JR.
ROGER COOK
EDWARD M. DERON
ALEXANDER G. DOMENICUCCI
CLIFFORD H. DOMKE J.
BRUCE DONALDSON
OSCAR H. FELDMAN
STEPHEN M. FELDMAN
LYNNTERI A. GANDHI
EUGENE A. GARGARO, JR.
MARJORIE B. GELL
ERNEST GETZ
GEORGE W. GREGORY
JOSEPH D. HARTWIG
STEPHEN I. JURMU
CAROL J. KARR
LOUIS W. KASISCHKE
JAY A. KENNEDY
JOHN L. KING
DONALD M. LANSKY
CHARLES M. LAX
JEFFREY A. LEVINE
ARNOLD W. LUNGERSHAUSEN
JERRY D. LUPTAK
JOHN W. McNEIL
JACK E. MITCHELL
DENNIS M. MITZEL
J. LEE MURPHY
LAWRENCE J. MURPHY
ERIC M. NEMETH
REGINALD J. NIZOL
JAMES H. NOVIS
ROBERT B. PIERCE
B. COURTNEY RANKIN
JOHN J. RAYMOND, SR.
WAYNE D. ROBERTS
DAVID M. ROSENBERGER
ANDREW M. SAVEL
BENJAMIN O. SCHWENDENER, JR.
JOHN N. SEAMAN
PETER S. SHELDON
AARON H. SHERBIN
SHERILL SIEBERT
WILLIAM J. SIKKENGA
CAROLEE K. SMITH
I. JOHN SNIDER II
ROBERT R. STEAD
GINA TORIELLI
LAWRENCE R. VANTIL
ERIC T. WEISS
WARREN J. WIDMAYER

p (517) 346-6300
p (800) 968-1442
f (517) 482-6248

306 Townsend Street
Michael Franck Building
Lansing, MI 48933-2012

www.michbar.org

TAXATION SECTION

To stay current on Committee activities and communications, I strongly encourage each of you to take a moment to visit the Committees' online landing pages and make sure you have "joined" the Committees you are most interested in. There is no additional cost: Committee membership is a benefit of being a Taxation Section member. But unless you add yourself to the Committee member list, you will not receive communications directly about events and news specific to your subject matter area.

Feel free to join as many Committees as you like:

1. Access the committee pages at this link: http://connect.michbar.org/tax/committees/mycommittees
2. Sign in using the link in the top-right corner of the page. Use the same username & password you currently use to access the Bar's Member Area, where you pay your dues or update your Member Directory profile. All SBM members have a login.
3. After you log in, you can see which tax committees you are currently a member of as well as which ones are available for you to join.
4. This private community will enhance the way we communicate. The committees you join will be able to share documents such as meeting agendas and minutes and create a meeting calendar. Your communication preference is automatically set to "Daily Digest," so you will receive one e-mail summarizing the previous day's activity.
5. There is also a discussion feature, where members can discuss issues by e-mail reply, without logging in. You can start a new discussion topic by clicking the "Post New Message" link in any e-mail.
6. If you no longer wish to be a member of a committee, simply visit the committee page, as discussed above, select the settings button, and click leave community.

We look forward to seeing you at a Taxation Section event or hearing from you on a Committee landing page soon.

Sincerely,

Jackie J. Cook
Chairperson, Taxation Section

Taxation Section Mission

The Section, as a representative of the legal profession, shall serve its members and the public through education and leadership in efforts to achieve an equitable, efficient, and workable tax system. The purpose of this Section is to improve public understanding of, confidence in, and respect for the federal, state and local tax systems; to provide leadership in simplifying and improving the federal, state and local tax systems; to provide unbiased, thoughtful and timely input into the legislative and administrative process at the national, state and local levels; to promote and maintain an active, vigorous, growing and interested Section membership; to provide programs and services of unique quality which promote professionalism, competence and ethical conduct; to provide a forum for communication among Section members and interchange between the public and private sectors.

PAST COUNCIL CHAIRS

MICHAEL M. ANTOVSKI
JESS A. BAHS
JOSEPH A. BONVENTRE
RONALD T. CHARLEBOIS
ALLAN J. CLAYPOOL
STEPHEN H. CLINK
JOHN J. COLLINS, JR.
ROGER COOK
EDWARD M. DERON
ALEXANDER G. DOMENICUCCI
CLIFFORD H. DOMKE J.
BRUCE DONALDSON
OSCAR H. FELDMAN
STEPHEN M. FELDMAN
LYNNTERI A. GANDHI
EUGENE A. GARGARO, JR.
MARJORIE B. GELL
ERNEST GETZ
GEORGE W. GREGORY
JOSEPH D. HARTWIG
STEPHEN I. JURMU
CAROL J. KARR
LOUIS W. KASISCHKE
JAY A. KENNEDY
JOHN L. KING
DONALD M. LANSKY
CHARLES M. LAX
JEFFREY A. LEVINE
ARNOLD W. LUNGERSHAUSEN
JERRY D. LUPTAK
JOHN W. McNEIL
JACK E. MITCHELL
DENNIS M. MITZEL
J. LEE MURPHY
LAWRENCE J. MURPHY
ERIC M. NEMETH
REGINALD J. NIZOL
JAMES H. NOVIS
ROBERT B. PIERCE
B. COURTNEY RANKIN
JOHN J. RAYMOND, SR.
WAYNE D. ROBERTS
DAVID M. ROSENBERGER
ANDREW M. SAVEL
BENJAMIN O. SCHWENDENER, JR.
JOHN N. SEAMAN
PETER S. SHELDON
AARON H. SHERBIN
SHERILL SIEBERT
WILLIAM J. SIKKENGA
CAROLEE K. SMITH
I. JOHN SNIDER II
ROBERT R. STEAD
GINA TORIELLI
LAWRENCE R. VANTIL
ERIC T. WEISS
WARREN J. WIDMAYER

SECTION COMMITTEE REPORTS

Employee Benefits Committee

On April 26, 2018, the Employee Benefits Committee held a networking event at the Knickerbocker in Grand Rapids. At that event, Kent Sparks (Warner, Norcross & Judd) gave a presentation on the new DOL rules on missing plan participants.

On November 7, 2018, the Employee Benefits Committee and the Estates & Trusts Committee will co-host an event on estate planning with retirement assets at Vinotecca in Birmingham. Nancy Welber will be presenting at that event.

To get more information on Employee Benefits Committee events, please be sure that you are registered for the Employee Benefits Committee on SBM Connect at http://connect.michbar.org/tax/, or contact Eric Gregory at EGregory@dickinsonwright.com or (248) 433-7669.

Estates and Trust Committee

The Estates and Trust Committee will be hosting a joint event with the Employee Benefits Committee on November 7, 2018. Speaker Nancy Welber will be discussing tax issues related to inherited IRAs. Nancy is widely recognized in Michigan for her work in estate and retirement planning. More details on the location to come.

The Estates and Trust Committee plans to organize events for the Winter of 2018. The dates, locations and speakers will be determined soon. The Committee is looking for volunteers to speak at future events and to write articles related to our field.

Please stay tuned for announcements regarding upcoming Committee events.

Nicholas E. Papasifakis
Clark Hill PLC
151 S. Old Woodward Ave., Ste. 200
Birmingham, Michigan 48009
P: (248) 530-9132
npapsifakis@clarkhill.com

Federal Income Tax Committee

The Chair of the Federal Income Tax Committee will transition from Jon Baloch of EY to Erick Hosner of Howard & Howard on October 1, 2018. The Committee would like to express its gratitude to Jon for his service and continued support of the Committee's activities.

The Committee is currently developing its schedule of events for the coming twelve months. If you are interested in presenting, have an idea for a topic, or want to become actively involved with the Committee, please contact Erick Hosner at ehosner@howardandhoward.com. All are welcome, and the Committee is currently seeking ideas for future events.

Erick W. Hosner
Howard & Howard Attorneys PLLC
450 West Fourth Street
Royal Oak, Michigan 48067
P: (248) 723-0416

Young Tax Lawyers Committee

On July 31, 2018, the Young Tax Lawyers Committee co-sponsored a happy hour with the Michigan Women's Tax Association in Lansing that was very well attended. We look forward to continuing to partner with other organizations for events and growing our membership in the middle and west side of the state. Upcoming, the Young Tax Lawyers Committee is hosting a happy hour in downtown Detroit on October 25, 2018 after the State Bar of Michigan Tax Fundamentals program. We will publicize more details closer to the event through our SBM connect page.

To receive more information about upcoming Young Tax Lawyers Committee events, join the committee on SBM connect or contact Rebecca Pugliesi at rebecca.pugliesi@plantemoran.com or Mary Hennessey at mhennessey@honigman.com.

- Rebecca Pugliesi

SAVE THE DATE
Fundamentals of Taxation Program

What: Second Annual Fundamentals of Taxation Program

When: October 25, 2018 from 12 PM until 4 PM
(lunch is served from 11:30 AM to 12: 30 PM)

Where: Honigman Detroit Office –
2290 First National Building, 660 Woodward Avenue, Detroit, MI 48226

Registration for the event will be available soon. Please feel free to contact Ryan Peruski at rperuski@honigman.com for more information.

THE CONTROVERSY REGARDING THE APPLICABLE STATUTE OF LIMITATIONS FOR STATE TAX ASSESSMENTS AND THE COURT OF APPEALS' RECENT DECISION IN *OLD ORCHARD BRANDS LLC V. DEP'T OF TREASURY*

By Daniel L. Stanley

Introduction

In the Summer 2017 edition of the Michigan Tax Lawyer,[1] I wrote an article regarding the Court of Claims decision in *Old Orchard Brands LLC v. Dep't of Treasury*, No. 16-000114 (Mich. Ct. of Cl. Feb. 3, 2017). That case involved a dispute between a taxpayer and the Michigan Department of Treasury (the "Department") over the application of certain amendments to the statute of limitations contained in the Revenue Collection Act.[2] The amendments were made as part of 2014 Mich. Pub. Act No. 3 ("Public Act 3") that became effective on February 6, 2014. The taxpayer claimed that the amendments should apply to all assessments issued after February 6, 2014, while the Department claimed that they should apply only to assessments that arise out of audits that were initiated after February 6, 2014. The Michigan Court of Claims decided in favor of the Department and, as I noted in the prior article, the taxpayer appealed that decision.

On May 22, 2018, the Michigan Court of Appeals issued a published decision in *Old Orchard, et al*[3] *v. Dep't of Treasury* and affirmed the Court of Claims. The taxpayers involved have filed Applications for Leave to Appeal with the Michigan Supreme Court. Nevertheless, because the filing of an Application for Leave to Appeal does not impact the precedential value of a published decision of the Court of Appeals,[4] state tax practitioners should be aware of this decision. There are many taxpayers affected by the legal issue involved this case.

