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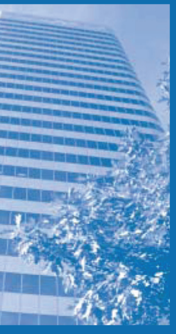
Business Law Newsletter



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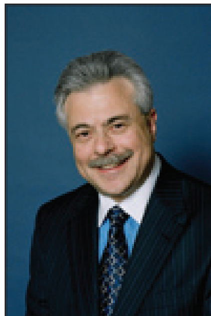
TAX LAW
FIN 48: Will it be the Feared Road Map for IRS?
by Ronald A. Feuerstein, Esquire



What is FIN 48? - FIN 48 stands for Financial Accounting Standards Board ("FASB") No. 48, Accounting for Uncertainty in Income Taxes.

When is FIN 48 effective? - While FIN 48 was issued in July 2006 effective for fiscal years beginning after December 15, 2006, it was at first only applicable to public companies. However, non-public companies are subject to FIN 48 for fiscal years beginning after December 15, 2008. Therefore, for instance, all calendar year non-public entities that issue GAAP Financial Statements will be subject to FIN 48 for their 2009 Financial Statements.

What does FIN 48 cover? - FIN 48 applies to all income tax positions and also including decisions not to file an income tax return, allocations among various taxing jurisdictions and characterizations of income. While another FASB, No. 109, exists for income taxes, FIN 48 was designed to provide consistent application of FASB 109.

The broad application of FIN 48 is impressive and may be somewhat surprising to many in that it applies to all types of non-public entities, not just C corporations. Its coverage includes all pass-through entities, such as general or limited partnerships, S corporations, LLCs, tax-exempt entities, sole proprietorships and single member LLCs. The key is GAAP Financial Statements. If your entity issues a GAAP Financial Statement, the company is generally subject to FIN 48.

FIN 48 will require thorough analysis, conclusions and documentation of all income tax positions. In many instances, this will result in entities having to add substantial amounts to tax reserves.

The new FIN 48 concepts involve: (1) Recognition, (2)

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Measurement and (3) Penalties and Interest.

A first step in analyzing FIN 48 will be to prepare a thorough inventory of all tax positions. Significantly, FIN 48 requires a conclusion that all or part of a tax position is more-likely-than-not sustainable, solely based on technical merits. The risk of detection or audit by tax authorities cannot be considered as a factor.

FIN 48's initial recognition factor must derive from the weight of relevant tax law authorities, including judicial doctrines, existing as of the reporting date, without any offset for other positions and assuming resolution in the highest court. FIN 48's reach includes state and local tax positions, including the often thorny issues of nexus, currently a hot button topic for most states' taxing authorities. The sweeping breadth of FIN 48 also includes foreign/international tax positions, including Internal Revenue Code section 482 transfer pricing.

In applying FIN 48's Measurement component, the recorded tax benefit will equal the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority. This determination must be made based upon management's experience in similar matters, management's plans for settlement, appeal or litigation, available documentation and expert advice. Non-filing positions (encountered most often for various states) are subject to an all or nothing test, which if not met, will require recording the entire exposure, unless apportionment is possible and chosen.

Under FIN 48, applicable Interest and Penalties must be accrued. Treatment of Penalties themselves will involve significant judgment and may entail reliance on tax counsel and potential waiver of privileged advice.

While FIN 48 does not require opinions from outside tax counsel, such may be necessary or advisable. Advice from outside tax counsel regarding FIN 48 positions will no doubt raise issues of attorney-client privilege or the Federally-authorized tax practitioner privilege.

Conclusion and Recommendations

If your non-public entity, including pass-throughs and nonprofits, issues GAAP Financial Statements, talk with your CPA and tax counsel to discuss FIN 48's impact. Given the sweeping application of FIN 48, it will likely provide the IRS with valuable information leading to more audits, with taxpayers being on the defensive much more. In the event your entity has uncertain tax positions, you would be well advised to prepare for FIN 48's new world. Your outside tax counsel can work as a team with your CPA to achieve the best results in order to assess and reduce tax risks.

