REID AND RIEGE, P.C.
COUNSELLORS AT LAW

Tax

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For many of us in the tax profession, a new year usually means the prospect of new tax laws. The Tax Reform Act of 1986 reversed a long-standing trend of federal income taxes of corporations being significantly lower than those of individuals. In addition, the treatment of ordinary income and capital gains changed such that it no longer mattered whether a business owner received long-term capital gains or dividends. Finally, the 1986 Act introduced the concepts of passive activities, portfolio income and other structural overhauls to make tax law “simpler” and, therefore, “fairer” to taxpayers.

The traditional C corporation that permitted income tax deferral of business profits to the extent of the previous income tax differential was replaced by the objective of avoiding a layer of tax with pass-through entities. The result was that many corporations attempted to transform themselves into pass-through entities, such as publicly traded partnerships, and Congress was quick to act with the Revenue Act of 1987 to categorize these partnerships as taxable like corporations. Since then, there have been nearly a dozen major modifications amending the 1986 Act in an attempt at simpler and fairer. The reality is that there are many tax traps out there, unintended consequences and the necessity for extensive tax planning and complicated tax provisions to keep pace with the speed of these changes.

Choice of Entity

When comparing the types of entities, the following factors need to be included in the discussion: (i) what are the federal income tax consequences between the various entities (e.g. entity level of tax versus pass-through and types of pass-throughs); (ii) tax treatment for the owners, including whether pro-rata distributions as opposed to special allocations are appropriate; (iii) FICA, FUTA and self-employment tax issues; (iv) retirement options with tax-free deferral and/or growth; (v) state-to-state income, franchise and other entity level taxes; (vi) type of income being generated and potential ramifications to the entity and/or owners; (vii) ability to use income, gain, loss and deductions; and (viii) a variety of other tax planning opportunities (e.g. family businesses and the relationship between the generations). In short, the form of entity is not dispositive of the ultimate tax treatment at the federal and state level; this

necessitates the trained professional to work through these issues with clients so that the risk of managing through the minefield of tax traps can be mitigated. Given the ever changing nature of tax law, the tax lawyer's role in establishing the entity and its operation is just the beginning.

Legal Representation

The regulatory nature of tax law is administered at the federal level by the Department of the Treasury and its enforcement arm, the Internal Revenue Service, and each state has its own agency or agencies administering its tax law; here in Connecticut it is the Department of Revenue Services. Reid and Riege regularly represents clients before the IRS and DRS on audits, and has the capabilities to take any matter through the administrative appeals process, up through the U.S. Tax Court, and through the Federal Court system. Reid and Riege lawyers have produced successful results for its clients in all these forums. In addition, we are often called upon to seek "informal" guidance from the IRS through the issuance of Private Letter Rulings in those instances where the law is ambiguous. Finally, through the issuance of a Power of Attorney, we are able to step in and represent clients' and their tax positions with the protection of the attorney-client privilege.

Tax Classification, Reporting and Filing

The question of how an entity (and its owners) would be taxed was actually "simplified" by the introduction of the "check-the-box" rules that introduced an elective regime. Accordingly, a single owner venture would, without an election, default into a disregarded entity and be taxed as a sole proprietorship. In the alternative, the single owner could elect that the venture become a taxable entity as an unincorporated association taxable as a corporation (that corporation could then make an S election). When two or more owners of an unincorporated entity venture together the default classification would call for partnership treatment. The entity could also elect to be treated as an association taxable as a corporation that still exists in our flow-through world; for example: when a multi-member limited liability company is doing business in all 50 states that may require the filing of non-resident returns for all those "partners" at the state level. An incorporated entity was taxable at the entity level and then a second time upon a distribution to its shareholders. Incorporated entities could file an S election in order to bypass the double-layer of tax.

Reid and Riege works with clients' other professionals with respect to

such decisions as tax elections, choice of taxable years, tax accounting, special allocations, choices of methods of accounting, alternative minimum tax, estimated tax payments and tax return filing requirements.

Conclusion

The Tax Group's largest client is the firm itself. The Group works with business lawyers on issues of choices of entities, formation and operation, as well as taxable and/or tax-free transactions. We are intimately involved with decisions involving capitalization, working with commercial and transactional lawyers in structuring and determining levels of equity, debt and various hybrids. Tax issues are found in issues involving employment law and general corporate matters. Finally, the Tax Group is also called upon to work outside the Business Law Practice Area with respect to issues of pensions and profit sharing arrangements, trusts and estates, personal wealth planning, real estate transactions and financing, litigation and settlement agreements, health care and nonprofit law.