Statutory Background

The procedures of the Revenue Collection Act generally apply to all taxes administered by the Department of Treasury.[5] The Revenue Collection Act contains a four-year statute of limitations for refund claims and assessments that can be suspended or extended under certain circumstances.[6] For decades, Michigan was a "notice" state for statute of limitations purposes. That is, upon notice of a state tax audit, the four-year statute of limitations was "suspended." Specifically, prior to amendment in 2014, MCL 205.27a(3) provided:

> (3) The running of the statute of limitations is suspended for the following:
>
> (a) 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.
>
> (b) The period for which the taxpayer and the state treasurer have consented to in writing that the period be extended.[7]

Due to this statutory provision, the Department took the position that (a) the statute of limitations was suspended after the Department issued an Audit Confirmation Letter to the taxpayer; and (b) remained suspended until the Department issued a Final Audit Determination Letter.[8]

All this changed when the Legislature passed Public Act 3. As amended by Public Act 3, MCL 205.27a(3) provides:

> (3) The statute of limitations shall be extended for the following if the period exceeds that described in subsection (2):
>
> (a) The period pending a final determination of tax through audit, conference, hearing, and litigation of liability for federal income tax and for 1 year after that period.
>
> (b) The period for which the taxpayer and the state treasurer have consented to in writing that the period be extended.
>
> (c) The period described in section 21(6) and (7) or pending the completion of an appeal of a final assessment.

> (d) A period of 90 days after a decision and order from an informal conference, or a court order that finally resolves an appeal of a decision of the department in a case in which a final assessment was not issued prior to appeal.[9]

As can be seen, the language that existed under the former version of MCL 205.27a(3)(a), which suspended the running of the statute of limitations during the pendency of a state tax audit, no longer exists. This omission gave rise to the issue before the Court in *Old Orchard* – what statute of limitations applies to assessments issued after February 6, 2014 that arose from audits that began before that date?

The Court of Appeals Decision

The Court of Appeals noted that Public Act 3 "allowed for a minimal extension of the four-year limitations period for a deficiency assessment if a Department audit was commenced after September 30, 2014". However, it was silent as to audits that commenced prior to that date, such as the audit at issue in the case. The Court of Appeals framed the issue before it as interpreting the "legislative silence" regarding the impact of Public Act 3 to preexisting audits. Specifically, the Court of Appeals held:

> Thus, the question is narrowed to whether there was tolling, which answer requires a determination of the import of the Legislature's silence in 2014 PA 3 with respect to audits commenced on or before September 30, 2014. Did the silence reflect a legislative intent to continue to allow for the application of tolling to the four-year limitations period where an audit had been commenced on or before September 30, 2014, or did the silence reveal a legislative intent to do away with tolling altogether, even in regard to earlier or ongoing audits.

After reviewing certain provisions of Public Act 3, the Court of Appeals came to the conclusion that the Legislature intended to gradually replace the tolling of the Statute of Limitations that was contained in the prior version of the Revenue Act but did not intend to immediately replace that prior tolling regime. Specifically, the Court of Appeals held:

> It absolutely cannot be ascertained from reading 2014 PA 3 that the Legislature was instantly repealing all tolling connected to Department audits, but only that it was eventually repealing or disallowing all tolling. Indeed, the necessary corollary of providing for extensions of the limitations period with respect to audits commenced by the Department after September 30, 2014, is that audits commenced on or before September 30, 2014, would remain subject to tolling.

The Court of Appeals' reference to the "extensions of the limitations period with respect to audits commenced by the Department after September 30, 2014" is somewhat difficult to follow and requires some explanation. The extensions of the limitations period contained in Public Act 3 are contained in MCL 205.27a(3), which provides:

> (3) The statute of limitations shall be extended for the following if the period exceeds that described in subsection (2):
>
> (a) The period pending a final determination of tax through audit, conference, hearing, and litigation of liability for federal income tax and for 1 year after that period.
>
> (b) The period for which the taxpayer and the state treasurer have consented to in writing that the period be extended.
>
> (c) The period described in section 21(6) and (7) or pending the completion of an appeal of a final assessment.
>
> (d) A period of 90 days after a decision and order from an informal conference, or a court order that finally resolves an appeal of a decision of the department in a case in which a final assessment was not issued prior to appeal.

As the reader can see, the September 30, 2014 date referenced by the Court of Appeals is not contained in this section of the statute. It is, however, incorporated by reference. Specifically, the provisions of subsection (c) above, which extend the statute for "[t]he period described in section 21(6) and (7)" incorporate by reference the provisions of MCL 205.21(6) and (7), which provide:

> (6) For audits commenced after September 30, 2014, the department must complete fieldwork and provide a written preliminary audit determination for any tax period no later than 1 year after the period provided for in section 27a(2) without regard to the extension provided for in section 27a(3). The limitation described in this subsection does not apply to any tax period in which the department and the taxpayer agreed in writing to extend the statute of limitations described in section 27a(2).

> (7) For audits commenced after September 30, 2014, unless otherwise agreed to by the department and the taxpayer, the final assessment issued under subsection (2)(f) must be issued within 9 months of the date that the department provided the taxpayer with a written preliminary audit determination unless the taxpayer, for any reason, requests reconsideration of the preliminary audit determination or the taxpayer requests an informal conference under subsection (2)(c). A request for reconsideration by a taxpayer permits, but does not require, the department to delay the issuance of a final assessment under subsection (2)(f).

Thus, Public Act 3 allows for a short extension of the statute of limitations for the time period that it takes for the Department to complete fieldwork, provide a written preliminary audit determination, and issue a final assessment; the provisions of MCL 205.21(6) and (7) provide time limits for those processes for audits commenced after September 30, 2014. The Court of Appeals held that, given this language:

> …it would defy logic to conclude that the Legislature intended to provide for no tolling or extension of the limitations period in regard to audits commenced on or before September 30, 2014, given that former and current MCL 205.27a(3) plainly reflect a legislative mindset that an audit should potentially have some type of effect on the running of the statute of limitations, allowing for a greater period than four years to assess a deficiency.

The Court of Appeals decision, however, is somewhat problematic given that the Court of Appeals admitted that, if it were to apply Public Act 3 literally, the taxpayers would win. The Court of Appeals decision, therefore, was not really based upon the provisions of Public Act 3 but, rather, as the Court of Appeals framed the issue, upon "a determination of the import of the Legislature's silence in 2014 PA 3 with respect to audits commenced on or before September 30, 2014." The Supreme Court, however, has taken a dim view of Courts engaging "in a guessing game regarding the meaning of legislative silence."[10]

Conclusion

The issues raised in *Old Orchard* are quite complex, and there are many other taxpayers who have assessments or refund claims that may be affected by the outcome of this case. The taxpayers who were affected by this consolidated decision filed Applications for Leave to Appeal with the Michigan Supreme Court on July 3, 2018. State tax practitioners may want to monitor the case to see if the Supreme Court takes any action.

About the Author

Daniel J. Stanley is a partner in the Lansing office of Honigman Miller Schwartz & Cohn LLP. Dan is a seasoned tax appeals attorney with significant experience representing taxpayers in various aspects of state and local taxation, including ad valorem real and personal property taxation, before the courts and the Michigan Tax Tribunal.

Endnotes

1. Daniel L. Stanley, *The Controversy Regarding the Applicable Statute of Limitations for State Tax Assessments and the Court of Claims Recent Decision in* Old Orchard Brands LLC v. Dept. of Treasury, 42(2) MI Tax L. 14 (2017).
2. Mich. Comp. Laws § 205.1, *et seq.*
3. The appeal by the taxpayer in *Old Orchard* (Court of Appeals Docket No. 337463) was consolidated with two appeals of unrelated taxpayers, Alticor, Inc. (Court of Appeals Docket No. 337404) and Access Business Group, LLC. (Court of Appeals Docket No. 337406). Alticor, Inc. v. Dep't. of Treasury, Nos. 337404, 337406, 337463, 2018 Mich. App. LEXIS 2514 (Mich. Ct. App. May 22, 2018).
4. Mich. Ct. R. 7.215(C)(2).
5. Mich. Comp. Laws § 205.20.
6. Mich. Comp. Laws §§ 205.27a(2) and (3).
7. Mich. Comp. Laws § 205.27a(3) prior to amendment by Public Act 3 (emphasis added).
8. *See* Mich. R.A.B. 2008-8.
9. Mich. Comp. Laws § 205.27a(3) (emphasis added).
10. *People v. Gardner*, 753 N.W.2d 78, 90 n.19 (Mich. 2008).

AVOIDING THE RISK OF TAX DEBTOR PRISONS IN THE CITY INCOME TAX ACT

By Joshua M. Wease

Just this August, the city of East Lansing joined 22 other Michigan cities that impose income tax. The City Income Tax Act ("CITA")[1], which was passed in 1964, is becoming a more important source of revenue for a growing number of Michigan cities. The typical assessment of a one percent tax on residents and a one-half percent tax on nonresidents[2] can be a prudent decision for communities. The income tax assessment may allow them to diversify their revenue and hedge against adverse real estate markets that may depress property tax revenues.[3] However, with the ability to raise revenue through income tax assessment comes the potential for delinquent taxpayers. East Lansing may soon find itself in the same position as the city of Lansing, whose Mayor reported earlier this year that it had 1,315 outstanding warrants to arrest taxpayers.[4] This article identifies a number of concerns related to CITA that are particularly relevant for low-income taxpayers. Those taxpayers are the sole clients who we serve at the Alvin L. Storrs Low-Income Taxpayer Clinic (the "Tax Clinic").

Enforcement

In general, CITA contains an enforcement provision[5] that makes it a misdemeanor to fail to comply with a city tax ordinance. Violation of the provision is punishable by fine of up to $500 and imprisonment for up to 90 days. Having an enforcement provision in a tax act is generally reasonable. Michigan's Revenue Act contains a similar provision for nonpayment of taxes.[6] However, CITA does not contain any recognition of economic hardship or prescribe payment tools (such as installment agreements, currently-not-collectible status, or offers in compromise) for those taxpayers who are too financially impoverished to pay.

Wilfulness

The most troubling provision of CITA is MCL §141.699(b), which imposes the penalties noted above for "[w]ilful failure, neglect, or refusal to pay the tax, penalty or interest imposed by the ordinance." The key term, of course, is "wilful." In reality, there is a distinction between a taxpayer who wilfully avoids payment and a taxpayer who simply cannot pay. However, a taxpayer's ability to pay does not factor into CITA's enforcement provision. Accordingly, there is a real danger that cities using CITA's enforcement provision against impoverished taxpayers may be establishing *de facto* debtor prisons.

Expedited Procedures

Under CITA, if a taxpayer has filed a tax return and has not paid the tax due, the city administrator may issue a 10-day demand for payment.[7] This demand notifies the taxpayer of potential prosecution under MCL § 141.699. The Tax Clinic has witnessed a dramatic 300% increase over the past two years in the number of taxpayers receiving a 10-day notice from cities. Such a notice threatens a warrant for the taxpayer's arrest if the tax assessment is not paid. Ten days can be a very short period of time for people who get paid every 14 days and have little or no savings. It can be impractical for people who only receive government or pension payments every 30 days and impossible for impoverished taxpayers who live on Social Security, unemployment or other government assistance. This last group includes the working poor, who, while employed, do not earn enough to pay for their basic living expenses.

Inconsistent Penalties

CITA also has some internal inconsistencies with respect to penalties. For instance, an intentionally false statement provided on a non-obligated spouse allocation form is only subject to the larger of $25 or 25% of the excessive claim.[8] However, a taxpayer who honestly files his or her tax returns and merely cannot pay the bill is subject to imprisonment for a period of up to 90 days.[9] Imprisonment in the context of tax administration should be reserved for intentional tax fraud and malfeasant tax avoidance.

