

TAX NOTES

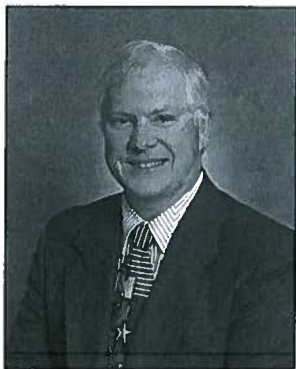
by C. Arthur Robinson II

FALL 2008

VOL. 3, ISSUE 5

S ELECTIONS FOR CORPORATIONS: *Relief is on the Way*

by: C. Arthur Robinson, II, Esq.



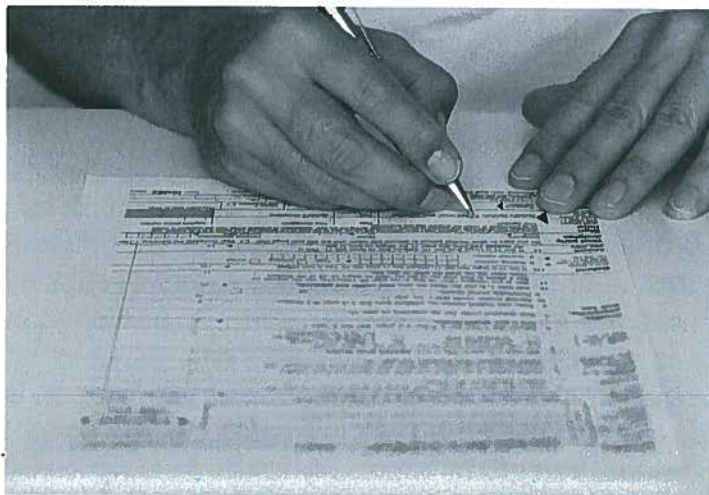
Quietly, over the last several years, we have seen a fundamental change from the Treasury Department with respect to what practitioners call “the choice of entity problem.” Some 15 years ago with the advent of limited liability companies, we saw significant changes in regulations which enabled individuals to make clearer choices about the tax treatment of their businesses and investments, and the degrees of freedom which were built into the law to choose the manner in which entities would be taxed became part of the structure of our law.

In recent years, we have seen this same development extended, to a significant degree to corporations which elect to be taxed under subchapter S of the Internal Revenue Code. An S corporation is treated for most tax purposes as a pass-through entity so that taxes are paid by the individual owners rather than the corporation. This tax structure can be highly favorable in many circumstances. This pass-through treatment option should be carefully considered by a business owner or for an owner making an investment.

Tax law is often driven by highly technical provisions which are mechanical in application. The S corporation election has for many years been a fairly typical example of a mechanical function. Specifically, when making the election, various time periods will apply mechanically and as

bright line standards, and this could cause a trap for the unwary taxpayer who fails to follow the “mechanical” time requirements.

In recent years, through a series of Revenue Procedures, the Internal Revenue Service has liberalized the procedures regarding S elections and has provided relief with respect to elections which are not filed within the statutory time frame. While there are some limitations to this relief, they give the Internal Revenue Service broad latitude in the circumstances where a taxpayer has inadvertently failed to file their S election but has reasonable cause for failing to do so.



This relief provides the opportunity to submit a request for relief to recapture results, which through inadvertent mistakes, would previously have been lost. As a result, it is possible under the current law to obtain S corporation status despite the failure to timely elect S status if there is some reasonable basis for the delinquency and it was

COPING WITH UNCERTAINTY: *The Perfect Storm of Fear and Greed*

by: **C. Arthur Roblnson, II, Esq.**



The last 12 months have been a remarkable time from a tax perspective. There have been significant changes in the law affecting financial and estate planning as well as fundamental economic changes.