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One More New Year's Resolution

by Jonathan C. Kinney, Esquire

Congress failed to act on estate tax legislation this year. Despite expectations throughout the 2009 calendar year by most estate planning commentators that Congress would act in some form or fashion, this did not happen. Congressional leaders indicate that they intend to retroactively reinstate estate taxes with an effective date of January 1, 2010. However, given the divisions in December that we saw in the Senate, we have become particularly concerned that it may not be possible to obtain a 60 vote majority on any plan involving estate taxes.

We urge you, either as part of your New Years' resolution or just out of caution, to review your estate plans immediately. The repeal of the estate

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tax may cause results that are totally unintended when you drafted your will and/or trust. By necessity, many wills and trusts have used formulas to determine how distributions are to pass to a spouse, children and grandchildren. Sometimes, for example, the will or trust has language that provides something to the effect "the largest amount that can pass free of federal estate taxes." With estate tax repeal, language of that nature may contradict the client's intent; with estate tax repeal the parties most likely to be effected by language of this nature are spouses who might see their inheritances either reduced or eliminated.

Most commentators still expect a retroactive "fix" to this matter in 2010, it is likely that any retroactive tax legislation will be challenged on constitutional grounds even if legislation can get through the Senate.

Effective January 1, 2010 estate, gift and generation skipping taxes are as follows:

1. Federal estate and generation skipping taxes are repealed;

2. $1 Million lifetime gift tax exemption, 35% rate;

3. Limited stepped up basis of estate assets (prior to January 1 all assets in an estate were stepped up to current market value); and

4. Limitation of $1.3 Million (plus $3 Million for surviving spouse) on the stepped up basis. Otherwise a beneficiary will receive the deceased basis in the property being conveyed.

What happens in 2011? Unless action is taken, estate, gift and generation skipping tax rates are scheduled to increase to 55%. The exemption (which had been at $3.5 Million in 2009) will be reduced to $1 Million.

It is extremely important that you review your estate plan immediately to see if the funding schedule in your estate plan is consistent with your wishes based on the possibility that Congress will be unable to act on estate tax changes during 2010.

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Feeling the Effects of Someone Else's Filing?

by Thomas. W Repczynski, Esquire

Bankruptcy isn't always an option, but more and more these days, it is the only option for many – consumers and businesses alike. Consumer filings and business filings (even farmer filings) are all up……way up!

First, a look at the numbers. According to the official filing statistics as recently reported by the American Bankruptcy Institute (ABI) (ABI Press Release, 11/25/09), there were nearly 400,000 bankruptcies filed during third quarter of 2009 representing a 33 percent increase over the same period in 2008. Total filings for the first nine months of 2009 were up 35% over the last year to over 1.1 million. Business bankruptcies in the first three quarters of 2009 already exceeded all of 2008. Some perspective? The more than 1.4 million filings for the 12-month period ending September 30, 2009 (the end of the third quarter), reflects a filing rate of more than 1 in every 250 Americans. Business filings over this same period were up more than 50% over the prior year.

As 2010 gets underway, more individuals and businesses, than ever before, are dealing with the effects of bankruptcy filings; either their own or those with whom they do business or have other financial dealings. If you are in this latter group, you should not simply throw in the towel if you receive notice of another's bankruptcy filing (i.e. because you are a creditor). Usually with very little additional investment, you can protect your fair

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share of whatever assets remain.

A bankrutcy filing does not necessarily mean you will get nothing. True, a "Chapter 7 liquidation" proceeding often produces no payments for a debtor's unsecured creditors, but these cases often do include a payment for creditors who are diligent in tracking and participating in the proceedings. For instance, in one recent case, husband and wife debtors had substantial business relatied debt owing to personal guarantees they had extended to their business creditors.

With a "Chapter 7 reorganization" proceeding (a consumer filing with a repayment option) it is presumed that the debtor's creditors will be receiving some sort of payment, but not if they fail to take basic action. The debtor's plan spells out the basics and even provides a percentage estimate as to how much unsecured creditors can expect. This figure is only an estimate, however, and is very often understated because creditors fail to take even minimal action to protect their claims.

The moral of the story? Don't look a potential gift horse in the mouth. Absent a debtor's bankruptcy filing, collection may have been time-consuming, unsuccessful, and, more often than not, even cost prohibitive. The bankruptcy debtor sees a "fresh start" ahead. Treat the debtor's bankruptcy as an opportunity, and make the most of it! Sometimes it will actually work to your advantage and pay off.

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