Payment Tools Unavailable

While both the Michigan and federal tax codes allow for certain payment tools,[10] CITA does not contain any provision for entering into installment agreements, addressing currently-not-collectible status, or compromising a city tax debt. In advocating for low-income clients – many of whom suffer from debilitating mental and physical health issues – the Tax Clinic has encountered significant resistance from cities with regard to entering into reasonable installment agreements. While some cities will accept payments as

low as $5 per month, others will demand monthly payments in amounts that the taxpayer simply cannot afford. While some may point to bankruptcy as an option, many impoverished taxpayers do not have the money for reasonable basic living expenses, let alone the money to pay bankruptcy court filing fees or an attorney.

Conclusion

While there may be some taxpayers who will be motivated by CITA to pay their taxes, there are others for whom the threat of jail cannot compel payment because they have no money. Cities should consider their approach to resolving tax controversies with impoverished taxpayers. For many financially insecure members of a community, being charged with a criminal misdemeanor and threat of jail will only exacerbate their situations. State and local officials should revisit CITA, and it should be amended to include provisions for mandatory withholding by employers, standard installment agreements, and currently-not-collectible status. The notice-to-pay deadline should also be extended from 10 days to 30 days.

About the Author

Joshua M. Wease *is the Director of the Alvin L. Storrs Low-Income Taxpayer Clinic at the Michigan State University College of Law.*

Endnotes

1 Mich. Comp. Laws §141.501, *et seq*.

2 Mich. Comp. Laws §141.611.

3 Few need to be reminded of the gutting of property tax revenues caused by the great recession that impacted Michigan from 2008-2012.

4 *See, Millions in income tax dollars owed to the City of Lansing,* Lansingcitypulse.com (Apr. 12, 2018), http://lansingcitypulse.com/article-15932-Millions-in-income-tax-dollars-owed-to-the-City-of-Lansing.html.

5 Mich. Comp. Laws § 141.699.

6 Mich. Comp. Laws §205.27(4).

7 Mich. Comp. Laws §141.686.

8 Mich. Comp. Laws §141.643(9).

9 Mich. Comp. Laws §141.699(b).

10 For compromising powers, see Mich. Comp. Laws §205.23a for the state of Michigan and I.R.C. § 7122 for the federal government.

THE END OF THE END-OF-YEAR GIFT? THREE PRACTICAL CHARITABLE GIVING STRATEGIES FOR CLIENTS TO CONSIDER AFTER THE 2017 TAX REFORM ACT

By Richard C. Mills

Introduction

The traditional flurry of end-of-year check writing and online giving to charities is likely to drop substantially in 2018 as a result of the Tax Cuts and Job Acts of 2017 (the "Tax Reform Act"), which went into effect January 1, 2018.[1] The Tax Reform Act significantly increased the Standard Deduction; the Standard Deduction for a married couple filing jointly nearly doubled from $12,700 in 2017 to $24,000 in 2018.[2] This is in addition to a new cap of $10,000 on the itemized deduction for the payment of state and local taxes.[3] Some commentators have estimated that the number of income tax returns that will report income tax savings from charitable donations will drop from 37 million in 2017 to 16 million in 2018.[4]

Many Americans will no longer need to itemize and, consequently, will no longer need to write a check or give online to a charity in order to claim an itemized charitable deduction. This has set off alarm in the nonprofit community. Many charities worry about whether middle-income taxpayers, who for decades took advantage of itemized charitable deductions as their only means of making charitable donations, will stop giving altogether. There is likely to be some decline in annual giving. However many, if not most, donors give out of a genuine sense of generosity to and affinity for their charities of choice. The challenge for advisors and charities will be to encourage giving in other ways so that donors can continue to gain a tax advantage by giving at the same or a higher level than they have given in the past.

Many options for middle-income donors remain after the increase in the Standard Deduction.[5] These options are likely to become more popular now that there will no longer be a tax advantage for many to simply write a check at the end of the year. The Tax Reform Act gives advisors and charities an opportunity to encourage middle-income donors, who historically have not been interested in other giving options, to think more strategically about how they give to their favorite charity. This article discusses three giving strategies that, while not new, are bound to receive more attention with the increased Standard Deduction.

Qualified Charitable Distributions From an IRA

A Qualified Charitable Distribution ("QCD") from an Individual Retirement Account ("IRA") remains an under-appreciated income tax planning tool. It is both a simple and a highly effective means of leveraging a charitable gift. Instead of taking a Required Minimum Distribution ("RMD") from the donor's IRA and paying the deferred income tax, the donor directs the payment of the RMD, or an amount of his or her choosing up to $100,000, directly to a charity. The donor is able to completely avoid paying the deferred income tax and is able to give the charity a larger financial gift than if the donor had simply taken the distribution, paid the tax, and then donated the difference. Another advantage of making a QCD is that a donor who is near the upper limit of his or her tax bracket can use a QCD to avoid taking an RMD that would otherwise bump the donor into a higher tax bracket.

The QCD strategy (sometimes confusingly referred to as a "Charitable IRA Rollover") was introduced by Congress in 2006. It was extended each year by extender bills until 2015 when Congress finally made the QCD a permanent part of the Protecting Americans from Tax Hikes Act of 2015.[6] The QCD will become an increasingly important planning tool for middle-income donors with the increase in the Standard Deduction. A few tips to remember for a successful QCD are listed below.

- In order to take advantage of a QCD, the donor must remember to instruct the custodian to make a direct transfer to the charity. Similar to the trustee-to-trustee rules for rollovers between qualified plans, the donor cannot take the distribution himself and then make the gift to the charity. The distribution must come directly from the IRA custodian. One option offered by some brokerage firms is the ability to use a so-called "IRA Checkbook," which permits the donor to write a check to the charity directly from his or her IRA.[7] These are likely to become more popular as more donors turn to QCD's as their regular means of charitable giving.
- Donors who wish to make a QCD and have set up automatic RMD distributions should adjust them at the beginning of the year to reserve funds to be distributed

to charity later in the year. Otherwise, it is easy to "set and forget" the RMD.

- IRA custodians are not currently required to identify QCD's on the donor's 1099-R form, so it is the donor's responsibility to inform his or her tax preparer of the gift. If that communication does not occur, any distribution is likely to be reported as a taxable one.

"Bunching" Gifts with the Use of a Donor Advised Fund

"Bunching" charitable gifts refers to making large enough gifts in a single year so as to take advantage of the Itemized Deduction, despite the increased Standard Deduction in that year. The donor can make the "bunched" gift to a Donor Advised Fund ("DAF"), or to a private foundation, and then make his or her regular annual gifts to the ultimate charity from the DAF or private foundation. This way he or she is able to take periodic itemized deductions while still providing the same regular stream of income from a gift to the charity that he or she would have made in the past. "Bunching" gifts is ideal for self-employed donors, donors whose income is tied to the stock market, and other donors whose income fluctuates from year to year. Making a gift through a DAF or private foundation allows the donor to give at the annual level to which he or she (and the charity) is accustomed.

One advantage of using a DAF instead of a private foundation is that the Internal Revenue Service permits donors to satisfy a legally-binding pledge through distributions from the donor's DAF.[8] This is not the case with a private foundation.[9] DAF's have dramatically increased in popularity since the 1990s and have also become the preferred means of endowment giving for middle-income donors because of their simplicity and low threshold for establishment (as low as $5,000 for some foundations). Many middle-income families are using them to make annual charitable gifts, teach philanthropy to their children, and lay the groundwork for family-planned giving in the future. Listed below are a few tips to remember to successfully bunch charitable gifts with a DAF.

- The donor should begin early to plan with his or her financial advisor to take advantage of good years when income is high and itemizing is most advantageous.

- In years when the donor makes a "bunched" charitable gift, he or she should also coordinate with his or her other potentially itemizable expenses, some of which may be deferred until the "bunching" year.

- Donors should be advised that they cannot "double-dip" the deduction. The gift to the DAF is deductible, but the later grant from the DAF to the ultimate charitable beneficiary is not.

Gifts of Appreciated Securities

The ideal gift to a charitable organization is a security that has a low basis, has been held long-term, and has appreciated in value. The donor is able to benefit the charity (by gifting the fully-appreciated value of the security) while completely avoiding the payment of capital gains taxes (on the difference between the security's sales proceeds, if sold, and its low basis). A gift of an appreciated security is ideal for a donor who does not rely upon dividends or interest to meet his or her living expenses and who has planned to carry the security indefinitely. Gifts of appreciated securities to a DAF can also be used as part of a gift "bunching" plan as described above. A couple of tips to consider when making a gift of appreciated securities are listed below.

- The deduction for gifts of long-term securities remains subject to a limit of 30 percent of Adjusted Gross Income.[10]

- Many small charities do not have brokerage accounts and are likely to sell gifts of securities immediately to raise cash. It makes sense in these instances to make the gift of securities to a DAF, which will then immediately sell the securities tax-free, and distribute the cash proceeds to the ultimate charitable beneficiary.

Conclusion

The end of the end-of-year gift is not the end of the world for middle-income giving. It will, however, require advisors to think more creatively about how they advise middle-income donors. For many baby boomers, IRA accounts hold the majority of their liquid assets. This trend will only increase. There is considerable opportunity for those donors to replace their annual cash giving with QCDs on an annual basis as their primary means of lifetime charitable giving. For those middle-income donors who are able to make "bunched" gifts to charity, there remains the opportunity to take the itemized deduction in those years when a large gift is made to a DAF. Finally, gifting appreciated securities remains a valuable option for leveraging a charitable donation and can be used effectively in conjunction with a gift "bunching" strategy.

About the Author

Richard C. Mills *is a shareholder at Marcoux Allen in the firm's Jackson and Ann Arbor offices, where he focuses his practice on estate planning, estates and trusts, and charitable gift planning. He is a member of the State Bar of Michigan Probate and Estate*

Planning Council, was one of the drafters of the Qualified Dispositions in Trust Act, and assisted James S. Spica, the drafter of Michigan's Trust Decanting legislation. He serves as a Vice Chair of the Charitable Planning Committee of the American Bar Association Real Property Trust and Estate Law Section.

ENDNOTES

1 Tax Cuts and Job Acts of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

2 I.R.C. § 63(c).

3 I.R.C. § 164(b)(6)(B).

4 Howard Gleckman, *21 Million Taxpayers Will Stop Taking the Charitable Deduction Under the TCJA*, THE TAX POLICY CENTER OF THE URBAN INSTITUTE & BROOKINGS INSTITUTION (Jan. 8, 2018), http://*www.taxpolicycenter.org/taxvox/21-million-taxpayers-will-stop-taking-charitable-deduction-under-tcja*.

5 Of course, many charitable giving strategies remain for upper-income donors, who may continue to itemize and/or continue to use charitable trusts and other more sophisticated vehicles.

6 Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, §112(a), 129 Stat. 2242 (2015).

7 Christopher R. Hoyt, *A Wake-Up Call to Senior Clients*, WEALTHMANAGEMENT.COM (May 18, 2018), *http://www.wealthmanagement.com/print/96666*

8 *Id*.

9 *Id*.