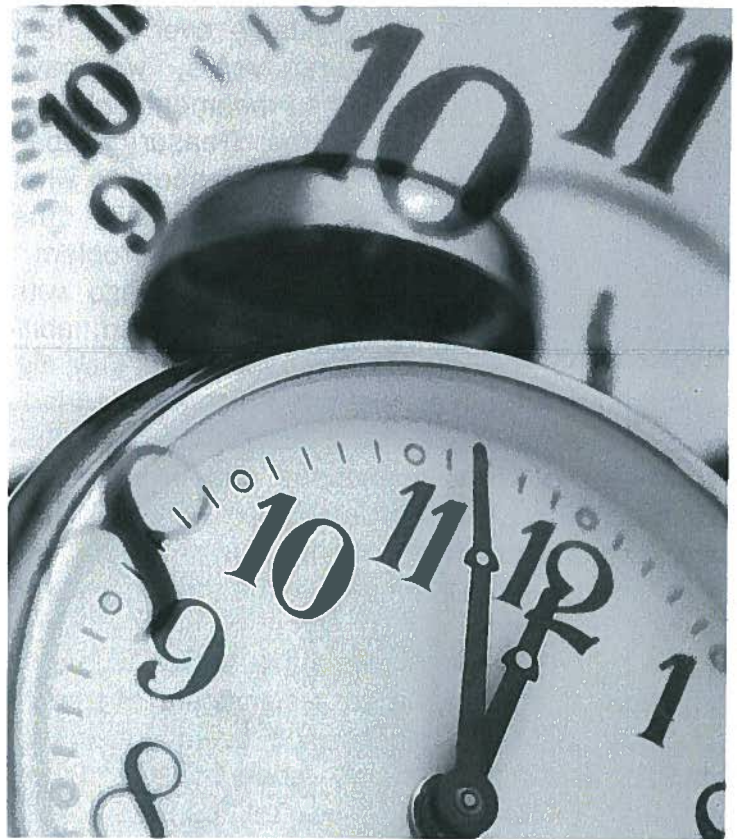
Most recently, the financial markets reacted to a credit crisis which was precipitated by a confluence of events, each of which viewed individually over the last 10-20 years were intended to be beneficial, but collectively have created risks which triggered significant failures in our financial and capital markets.

The trying financial times we are experiencing, have been driven by both greed and fear. The sub-prime lending phenomenon, which began several years ago and accelerated drastically through the real estate boom of 2005-2006, is a perfect illustration of the kinds of problems which fear and greed can create. As a result of substantial new opportunities created by sub-prime lending, we ended up with a real estate bubble and collateralized debt obligations which entail significant and substantial risk which no one is able to properly quantify because these instruments are far from transparent. As a result, we have seen the collapse of real estate markets around the country, significant devaluation of property and catastrophic failure of lending institutions that could neither quantify nor deal with the risky investments which they unwittingly made.

This activity, which created the current predicament that we all find ourselves in, was driven largely by greed on a number of levels. Individual investors, especially in the feeding frenzy during the latter part of the real estate bubble, threw both caution and good financial sense to the wind, concentrated their risk and became overextended; and financial institutions, by virtue of being lenders to these individuals, both facilitated the

real estate bubble and the fallout from sub-prime lending which followed.

It is fascinating that emotional drivers clearly overrode what would otherwise be rational decision making in the financial markets. A well-executed financial plan which is properly diversified to ameliorate risk has proven over a very long time frame to be the very best investment strategy. Diversification outperforms all other investment strategies over the long term, especially if they involve any significant concentration in a given market sector or exposure to a given type of risk.



It is a perfect illustration of why planning at every level becomes important. Generally, people are not rational decision makers, rather we react emotionally and make decisions based on qualitative factors which sometimes bear little or no relation to a logically thought out strategy. It is especially important to have a sound strategy in times like these when we are facing the consequences of the latest cycle of greed and are now facing the stark



realization that in fact the excesses of the recent real estate run up and the sub-prime lending which facilitated it, have come home to roost.

It is possible to deal with trying financial times and the best strategy for doing so is to have planned and executed a solid financial strategy which involves appropriate financial planning, diversification among assets classes, appropriate planning documents and information, so that irrespective of what happens in the future, you are in a position to weather a financial storm.

