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STATE AND LOCAL TAX NEWSLETTER

Business Strategists & Certified Public Accountants *2008-23*

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EHTC STATE AND LOCAL TAX SERVICES

INCOME & FRANCHISE TAX

Tax Minimization Studies

Tax Planning for the Michigan Business Tax

GRAND RAPIDS, MI – Monday, June 16, 2008 – A substantial part of my practice at EHTC involves tax planning. The firm has excused me from compliance work, which is tax preparation. What this means is that I can really focus on the planning aspect of state taxes.

With the Single Business Tax (SBT) gone and the Michigan Business Tax (MBT) not a year old yet, tax planning has slowed down. However, in just the last two weeks I have been presented with many tax planning opportunities from some very unusual sources.

For example, I'm in the process of looking for a builder to construct a cottage. One builder I talked to wanted me to purchase the material. I asked why. He said to avoid the MBT. I have, in recent days, heard of tax planning techniques from realtors, contractors, developers, retailers, insurance agents and others. It is true; the complexity of the MBT opens the door to some very unique tax planning ideas. The purpose of this newsletter article is to sound a warning to anyone who may be tempted to try out some of the ideas that are being circulated.

The experience with the SBT has taught us many lessons. The complexity of that tax opened the door to a significant number of tax planning techniques. However, I have see many tax plans that did not have economic substance, business purpose, were poorly thought out, improperly implemented, lacked documentation, or were simply a bad idea.

I spent a lot of time doing follow-up studies on SBT plans that were not done right for various reasons. Fortunately, most of the time the corrections were made before the disaster of a state tax audit. A lot of the other cases are now in litigation. A well thought out tax plan, combined with effective implementation and follow-up can, and will, assure a desirable outcome.

When involved in tax planning, it is very important to recognize and distinguish between *avoiding* taxes and *evading* taxes.The first is legal, the latter is not.

Tax avoidance involves arranging personal and business, financial and investment, matters to legally minimize taxes. Investing in municipal bonds is a legal way to avoid tax on interest income.

Tax evasion involves arranging personal, business, and legal documents and transactions to hide or disguise the true character of a transaction. An abusive tax shelter is an example of illegal tax evasion.

The concept of tax avoidance or tax planning is to legally reduce tax liability and preserve monetary assets. Tax court opinions have suggested tax *avoidance* can be defined as falling short of tax *evasion*. It is imperative that tax practitioners and their clients avoid rising to the level of tax *evasion*.

How Do the Courts Interpret Tax Planning?

Judge Learned Hand of the United States Supreme Court opined in his 1935 opinion in *Helvering v. Gregory* that "any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."

Other U.S. Supreme Court opinions have distinguishing tax avoidance from tax evasion based upon two key elements. Those elements are economic substance and business purpose. Both elements must be present to escape the tax evasion realm. Essentially, if a transaction is created entirely to reduce tax liability or has no business foundation, it is likely to be considered tax evasion.

Ethical Tax Planning

Tax planning is a legal method of reducing taxes. However, ethical issues may come into play. Individualshave various ethical standards, and these may create uncomfortable decisions for those working through tax situations and planning. When Jimmy Carter was President of the United States, a combination of investment tax credits and accelerated depreciation from his family peanut farm eliminated his entire tax liability in one year. Because of ethical considerations, he wrote a contribution check to the IRS in the amount of $10,000.

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A Recent Controversal Issue Involving Patenting Tax Planning Strategies

Recently, Congress discussed issues relating to the patenting of tax advice. Tax practitioners have requested patents from the U.S. Patent and Trademark Office for the various tax tactics they have utilized. The U.S. Patent and Trademark Office has issued several tax planning patents and more are pending. Many consider the act of patenting tax advice morally wrong since it does not benefit the taxpayer, which is the sole purpose of tax planning.

Elements of an Effective MBT Planning Technique

Up Front Planning

Tax planning for the MBT, as it was for the SBT, is best done with a team effort. The key members of the team are the CPA and the attorney. The CPA can crunch the numbers, develop several alternatives, and determine the most effective tax strategy. The CPA and the attorney can research the tax law to find support for the approach desired. The attorney is essential in the documentation of the transactions intended. Other professionals in insurance, employee benefits or banking may be an essential part of the tax plan. It is important that anything suggested for tax planning purposes make business sense.

Adaptability

Many tax plans fail out of the box because they just don't make sense.That is why the CPA/attorney team approach is essential. The CPA and the attorney provide a cross check against each other. The tax plan must fit into the normal business operation and must make sense from a pure tax point of view. In other words, do the research before you get started.

Implementation

Some very good tax plans fail because of incomplete or omitted implementation. I remember a great tax plan that saved a company hundreds of thousands of dollars. When the state auditors came in to audit the SBT returns, we pulled out the legal documents. To our surprise, they were never signed. We can all remember "S" elections that were never filed. On another case, that involved moving employees from one entity to another, no one informed the employees. A lot of damage control was necessary.

Follow Up

Tax laws are constantly changing. Every tax plan must have an exit strategy. What may work now may not work in the future. The tax laws may change. The Department of

Treasury may issue or revoke a promulgated rule, bulletin or ruling. The courts may, as they have in the past, reverse Treasury rulings or may impose rules of their own. Sometimes the business may change. After the effective implementation of a tax plan, it is very important that the plan be revisited on no less than an annual basis to make sure everything was done correctly and no changes have occurred.

I have spent most of my career in tax planning. It is the most demanding part of tax practice because it requires a multidiscipline approach to a problem. The tax planer must be creative and must consider the accounting, legal, and business aspects of the project. If you drop the ball on any front, the result could be disastrous.

Stay tuned for more news and follow the MichiganStateAndLocalTaxBlog for information as it becomes available. It you have any questions, please go ahead and contact me. I will be happy to be of assistance.

Sincerely,

Ed Kisscorni, CPA/MBA

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