10 I.R.C. § 170(b)(1)(C)(i); Treas. Reg. §1.170A-8(d)(1).

AN INTERVIEW WITH THE HONORABLE MICHAEL J. TALBOT

By Christopher M. Jacobsen

Background

On April 25, 2018, Judge Michael J. Talbot retired after forty years of judicial service to the people of Michigan. Judge Talbot was appointed to the Michigan Court of Appeals in 1998 and served as the Court's Chief Judge from January 1, 2015 until his retirement. Before his appointment to the Court of Appeals, Judge Talbot served as a judge on the Wayne County Circuit Court; the Detroit Recorder's Court; and the Detroit Common Pleas Court, which was the predecessor to the 36th District Court. Judge Talbot was also a member of the Michigan Judicial Tenure Commission from 2004 to 2010.

On November 13, 2013, the Michigan Supreme Court appointed Judge Talbot as Chief Judge of the Michigan Court of Claims. The Court of Claims, which is part of the Michigan Court of Appeals, is a court of statewide limited jurisdiction. It hears and determines all civil actions filed against the State of Michigan and its departments, agencies and officers, including tax-related suits against the Michigan Department of Treasury.

During his tenure as Chief Judge and pursuant to Administrative Order 2014-01[1], all tax-related suits were assigned to Judge Talbot and constituted the Court of Claims' "tax docket."

Interview

On April 9, 2018, I had the honor and great pleasure of interviewing Judge Talbot in his Detroit chambers where we discussed the tax docket, his judicial tenure, attorneys who have appeared before him and some of his personal accomplishments, interests and reflections. The text of that interview is provided below.

JACOBSON: Thank you, Judge Talbot, for agreeing to this interview and congratulations on your upcoming retirement.

TALBOT: You're welcome, and thank you very much.

JACOBSON: 40 years on the bench is an impressive accomplishment. I'd like to start with some background questions.

TALBOT: Sure.

JACOBSON: Please tell me a bit about yourself prior to attending law school.

TALBOT: Well, here in downtown Detroit is the Bell Tower of Sacred Heart Seminary. It's at Chicago and Linwood. I was at the high school seminary for a few years, but I flunked Latin and finished at Divine Child in Dearborn. After that, I attended Georgetown University. While I was at Georgetown, I worked for Martha Griffith and, then, Senator Phil Hart for two years. I was very lucky to have some marvelous exposure to practical applications to government.

JACOBSON: When did you first have an interest in becoming an attorney – what caused that interest?

TALBOT: The reason why I mention the Seminary is that if you talk to some Catholic lawyers, you will find that many will have considered the idea of priesthood. It is not uncommon, interestingly enough. Many of us ultimately decide not to pursue priesthood but still find ourselves looking for some sort of a service role. It just seems to happen that way. Sometime in high school, maybe in early college, you say to yourself, "Well, that's the type of work that would give me satisfaction and, hopefully, do some good."

JACOBSON: Your Court of Appeals website profile states that you worked as an attorney in private practice before taking the bench.

TALBOT: Yes, I did. I studied at [University of Detroit Mercy] Law School, and that was

a different time. It was during the Vietnam War, and so many guys were coming and going. In my case, I lost about a year for active duty and training and so forth. Other guys lost far more time than that serving in the military, but it all came down to some men that I came to know at the Urban Law Clinic. We were all in the Clinic at the same time and enjoyed each other's company. We decided to take a chance, and so we became the first law firm that came out of U of D's Urban Law Clinic together. We specialized in just about anything that came to our door. We would learn what we needed to learn, and that was a great experience. We just hustled all the time and divided the labor. I did mostly criminal at the Frank Murphy Hall of Justice in Detroit. I tried quite a few cases.

JACOBSON: Yeah – some great practice experience.

TALBOT: You bet.

JACOBSON: Did you ever have an interest or desire to be a judge? What caused that interest?

TALBOT: Not when you first come out of law school. You just want to make a living, pay off some bills, and maybe do some criminal work. I think that's why you see many younger lawyers who are attracted to criminal work. It is sort of a fast track, and you have a vision of being able to defend someone against the terrible system. But then you realize, wait a minute, you're lucky if you can get a good plea for the client. So, there's an education there. I suppose somewhere along the line, especially given my time at Frank Murphy, I said, "I could do that job. I could do what that Judge is doing." And, so, somewhere it came in. But I can't point to a specific moment.

JACOBSON: Which current or former Judge do you most admire and why?

TALBOT: It's a mix of the styles and temperaments and scholarship of different individuals. I think I just mentioned to you, when we were chatting informally, Judge Robert Colombo, Sr., was just an extraordinary judge. Bob sometimes would become impatient with people, but he had a great mind and great instinct for finding exactly what was the real problem, what's going on in each case. There are other judges, Judge Colombo, Jr., his scholarship is wonderful. He might get ahead of the lawyers; as in, "don't argue so much because I know where you are going. I'm past you." But he generates wonderful opinions. He's very prolific at doing all of that. And there are other Judges that you wouldn't necessarily think about right away. Patricia Boyle, when she was a judge in Recorder's Court, and then later as a Justice on the Supreme Court. She was just a marvelous human being who cared about the law so much. She was a great personal friend and a terrific role model. There's a number of people like that who come to mind.

JACOBSON: What do you believe are your best attributes as a judge?

TALBOT: Well, I think that's for others to decide. I just pray that I have some good attributes. I'm certainly not afraid of work and, so, if someone says, "I'm here to try a case." – "Please have a seat. I'll be ready for you." I seem to have a knack for managing cases and courts. But my weak spot is probably an absence of patience. I know what you're trying to say, so I'll ask you to get out of the way and let me take care of the problem. Most of the time I'm probably right, I know where things are going. But once in a while, you lose something. Someone may have a nugget in there that you didn't wait for, and I regret that.

JACOBSON: I'd like to turn now to some questions about Michigan's Court of Claims. As of November 12, 2013, Michigan's Court of Claims became part of the Michigan Court of Appeals and on November 13, 2013, you were appointed the Court's Chief Judge. What were your initial impressions of the administration and the functioning of the Court?

TALBOT: When that was all taking place, I was still down at the 36th District Court. I had been assigned to act as a special judicial administrator, and so my focus and time and energy was on that court. But then I

heard about this legislation transferring the Court of Claims to the Court of Appeals. I knew what the Court of Claims was, but I did not know that anybody was thinking of taking it out of Ingham County Circuit Court and changing, at least in some respects, the structure of it, let alone giving it to the Court of Appeals. It all happened within a few weeks. I was sort of watching it all transpire.

I looked at the way the legislation was written, and I thought, "Holy smokes, is this going to be difficult." But, before I could say much more, I got a call from the Chief Justice, and he said, "I need you to implement this." I said, "I've got something else that I'm working on right now," and he said, "Yeah, I know what you're doing, but you have to add this to your plate."

The problems were just incredible. When you think about it, first of all, we're the only intermediate appellate court in the United States that now has a trial division. Second, I didn't have much funding to work with. We had no case management system. The system we had was designed exclusively for an appellate structure. None of our staff worked in a trial court. They had completely grown up in an appellate structure, so I had no staff, no case management system, no anything. It was brutal and disconcerting figuring out how we were going to deliver a quality product.

JACOBSON: What, if anything, did you do to improve the administration?

TALBOT: The clerk of our court, of the Court of Appeals, was also designated by statute as Clerk of the Court of Claims. I said to Jerry Zimmer, "Jerry, we need to go to Ingham County Circuit Court and find out what we are talking about. How many cases?" Ingham was difficult in some respects. The cases were dispersed all throughout the state court system. Ingham's system could give you an estimate of how many cases there were, but it had some practices that we didn't learn about right away. For example, if a case was taken up on appeal, the system would close it. So, when I would ask "how many cases do you have," it would give you a number, but that number wasn't accurate. For a year or two, cases kept appearing that we did not expect.

Ingham used a case management system product. Well, we didn't have that, and the question was, "Well, do I use their case management system or do I use something else?" That had to be determined very quickly. "What do I need and how do I pay for it?" What most people might not know is that there is a budget that is in the Supreme Court Administrator's office that reimburses Ingham for the work they do on these cases and other types of State cases. The legislative staff knew that, but none of us did. It's a half a million dollars, which is nothing, quite frankly, and it doesn't all go to the Court of Claims, because there was reimbursement for other kinds of cases that had State involvement. It was difficult to determine how much funding I even had available. But we had to just dive in and deal with it.

Then the files start coming over, and they're coming from every courtroom. But every courtroom over there seemed to run things differently. We had many questions to answer – Is this case alive? How far along is it? What's next? Where is it going? Just a huge amount of administrative work. The total volume of cases wasn't that great, but the challenge of a system absorbing something we had never seen before was very tough. Fortunately, the Supreme Court Administrator's office was very helpful.

JACOBSON: Later, in January 2014, the Court of Claims ordered that all new or pending cases with the MT case-type code (tax-related suits) were reassigned to the Court's Chief Judge [(the "Chief Judge rule")]. What was the rationale supporting that decision?

TALBOT: That was very easy. I told you the history up to then. And at this point, we've got our arms around it. By statute, I had three other judges who have been picked/volunteered to some degree. So, I have

good judges with backgrounds as trial court judges, but there was to be no break from doing all of your Court of Appeals work. And they very legitimately asked, "Are we going to get any sort of help here?" We came to see that there weren't very many trials, but quite a bit of dispositive motion work that had to be done. So I said, "We'll give you a research lawyer, separate from your own staff, who will help you out on dispositive motions and so forth. And, we'll give you clerical support because one or two people in Lansing can function as the docket clerk for all four. So, I can give you that support, but that's all I can do." We also wanted to clean up the old and develop good practices for the new. For example, we developed a series of templates for routine orders for the life of the case. Our goal is that no case in the Court of Claims should ever last for longer than a year.

Under the Chief Judge rule, you have the authority to manage the cases and the delivery of legal services. What we found was that about half of the whole court was tax-related. I decided that if I absorbed all of the tax cases, the burden left to the other judges should be such that we would all be able to manage. So, we looked it over, and I called the Attorney General's tax staff, and also [the Honigman firm], because they had half, or maybe more, of all of the tax cases, and also a number of others from the State Bar of Michigan tax section. We sat at a table and I explained to them that, for a variety of reasons -- and I tried my best to explain them -- I'm going to reassign all of the tax cases to myself.

After that decision was made, I thought, "Who do I have internally who is strong on tax?" The answer at the time was, "Nobody." I've got a lot of bright lawyers, and they could certainly have learned and gained a comfort level with tax law, but that was not as efficient, and they wouldn't have that same insight as someone who lives and breathes tax. That's when I decided to try something else. It wasn't easy to find someone who wasn't practicing, who had no conflicts, and who would be interested in helping us. But I was extremely fortunate and found Professor [Marjorie B.] Gell.[2]

JACOBSON: Are you still using Professor Gell?

TALBOT: Yes, but we are trying to lighten her load. We are aware of at least one senior research attorney that has some strength in tax, so there's now someone to look to internally as well.

JACOBSON: What's your professional experience in state tax matters?

TALBOT: Before this? Slim to none. And I was told that at a [State Bar Taxation] section meeting. "I know that guy Talbot and he doesn't know a damn thing about tax…." Honestly, he wouldn't have been too far off. But I was stuck. I've got to plow through. And so, some of it was trial and error, there's no question. There was no great vision.

I also did not know at the time what the Multi-State Compact[3] was all about, and I surely didn't understand what the problem was. I had a vague memory of a Court of Appeals' case I had read that was published dealing with this issue. That was about it.

When meeting with Professor Gell, I said, "Would you be interested in helping us?" She said, "You bet I will, that would be fun, and also gratifying." I said, "I'm not asking you to take my place." I would still do my job, but I asked her to take a problem at the dispositive level, help with the research, and guide us on the concepts and principles. She said that would be very satisfying. So, she gives us the background we need to understand the problem, and we can take it from there. I think that was invaluable when it came to the Compact because she knew what the issues were. She was very aware of all the problems and could show me Florida, show me Texas, show me California, and show me Minnesota; what the debates were nationally. She was very, very valuable.

JACOBSON: What have you found to be the most intellectually stimulating or thought provoking state tax issues since you've been a Court of Claims judge?

TALBOT: I think the Compact was the most fascinating. I took a tax course and didn't enjoy it all that much. But when I was told that I can actually write a statute that, if you do it carefully, has retroactive impact, that was unbelievable to me. I would not have given that a moment's thought. My knee-jerk reaction would have been, no, you can't do that. But, yes you can, if you do it very carefully. That was amazing to me. That's a very short version of what was quite a few days of me trying to really wrap my arms around that idea. That was amazing to me. I know that the poor readers/members of your section are going to say, "you naïve soul, we all know that." Well yes, I was naïve, but I still found that to be compelling and interesting.

JACOBSON: Would you also say that it's been your most challenging state tax issue?

TALBOT: Of course, there's no doubt about it. There's a lot of work from a lot of good lawyers that went into that. We probably had 50 or 60 cases pending on the topic, and the dollar impact to the State of Michigan, potentially, was very serious. Conservatively, it was a half a billion dollars. And what we did was, the day I issued my opinion on that, at the same time, we also issued the opinions on all the other Compact cases, which had never been done before.

JACOBSON: Now I'd like to turn to the attorneys appearing before you. What were your general impressions of the attorneys appearing before you on state tax matters, both at the Court of Claims and Court of Appeals? Do you believe they adequately explained the tax issues to the Court, and, if they did not, how were they deficient?

TALBOT: I don't think there's any difference between the trial and appellate levels. There are lawyers who come to see us that are anywhere from the greatest to the least so. And that happens in tax, too, but not as often, so I'm blessed that way. It is generally a smaller pool of lawyers who have the business, so to speak, but there's a reason for that. These are the folks that know what they're doing and can do a good job for a client. Wandering into the territory as an advocate, good luck to you. That's tough. I think it was a learning curve for me, but it's a learning curve for the practitioners, too. I did not understand, and must admit, that I still struggle sometimes to understand why discovery is needed. The parties spend a year or two in [the Michigan Department of Treasury's informal conference process] and now we need discovery? I couldn't for the life of me figure that out at first, and I still struggle to have that make some sense now. But what I didn't fully appreciate is the clients who don't come to see the practitioner until well down the road, and so that's what the lawyer was really saying. The lawyer has to get caught up with what [the] client just did. And then the other side of the coin is the attorney at the [Attorney General's] office who says, "I don't know any more about this case than you do, Judge. I'm just stuck with it, and I've got a whole bunch of other cases, and I've got to call Treasury and they're not always so helpful." That I couldn't figure out for the longest time, but I appreciate it now.

JACOBSON: What have been your general impressions with the quality of the pleadings and the motions and briefs filed on State tax matters?

TALBOT: Really, it is all over the place. Professor Gell might understand it, but I'll read something and try as I might, I can't figure out where they're going here. I will give it to her and say what do you think, gosh, there's a lot of words, but I don't know where they are going. So, here's what I see as the problem for the attorneys. Whichever side you are on, you inherit the work that was done by that respective client before it comes to you. And if the client hasn't had you actively involved, you're desperately trying to spin a little gold out of the straw. But that can

get tough to read sometimes because it doesn't make an awful lot of sense.

JACOBSON: What could state tax attorneys do to improve the quality?

TALBOT: Well, I think it comes down to clean thinking. It's got to be clean thinking. If you hand it to your colleague down the hall and ask them to read it before you send it in, and your colleague says they don't understand where you are going with this, that isn't very clean. To me, quality means good, solid, clean thinking, taking you to a good, solid result, and facing the ugly when you have to.

JACOBSON: Moving away from the tax docket, what do you deem to be your greatest accomplishment to date in your legal career and in your personal life?

TALBOT: Oh, I haven't hit the personal life accomplishment, because I'd like to at least play a decent round of 18. Consistency through 18 holes would be wonderful, so maybe that's on the horizon.

Really, you'd like to think that every day you're doing something useful. The assignment I had at 36th District Court brought me great fear, if I'm really honest about it. When I got the call, I thought it was basically a money problem. I thought they were spending over their budget. They were 4-5 million a year over-budget, and the emergency manager had no control over it. It had to be funded, but it didn't have any management. So, when the Chief Justice called me and sent me in there, I thought, "Okay, it is a money problem."

When I got a sense of what that was really all about, I was scared. I knew the lawyers who would complain about going to that court. Some of it didn't function at all, and some of it certainly didn't function well. Learning why and then trying to fix those areas -- it scared the pants off of me. I didn't think we could get this done. How do we fix all of this? I learned a lot about myself by finding two or three, maybe four, things that I thought were overarching goals. I stayed on those because I could walk in there on any given day and see problems. But you can't let all of those problems distract you. Stay with your big four, and if you pick the right big four, you'll be alright. The rest will fall into place. Given the fine work of the people that are there now, I think it's a great court.

JACOBSON: You mentioned golf. What else do you enjoy doing apart from legal work?

TALBOT: I can sit and read a book without any problem whatsoever. That's pretty passive, but give me a nice murder mystery and I'm a happy man. I do like to travel, although I haven't done as much as I would like. It can be difficult when you're single, and I am. Having the will to get up and go out and do it yourself is even more challenging as you age, so I've got to make myself get up and get out. But, I have some goals in retirement. I'll take on singular projects that have a beginning and a foreseeable end. I'm happy to do that. I told the Supreme Court that I'm happy to be of service to them if I can help, and I want, at least part of each year, to integrate some continuing education. Maybe on subjects that have nothing to do with law, but maybe subjects that when I go back to a University or something, I actually want to listen and pay attention.

JACOBSON: Ha-ha, great. Any final advice?

TALBOT: No, I'm still learning. I'll take advice from others.

JACOBSON: Well, thank you for your time and thoughtful responses.

TALBOT: I hope this gives you what you had in mind.

JACOBSON: Absolutely and I wish you all the best.

TALBOT: Thanks very much, Chris.

About the Author

Christopher M. Jacobson *received his LL.M. in Taxation (2011) from Wayne State University Law School. Mr. Jacobson is an attorney at the Honigman Miller Schwartz & Cohn law firm in Detroit where his practice includes state and local tax matters. Mr. Jacobson is a former Michigan Assistant Attorney General who represented the Michigan Department of Treasury in state tax litigation.*

Endnotes

1 Court of Claims Administrative Order 2018-02, which was issued April 26, 2018, rescinded Court of Claims Administrative Order 2014-01. Order 2018-02 ordered that all new or pending tax-related suits would be assigned to the Court's chief judge *or another designated judge*. The Court's tax docket is currently assigned to Judge Colleen A. O'Brien as of the date of publication of this article.

2 Marjorie B. Gell is a tax professor at Western Michigan University Cooley Law School's Grand Rapids campus and is past chairperson of the Taxation Section of the State Bar of Michigan.

3 For more information on the Multistate Tax Compact, see Multistate Tax Commission, http://www.mtc.gov/The-Commission/Multistate-Tax-Compact (last visited Sept. 19, 2018).

STATE FIDUCIARY INCOME TAX CHECKUP, PART 2: TRUST NEXUS IN MICHIGAN

By Raj A. Malviya

Introduction

This article is the second part of a two-part series on state fiduciary income tax planning.[1] The first part addressed an overview on the general rules that govern nexus for state income tax purposes and the narrow application of Michigan's nexus laws. This article will address key developments in the state fiduciary income tax arena over the past year and will, with Michigan's nexus rules in mind, provide planning considerations to shift a Trust's state tax nexus.[2]

As mentioned in the first article, state fiduciary income taxation of a non-grantor trust is often an afterthought in the design and administration of a trust.[3] To flesh out this observation, listed below are several examples the author has noticed in the fiduciary practice when surveying fellow colleagues.

i. The practitioner tends to focus more on the federal income tax issues, especially since the non-grantor trust rules under Internal Revenue Code Section 641, et seq. are complicated enough to understand and implement.[4]

ii. State income tax rates are lower and have different bracket structures, if any at all.

iii. States have differing sets of rules for taxing trusts. Consequently, it is more difficult to keep track of, or even be aware of, the different rules and how and when they apply.

iv. Continuing legal education typically focuses on federal fiduciary income tax planning, since it is uniform among states and is more "sexy."

v. Clients may not want to incur the additional professional expense that is necessary to review, analyze, and monitor state fiduciary tax compliance and planning opportunities.

With regard to this last point, several key court decisions were rendered in 2018 that have continued to shape the state fiduciary income tax area. Two of those decisions, *Kaestner*[5] and *Fielding*,[6] will be examined in this article, as they are important to better appreciate the continued developments in trust nexus planning.

A "full service" trust administration practice requires more than an understanding of the federal fiduciary income tax rules. Determining where a Trust "lives" for state income tax purposes or whether a Trust has sufficient contacts to a particular state is **equally** as important. Sometimes more than one state is involved. State fiduciary income tax returns are required if the applicable state's rules trigger reporting. Failure to file a state fiduciary income tax return can lead to penalties and interest which will have a cumulative effect after multiple years of omitted filings. A practitioner engaging in effective state income tax compliance and planning will add value to the administration by not only allowing a Trustee to fulfill fiduciary duties by filing necessary returns, but also managing overall tax exposure if a return or tax liability is not due.[7]

Michigan Residency Tax Rules and Nexus Management

Before examining nexus planning considerations, it is important to revisit Michigan's rule on state fiduciary income tax nexus. Michigan imposes income tax on estates and trusts.[8] As outlined in the author's first article, **Michigan is a "Founder" state for fiduciary income tax nexus**. This is because a Trust is generally a resident trust if it was created by the will of a Michigan domiciliary at the time of death ("testamentary trust") or if it was created by a Michigan domiciliary at the time that the trust becomes irrevocable ("resident trust").[9]

A resident trust is subject to Michigan income tax on all income from any source, except income properly attributable to another state under Michigan Income Tax Act sourcing rules.[10] Taxable income of a resident trust is federal taxable income subject to Michigan adjustments.[11] As of October 1, 2012, the Michigan income tax rate is a flat rate of 4.25 percent.[12]

A nonresident trust is one that does not meet the definition of a resident trust. Importantly, a trust that initially constitutes a resident trust under Michigan statute may nonetheless "convert" into a nonresident trust if <u>all</u> of the following are true:

i. The trustee is not a Michigan resident;

ii. The trust assets are not held, located or administered in Michigan; and

iii. All of the beneficiaries are nonresidents.[13]

The seminal Michigan case, *Blue v. Michigan Department of Treasury* (the "*Blue* case"),[14] paved the way for a Michigan revocable living trust that became irrevocable upon the Settlor's death to effectively "break" nexus in Michigan. Importantly, the Michigan Department of Treasury also recently released guidance that Michigan will follow the *Blue* case factors.[15] Given the guidance stemming from the *Blue* case, it is important for a practitioner to identify the basis for which a trust is taxed in Michigan, and to perform this exercise annually. Being able to distinguish between a "resident trust" and a "nonresident trust" will enable the practitioner to perform this task properly. Setting aside non-tax reasons for the trust to stay in Michigan, the practitioner should regularly analyze whether there are (or could be) sufficient contacts in another state that would provide a more palatable or beneficial state income tax regime for the Michigan resident trust; e.g., a state with no state income tax. [16]

Trusts that began as revocable living trusts and became irrevocable upon the Settlor's death should be analyzed under the *Blue* case factors. If contacts have evaporated from a Michigan resident trust over time, as they often do, it is critical for the practitioner to assess whether there are still sufficient contacts for Michigan to tax the trust. If not, the Trustee may be unnecessarily paying income tax when a "break" from residency has already happened, perhaps years ago.

On the other hand, trusts that were initially established as irrevocable trusts with Michigan ties do not fall squarely under the *Blue* case facts. While the *Blue* case may provide guidance, an understanding of other state law decisions is important to better examine whether an argument can be made to break Michigan nexus and establish nexus in a more taxpayer-friendly state.

Recent Decisions in State Fiduciary Income Tax (2018 Decisions)

As noted above, to appreciate the continued development of state fiduciary income tax planning, the recent out-of-state decisions of *Kaestner* and *Fielding* will be examined. Both decisions continue the taxpayer-friendly trend of courts striking down state nexus residency statutes as unconstitutional.

A. *The Kimberley Rice Kaestner Trust v. North Carolina Department of Revenue*

In *The Kimberley Rice Kaestner Trust v. North Carolina Department of Revenue* (the "*Kaestner*" case),[17] the North Carolina Supreme Court upheld the North Carolina Court of Appeals' and lower court's holdings that a North Carolina trust residency statute that sought to tax a trust's accumulated income was unconstitutional as applied to the trust at issue. Each holding was based on the grounds that taxing a trust on the **sole** basis of the North Carolina residency of the trust beneficiaries violates the Due Process Clauses of the U.S. Constitution and the North Carolina Constitution.

The facts of the *Kaestner* case are summarized below. Joseph Lee Rice III established an irrevocable trust in 1992 for his three children and their families with substantial ties to New York. Joseph was a resident of New York, created the trust in New York, and the initial trustee was a resident of New York. In addition, the trust was governed by New York law, the tax compliance and trust accountings were prepared in New York, and the trust's financial, tax and legal books and records were located in New York. However, upon the initial trustee's resignation, the individual successor trustee was a resident of Connecticut. Additionally, the custodians of the Trust accounts were located in Massachusetts. Upon Joseph's death, the trust was divided into separate trusts for each beneficiary. The *Kaestner* case, however, concerned only one of the three trusts -- the trust established for Joseph's daughter, Kimberley Rice Kaestner (the "Trust"). Mrs. Kaestner was a discretionary beneficiary under the Trust. The only contact Mrs. Kaestner had with North Carolina was her residency when she moved her family there in 1997.

The Trust had been paying significant North Carolina state income tax based on a statute that imposed income tax on undistributed income in trusts as follows:

> The tax is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State, or for the benefit of a nonresident to the extent that the income (i) is derived from North Carolina sources and is attributable to the ownership of any interest in real or tangible personal property in this State or (ii) is derived from a business, trade, profession, or occupation carried on in this State.[18]

The Trust paid over $1.3 million in North Carolina income tax and interest for tax years 2005-2008, the years at issue in the case. In contrast, the Trust did not pay New York or any other state income tax. During those years, Mrs. Kaestner and her family were the sole primary beneficiaries of the Trust and were North Carolina residents. That said, they did not receive any distributions from the Trust during the tax years at issue, though the trustee was afforded the discretion to make distributions.

In 2009, the trustee filed for refunds of the more than $1.3 million in income tax and interest paid for tax years 2005-2008. The refund was denied, and in 2012, an action was filed in state court to recover this money. In the suit, the trustee argued that North Carolina's broad trust income tax

reach violated the U.S. Constitution's Due Process and Commerce Clauses. In 2015, the North Carolina Business Court issued an opinion and order for the trustee on cross motions for summary judgment, finding that North Carolina could not tax the income of the Trust for the years in question. The appellate court upheld the decision in 2016 and now the North Carolina Supreme Court has upheld it as well.

The constitutional attacks on the North Carolina statute under the Commerce and Due Process Clauses were consistent with the reoccurring approach by state courts in other jurisdictions in dismantling similar taxing statutes, including the *Blue* case. The lower court examined both constitutional attacks and held that the statute violated the Due Process and Commerce Clauses. However, the North Carolina Court of Appeals did not address the Commerce Clause attack, so it was not examined in the North Carolina Supreme Court's opinion.[19]

Kaestner is an important case for Constitutional analysis. At least eleven other states include beneficiary residency as a critical factor under their respective taxing statutes (or administrative interpretations of such statutes).[20] However, the North Carolina Supreme Court's reasoning and analysis also exposes the statutes of many other states, like Michigan, that incorporate the residency of the Settlor as a crucial factor to Constitutional scrutiny. Because this decision is from a state's highest court on a federal constitutional issue (and was shortly thereafter followed by the Minnesota Supreme Court in its similar decision in *Fielding v. Department of Revenue*, examined below), it may have persuasive impact on many other states' constitutional nexus jurisprudence, including Michigan's.

B. *William Fielding, Trustee of the Reid and Ann MacDonald Irrevocable GST Trust for Maria v. MacDonald, et al. v. Commissioner of Revenue*

In *William Fielding, Trustee of the Reid and Ann MacDonald Irrevocable GST Trust for Maria v. MacDonald, et al. v. Commissioner of Revenue* (the "*Fielding*" case),[21] the Supreme Court of Minnesota, over two dissents, issued an affirmation of the lower court's decision finding unconstitutional Minnesota's trust residency and taxing statute, as applied to the trust at issue. The Minnesota Supreme Court found that "the State lacks sufficient contacts with the Trusts to support taxation of the Trusts' entire income as residents consistent with due process."

The facts of the *Fielding* case are summarized here. Reid MacDonald was a Minnesota resident who created four irrevocable generation skipping trusts on June 25, 2009 for the benefit of each of his children and such child's descendants (the "Trusts"). The Trusts were initially established as grantor trusts using a power of substitution under Code Section 675(4) and were funded with nonvoting shares of Faribault Foods, Inc. ("FFI"), a Minnesota corporation. The initial trustee of the Trusts was a California resident. Only one of the beneficiaries of the Trusts was a Minnesota resident. Likely anticipating a sale of the FFI shares and the desire to apply more favorable state income tax laws, on December 31, 2011, the Minnesota resident settlor, Mr. MacDonald, released his grantor trust power to substitute assets under the Trusts. Going forward, the Trusts were taxed separately as non-grantor trusts. Not coincidentally, the California resident trustee resigned as of that same date, and thereafter trust administration was conducted in Colorado. On July 24, 2014, a Texas resident became sole trustee of the Trusts. Shortly thereafter, the Trusts joined in with all FFI shareholders and sold their shares of FFI stock. After the Trusts ceased to be grantor trusts in 2012, they filed Minnesota income tax returns as resident trusts, without protest, for tax years 2012 and 2013. In 2014, the Trusts filed Minnesota income tax returns under protest, asserting that the statute classifying them as resident trusts was unconstitutional, as it applied to them. The Trusts then filed amended tax returns claiming refunds for the difference between the taxes owed as resident trusts under the Minnesota statute and the taxes owed as nonresident trusts. This amount was an estimated $250,000 of tax liability for each of the Trusts.[22]

The Minnesota residency statute at issue provided as follows: "Resident trust means a trust, except a grantor type trust, which . . . is an irrevocable trust, the grantor of which was domiciled in this state at the time the trust became irrevocable."[23] Because the grantor was a Minnesota resident when the Trusts were created, this statute was triggered. The issue was whether the statute was Constitutional, as applied to the Trusts.

The Minnesota Tax Court focused its examination on the Due Process constraints of the residency statute.[24] On May 31, 2017, the Minnesota Tax Court, in entertaining cross-motions for summary judgement, issued an order granting the Trusts' motion and holding that the residency statute violated the Due Process Clauses of the Minnesota and U.S. Constitutions, as applied to the Trusts.

Specifically, in striking down the residency statute as unconstitutional, the Minnesota Tax Court held that Minnesota lacked subject matter jurisdiction over intangible personal property located outside of Minnesota. The Court opined that consideration of the grantor's historical domicile was insufficient to establish subject matter jurisdiction for two reasons: (1) "it reaches back through time to a discrete historical moment, and purports to rely on state protections extended (to the grantor) at that moment" and resorts to protections provided in previous tax years, not the period when the income was earned; and (2) the "grantor domicile method" to

establish taxing jurisdiction "reaches across persons", relying on connections with the grantor rather than the trust."

The Commissioner of Revenue appealed the Tax Court's holding to the Minnesota Supreme Court. **Despite working from the strong presumption that its trust residency statute was valid, the Minnesota Supreme Court affirmed the Tax Court in holding that the statute was unconstitutional as applied to the four irrevocable Trusts, regardless of the following Minnesota nexus contacts:**

i. The settlor was a Minnesota resident at the time of funding and the tax year in question;

ii. The Trust applied Minnesota as governing law;

iii. The Trust was drafted by a Minnesota attorney;

iv. The Trust records were maintained in Minnesota;

v. One of the Trust beneficiaries was a resident of Minnesota; and

vi. The primary Trust asset and source of income was stock in FFI, a closely held S-Corporation, which was incorporated in the State of Minnesota and has always been headquartered in Minnesota.[25]

The Minnesota Supreme Court refused to consider the above list as arguable nexus contacts that would trigger the application of the residency statute. The Court found the contacts to be either "irrelevant or too attenuated to establish that Minnesota's tax on the Trusts' income from all sources complies with due process requirements." **Specifically, the Court provided three reasons for reaching its conclusion, which are summarized below.**

i. The residency of the settlor is irrelevant, as well as the use of a Minnesota law firm to draft or store a copy of the trust – once the Trusts became taxpayers (non-grantor trusts), it is the state's connections with the trustee and administration that are important.

ii. The Trusts did not own any physical property in Minnesota that might serve as a basis for taxation as residents. Intangible personal property such as the Minnesota S-Corporation stock was held outside of Minnesota – its situs moves with the trustee.

iii. Prior year contacts were irrelevant. Each year should stand on its own. During the tax year in question, the Trustee traveled to Minnesota for a weekend to attend a wedding, but he never traveled to Minnesota for any purposes related to the Trusts. "This level of contact is clearly not enough to establish residency for taxation purposes." [26]

As a result of the Court's ruling, Minnesota could not tax the interest, dividends and, most importantly, the Trusts' significant capital gains derived from the sale of FFI shares. This was a significant win for the taxpayer, although the Trust's pro rata share of flow-through income from FFI, as an operating business, could still be subject Minnesota income tax on an apportioned basis under another Minnesota statute.

The *Fielding* case is arguably a more taxpayer-friendly decision than the *Kaestner* case. This is because it is the first case of which the author is aware that severed tax nexus under a Settlor residency-based nexus statute, even when significant ties to the taxing state, including the Settlor's state of residency, remained intact. Compare the *Fielding* case to the *Blue* case, which stood for the proposition that essentially *all* of the Michigan contacts with a trust must terminate before the trust's residency can be broken. While the *Fielding* case is not precedent in Michigan, it is guidance for practitioners who are considering breaking tax nexus in Michigan for an irrevocable trust when contacts similar to those in *Fielding* still exist.

NEXUS PLANNING CONSIDERATIONS

A. KNOW YOUR TRUST

One of the first tasks for the practitioner is to understand and appreciate the type of irrevocable trust being administered. Surprisingly, this task is often overlooked by practitioners who do not specialize in the Trusts & Estates area and may generally assume that all trusts are subject to Michigan income tax. As an example, a "grantor" trust for federal income tax purposes will be a grantor trust for Michigan state income tax purposes, and consequently, Michigan rules direct the grantor to report the trust's income, deductions and creditors on the grantor's individual Michigan income tax return.[27] In that case, the grantor's state of residency will matter for purposes of state income tax reporting and planning. If the grantor is a resident in a "no-tax" state, then Michigan income tax may only be assessed to Michigan sourced items of income. Conversely, if a non-grantor trust distributes all of its income, a beneficiary's portion of distributable net income will be taxed at his or her individual rate in the applicable state -- not at the trust level in Michigan.[28]

B. PERIODIC ASSESSMENT

Given all the moving parts, the practitioner should conduct a periodic assessment of the trust administration. If contacts have evaporated from a Michigan resident trust over time, as they often do when families evolve, fiduciaries move, and

assets change situs, it is critical that the practitioner assess whether sufficient contacts still exist for Michigan to tax the trust. If not, the Trustee may be unnecessarily paying income tax when a "break" from residency has already occurred.

C. Shifting Residency

The practitioner should also focus on knowing the "ins and outs" of the applicable residency rules. Because Michigan is a Founder state for state fiduciary income tax purposes, the practitioner should assess whether there is an opportunity to shift "residency" out of Michigan under the *Blue* case factors.

For revocable living trusts, the practitioner can consider having the grantor change his or her state of residency prior to the time when the trust becomes irrevocable. Additionally, the Trustee should shift to another state and no income producing assets should remain in Michigan, including real estate.

For irrevocable trusts, shifting residency may present more difficulties, both procedurally and practically. For trusts that became irrevocable due to the death of the Settlor, the practitioner can consider changing Trustees (by resignation, declination, and removal), shifting situs of Trust assets (such as accounts with financial institutions, closely held interests), and assessing situs of beneficiaries, to name a few. It may not be viable to move all contacts out of Michigan, but there are some exceptions under the *Blue* case. It may be possible to bifurcate portions of the applicable Trust so that only a portion of income is taxed in Michigan if other portions can be shifted out of state. Upon a complete "break" of ties to Michigan, it is advisable to file a final Michigan Fiduciary Income Tax Return for the final tax year.[29] For trusts that were established as irrevocable trusts by a Michigan resident, and for which the *Blue* case factors cannot be met, the practitioner can consider looking to out-of-state decisions, such as *Fielding*, to assess whether there is support for breaking the Michigan nexus and bringing a subsequent constitutional challenge, if needed.

D. Adapting a Trust

For existing trusts where it is not viable to shift residency based on the facts of the administration (Trustee residency, asset situs, beneficiary location, etc.), the practitioner can consider the strategies listed below.

i. Utilize Trustee powers that allow for shifting the situs of administration. This should be coupled with other direct facts of the administration for purposes of supporting a complete "break" of ties to Michigan.

ii. Utilize Trustee powers that allow for change in governing law of administration. Again, this should be coupled with other direct facts of the administration for purposes of supporting a complete "break" of ties to Michigan.

iii. Utilize Trustee powers that allow for bifurcation of shares and administering certain shares for beneficiaries who are residents in a more state income tax-friendly jurisdiction as separate and distinct trusts.

iv. Utilize Trustee powers that allow for distributions to be made in further trust for the benefit of a beneficiary. This will allow the Trustee to send assets to a new or existing trust in a more state income tax-friendly jurisdiction.

v. If sufficient Trustee discretion exists, decant the trust (or a portion of it) pursuant to the governing instrument and/or Michigan law, into one or more new trusts in a more state income tax-friendly jurisdiction.[30]

vi. For irrevocable trusts that have a toggle feature to turn off and on "grantor" trust status for federal income tax purposes, turn on grantor trust status to allow the grantor to move to a more state income tax-friendly jurisdiction before toggling off again.[31]

vii. If a Trust Protector is involved (or can be appointed), amend applicable Trust provisions to enable the above maneuvers.

E. Consider DINGs, NINGs, WINGs and KINGs

DINGs, NINGs, WINGs and KINGs are acronyms for an "Incomplete Non Grantor Trust" in the states of Delaware, Nevada, Wyoming and Alaska, respectively.

i. An "ING" trust is an irrevocable trust established under the laws of one these states because they are tax-friendly jurisdictions for state income tax purposes (i.e., no income tax).[32]

ii. Typically a Settlor who does not reside in a tax-friendly jurisdiction will establish an ING trust using sufficient contacts in the tax-friendly jurisdiction (corporate Trustee, asset situs, source income, etc.).

iii. The concept of an ING trust works something like this: The Settlor retains sufficient control of the assets transferred to the trust so that the transfer is treated as an incomplete gift for federal gift tax purposes; however, the Settlor does not retain the necessary powers that would cause the trust to be treated as a "grantor" trust for feder-

al income tax purposes.[33] Consequently, upon creation and funding, if done properly, the Settlor does not incur a taxable gift and the trust is taxed on the income of the trust with no applicable state income tax.

iv. Establishing an ING trust requires satisfying nexus in the state of establishment and careful drafting of grantor, fiduciary and related powers provisions. For example, key "players" in a properly drafted ING trust generally include (i) an out-of-state Settlor; (ii) a tax-friendly state corporate trustee; (iii) a distribution committee or similar body consisting of adverse parties under fiduciary income tax rules; (iv) discretionary beneficiaries; and (v) a potential investment trust advisor. The Settlor should also have a testamentary limited power of appointment to assure there is no completed gift upon funding.[34]

v. If implemented correctly, an ING trust can be a powerful planning technique when a Settlor has fully utilized his/her lifetime gift tax exemption (or wants to save the exemption for other transfers) but wants to avoid state income tax. Additionally, because of the incomplete gift, the ING trust assets are included in the Settlor's gross estate and will receive a basis step-up adjustment at death. During the lifecycle of the ING trust, as long as situs is maintained in the planned jurisdiction, no state income tax will be due on accumulated taxable income at the trust level.[35]

F. All Ties Severed Except Settlor's Residency

When trying to engage in nexus planning with non-grantor trusts for which the Settlor is still living, it may be difficult to avoid Michigan's residency statute if the Settlor is still a Michigan resident and shifting residency may not be a viable option. The *Blue* case arguably only applies to trusts that become irrevocable at the Settlor' death. A planning idea to potentially prevent the Michigan residency tie could involve having the trust initially formed by a single member LLC in another tax-friendly state. Assuming the formalities of organization and operation have been met and there is legitimate ongoing activity in the state of LLC organization, this approach may be worth exploring.[36] Without a Michigan resident Settlor or other Michigan ties, the *Blue* case possibly supports avoidance of Michigan residency. The *Fielding* case could also be used as additional support, given that a Michigan Court may look to out-of-state decisions in reaching its decision, as was done in the *Blue* case.

G. Exercise Caution When Using Grantor Trust Powers

The irrevocable trusts in *Fielding* were analyzed for nexus soon after the Minnesota Settlor released grantor trust status. Query whether the type of grantor trust power being released may cause a court to analyze a residency statute differently. If an independent person must exercise a grantor trust power in conjunction with the grantor (e.g., a law firm or trust protector who is non-adverse) without the consent of anyone in a fiduciary capacity, would the state of residency of the independent person (not the settlor) create nexus? What if the designated independent person is also the Trust Protector, who is deemed a fiduciary under state law?[37] The answers are unclear.

Conclusion

Trust nexus of a non-grantor trust is not a "one-size fits all" analysis; the analysis itself is certainly complex. Multiple layers of taxation warrant careful review of the applicability of the income tax laws of Michigan and other states that have or could have a connection or nexus to a Trust. Moreover, engaging in the features of a more robust or flexible trust design, which is commonplace these days, may actually present potential roadblocks when trying to prevent or navigate through a trust nexus issue. While understanding the *Blue* case and related guidance is important, practitioners also need to consider the many variables in the life cycle of a trust administration that could allow for (or alter) the taxpayer-friendly results seen in the *Kaestner* and *Fielding* cases.

About the Author

Raj A. Malviya, J.D., LL.M*. (Tax), is a partner in the Private Client practice group at Miller Johnson, and he practices in all areas of transfer tax and fiduciary income tax planning. Mr. Malviya is a member of the Tax Section and Probate and Estate Planning Section of the State Bar of Michigan, where he is a member of the Probate and Estate Planning Council. Mr. Malviya is a former Fellow of the American Bar Association's Section of Real Property, Trust & Estate Law Section and is a Fellow of the American College of Trust and Estate Counsel, where he serves on the Fiduciary Income Tax and International Estate Planning Committees. He is recognized in Best Lawyers of America, Michigan Super Lawyers and Chambers High Net Worth Guide.* *Mr. Malviya would like to thank his colleagues in the fiduciary income tax area, David A. Berek, of Baker & McKenzie, LLP and Edwin P. Morrow, III, of US Bank, for their continued insight and collaboration in this area, and contributions to portions of this article.*

Endnotes

1 The first article, Raj Malviya, *Fiduciary Income Tax Checkup, Part 1: Trust Nexus in Michigan*, 42(2) Mi Tax L. 4 (2017), can be retrieved by emailing the author or accessing it online through the Mi Tax L. archives webpage http://connect.michbar.org/tax/mitaxlawyer.

2 Some of the substance of this two-part article series was addressed in the following materials: Raj A. Malviya, David A. Berek, *State Fiduciary Income Tax Checkup and Planning: Does Your Trust Have A Tax Nexus?*, The 25th Annual Probate and Estate Planning Institute, Michigan Continuing Legal Education, University of Michigan Press (May 18, 2017); Raj Malviya, *State Fiduciary Income Tax Checkup: Drafting to Avoid State Income Taxes*, Presentation for 27th Annual Drafting Estate Planning Documents Seminar, Michigan Continuing Legal Education (ICLE), University of Michigan Press (Jan. 2018).

3 The planning considerations discussed in this article apply to non-grantor trusts taxed under I.R.C. § 641, et seq. This article will not address planning involved with the special rules in subchapter J (known as the "grantor trust rules") that provide that if a grantor (or another person) of a trust holds an interest or a power described in I.R.C. §§ 671 through 679, then such grantor (or other person) is deemed to be the owner of the trust for federal income tax purposes.

4 All references and citations to the Internal Revenue Code throughout this outline shall be to the "Code" or "I.R.C."

5 *The Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue*, (N.C. June 8, 2018) opinion at https://cases.justia.com/north-carolina/supreme-court/2018-307pa15-2.pdf?ts=1528472496.

6 *William Fielding, Trustee of the Reid and Ann MacDonald Irrevocable GST Trust for Maria v. MacDonald, et al. v. Commissioner of Revenue*, (Minn. July 18, 2018) opinion at https://mn.gov/law-library-stat/archive/supct/2018/OPA171177-071818.pdf.

7 A general understanding of fiduciary income tax rules and concepts is important in engaging in state fiduciary income tax planning. The following resources can be consulted, if desired: Raj A. Malviya, John R. Strohmeyer, *Fundamentals of Trust Administration and Fiduciary Income Taxation*, American Bar Association Section of Real Property, Trust and Estate Law Fundamentals of the Modern Estate Planning Practice Series (May 25, 2017); Raj Malviya, Jonathan K. Beer, *New Year's Resolutions for Trustees and Beneficiaries: Ten Fiduciary Income Tax Planning Considerations,* 36(1) Mich. Prob. & Est. Plan. J. (January 2017); Raj Malviya, George Gregory, *Drafting Trusts for the Net Investment Income Tax*, Presentation for 25th Annual Drafting Estate Planning Documents Seminar, Michigan Continuing Legal Education, University of Michigan Press (Jan. 2016); Raj Malviya, Sara N. Nicholson, Richard J. Puhek, *Fiduciary Income Tax Planning: Including Capital Gains in Distributable Net Income (DNI)*, 40(2) Mi Tax L. (2014).

8 *See* Michigan Income Tax Act of 1967, Mich. Comp. Laws §§ 206.1, et seq.; Berek, David A., Federal Income Taxation of Decedent's, Estates and Trusts, Ch. 15 (2016).

9 Mich. Comp. Laws § 206.18(1)(c).

10 Mich. Comp. Laws § 206.110(1).

11 Mich. Comp. Laws § 206.36.

12 Mich. Comp. Laws § 206.51(1)(b).

13 This was the decision in the *Blue v. Michigan Department of Treasury*, 462 NW2d 762 (Mich. Ct. App. 1990); see also Mich. Dept. of Treas., Instructions for Filing Michigan Fiduciary Income Tax Return MI-1041 (2017), at pg. 2.

14 *Blue v. Michigan Department of Treasury*, 462 NW2d 762 (Mich. Ct. App. 1990)

15 See Mich. Dept. of Treas., Revenue Administrative Bulletin ("RAB")2015-15, approved August 20, 2015. Pursuant to Mich. Comp. Laws § 205.6a, a taxpayer may rely on a Revenue Administrative Bulletin issued by the Department of Treasury after September 30, 2006, and shall not be penalized for that reliance until the bulletin is revoked in writing. However, reliance by the taxpayer is limited to issues addressed in the bulletin for tax periods up to the effective date of an amendment to the law upon which the bulletin is based or for tax periods up to the date of a final order of a court of competent jurisdiction for which all rights of appeal have been exhausted or have expired that overrules or modifies the law upon which the bulletin is based.

16 The states with no income tax include: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. There are several states, like Delaware, for example, that do not tax the income of a trust as long as all beneficiaries are nonresidents.

17 See *supra* note 6.

18 N. C. Gen. Stat. §§ 105-160.2.

19 The Due Process Clause of the U.S. Constitution was briefly addressed in the author's first article. For a more detailed discussion on the Due Process Clause and constitutional challenges to state taxing statutes, see Raj A. Malviya, David A. Berek, *State Fiduciary Income Tax Checkup and Planning: Does Your Trust Have A Tax Nexus?*, The 25th Annual Probate and Estate

Planning Institute, Michigan Continuing Legal Education, University of Michigan Press (May 18, 2017); Raj Malviya, *State Fiduciary Income Tax Checkup: Drafting to Avoid State Income Taxes*, Presentation for 27th Annual Drafting Estate Planning Documents Seminar, Michigan Continuing Legal Education (ICLE), University of Michigan Press (Jan. 2018); Berek, David A., Federal Income Taxation of Decedent's, Estates and Trusts, Ch. 15 (2016); Ed Morrow, David Berek, & Raj Malviya, *On the North Carolina Supreme Court's Affirmation on Kaestner and Its Impact on both North Carolina and Other States' Abilities to Tax Trust Income*, LISI Income Tax Planning Newsletter, Aug. 20, 2018 at #153.

20 Alabama, California, Connecticut, Georgia, Michigan (not by statute but by administrative interpretation of case law), Missouri, North Carolina, North Dakota, Ohio (one factor), Rhode Island and Tennessee all consider beneficiary residency as a factor. Ala. Code § 40-18-1(21), Cal. Rev. & Tax. Code § 17742; Conn. Gen. Stat. § 12-701; GA. Code § 48-7-22; *Blue v. Dep't of Treasury* 462 NW2d 62 (Mich. Ct. App. 1990) and followed/interpreted by Michigan Department of Treasury Bulletin RAB 2015-15; Mo. Rev. Stat. § 143.331, N.C. Gen. Stat. §§ 105-160.2.; N.D. Admin. Code 81-03-02.1-04(2), Ohio Rev. Code § 5747.01, R.I. Gen. Laws §§ 44-30-5(c)(2)-(5); Tenn. Code Ann. § 67-2-110(a). Many of these states also require settlor residency in state, such as Alabama, Connecticut, Michigan, Missouri, Ohio and Rhode Island, but the *Kaestner* case calls into question whether settlor residency is relevant or sufficient to provide nexus to tax the trust.

21 See *supra* note 7.

22 The Trusts did not contest the ability of Minnesota to tax the ongoing S-Corporation source income (reported on K-1) of FFI attributable to the S-Corporation shareholders (including the Trusts) but contested the imposition of Minnesota state income tax on the capital gains from the sale of the FFI shares and other non-source income generated inside the Trust's investment portfolio.

23 Minn. Stat. § 290.01, subd. 7b(a)(2).

24 For resources available on the due process and commerce clause, see *supra* note 20.

25 See *supra*, note 7.

26 *Id*.

27 Mich. Comp. Laws § 206.51(7); Michigan RAB 2015-15. Note, however, that not all states follow the federal rules for grantor trust purposes. For example, up until 2013, Tennessee did not recognize revocable trusts as grantor trusts and required the filing of an income tax return to report trust taxable income.

28 See Mich. Comp. Laws § 206.36(2).

29 This can be done by checking the box "This is the final return" on the first page of MI-1041. A link to the 2017 MI-1041 can be accessed at the following link: https://www.michigan.gov/documents/taxes/MI1041_Book_609426_7.pdf. Note, there is a specific Michigan Treasury Form called "Statement to Determine State of Domicile," Form 3799, which some tax preparers have considered filing on behalf of trusts when a change of domicile occurs. Although the Form 3799 specifically states it applies to individuals, query whether filing such form with the final MI1041 supports the Trustee's position that domicile in Michigan has concluded or alternatively, raises a "red flag" for audit of the final return because the form is not required.

30 See Mich. Comp. Laws § 556.115a, et seq. (Michigan's decanting statute) and Mich. Comp. Laws § 700.7820a, et seq., (Michigan's power of appointment statute). But query whether utilizing Michigan's decanting or power of appointment statutes creates a "purposeful availment" argument for Michigan Treasury that the Trustee is establishing a residency contact or nexus in Michigan because of the utilization of Michigan's laws.

31 This strategy is not without risk, however. Separate from whether it will pass muster from a state income tax perspective to shift trust nexus, there are potential federal income tax consequences associated with the practice of toggling grantor trust status off and on. A discussion of this issue is beyond the scope of this outline; however, see generally, Treas. Reg. §1.1001-2(c), Example 5; *Madorin v. Comm*. 84 T.C. 667 (1985); Rev. Rul. 77-402, 1977-2 C.B. 222. Moreover, multiple toggles off and on is a "transaction of interest" to the IRS and subject to specific and detailed reporting requirements under Treas. Reg. §1.6011-4(b). See I.R.S. Notice 2007-73; 2007-2 C.B. 545.

32 See *supra* note 17.

33 There are many private letter rulings that confirm a properly structured ING trust will work under these jurisdictions. For example, see I.R.S. P.L.R. 200148028 (Nov. 30, 2001), I.R.S. P.L.R. 200247013 (Nov. 22, 2002), I.R.S. P.L.R. 200612002 (Mar. 24, 2006), I.R.S. P.L.R. 200502014, (Jan. 1, 2005), I.R.S. P.L.R. 200637025 (Sept. 15, 2006), I.R.S. P.L.R. 200647001 (Nov. 24, 2006), I.R.S. P.L.R. 200715005 (Apr. 13, 2007), I.R.S. P.L.R. 200729025 (July 20, 2007), I.R.S. P.L.R. 201310002 (Mar. 8, 2013), I.R.S. P.L.R. 20141001-201410010 (Mar. 7, 2014), I.R.S. P.L.R. 201430003 (July 25, 2014), I.R.S. P.L.R. 201430007

(July 25, 2014), I.R.S. P.L.R. 201510001-201510008 (Mar. 6, 2015), I.R.S. P.L.R. 201550005 (Dec. 11, 2015), I.R.S. P.L.R. 201613007 (Mar. 25, 2016), I.R.S. P.L.R. 201636027-201636032 (Sept. 2, 2016), I.R.S. P.L.R. 201642019 (Oct. 14, 2016). However, be careful about drafting a distribution power that would constitute a reversionary interest in the Settlor. This can easily "ding" your purported ING by killing the non-grantor trust treatment of an ING under I.R.C. § 673. See I.R.S. P.L.R. 201426014 (June 27, 2014).

34 See Treas. Reg. § 25.2511-2(b).

35 While the author is still trying to develop his ING Trust form, see I.R.S. P.L.R. 201310002 (Mar. 8, 2013) and I.R.S. P.L.R. 201430003 (July 25, 2014) for helpful summaries on key features for the design of an ING blessed by the I.R.S. Note, however, that private letter rulings may only be relied upon by the taxpayer to whom they are issued and are not legal precedent for other taxpayers.

36 An entity can be a Settlor of a Trust. See Restatement of (Third) Trusts, § 3, cmt. e.

37 For example, see Mich. Comp. Laws § 700.7809(1)(a), where the Trust Protector is a fiduciary, unless the terms of the trust provide the trust protector acts in a non-fiduciary capacity under certain circumstances, e.g., a power to substitute assets of equivalent value under I.R.C. § 675(4). This issue is beyond the scope of this article, but query whether the last sentence of Mich. Comp. Laws § 700.7809(2) stating that the Trust Protector cannot be relieved of the duty of good faith and the duty to act in accordance with the terms and purposes of the trust and interests of the beneficiaries, effectively swallows the exception that a Trust Protector can act in such a non-fiduciary capacity.

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

NON PROFIT
U.S. POSTAGE
PAID
LANSING, MI
PERMIT NO. 191

Jackie J. Cook
Chairperson

James H. Combs
Vice Chairperson

William C. Lentine
Treasurer

Andrew W. MacLeod
Secretary

Mindi M. Johnson
Editor