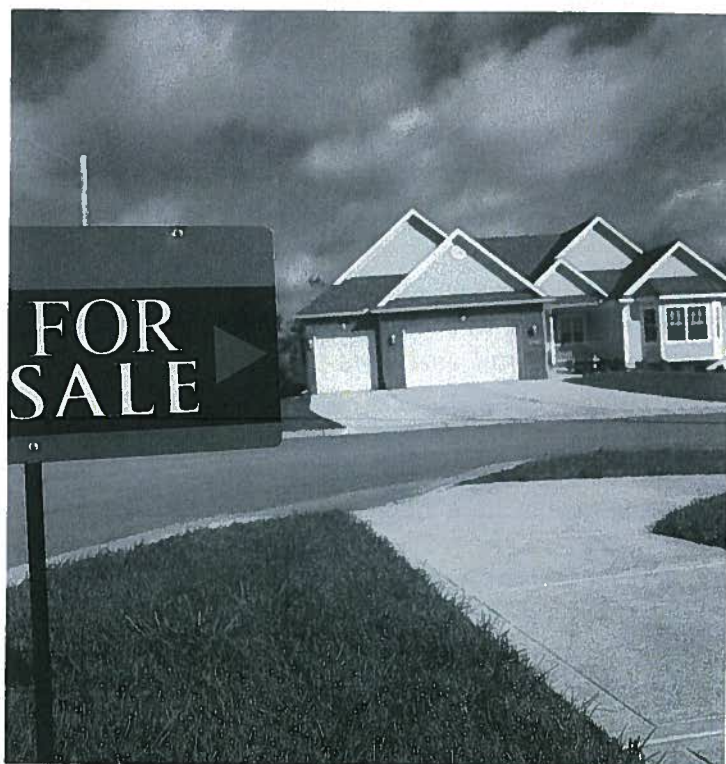
Clearly these times are both trying and painful. There is no doubt that fear can become an extremely powerful driver under the circumstances. The key is not to give in to the normal fear which is experienced by any one who watches their investments wildly fluctuate in value in the current uncertain financial markets.

Just as greed should not be a motivator and should not lead you to concentrate investments in any one sector, neither should fear drive the investment process. The importance of a well executed and thought out plan and the discipline to continue with the plan in the face of declines in value and the constant barrage of doom and gloom in the popular press, is an extremely difficult discipline to maintain. The long term results of such discipline is what matters. In times such as these when your emotions will send you false signals, just as they do on the other end of the cycle, where greed motivates investors to get into sectors which later prove to be problematic, you should take care to continue to execute a long term strategy driven by facts rather than feelings, and by logic rather than emotion.

Although it may be difficult to see the reward for this discipline in the short run, as a matter of historical fact through all of the economic cycles which have occurred in the last 100 years, the ability to persevere, act rationally in the face of both fear and greed, and carefully plan and then execute financial and estate planning goals, has historically rewarded the disciplined investors. There is no reason to believe that human nature or the financial

markets have changed in that regard with the last few years. The details of the current trying times are different from the cycles which have gone before, but the root causes remain the same. Those with the willpower to resist fear and greed will be thankful that they have done so. But the discipline required is, not easy.

We at Wolcott Rivers Gates can assist you in obtaining a global perspective which will help you weather the storm.



This article has been authored by C. Arthur Robinson, II, Esquire, who practices in the areas of tax planning and reformation, tax sensitive transactions, estate planning and estate administration. Please call Mr. Robinson at 757-470-5551 if he can be of any assistance to you with the matters mentioned in this article or any other matter within his areas of practice.



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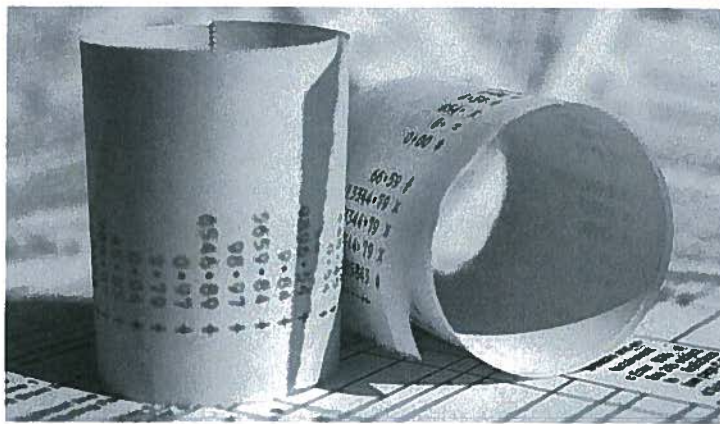
Relief is on the Way - continued

not intentional or amounted to willful neglect on the part of a taxpayer.

As is always the case with tax law, there are technical provisions and conditions which must be followed. However, this treatment is a liberalization rational and benefits taxpayers.

We at Wolcott Rivers Gates are very familiar with both the S election and the recent relief which has been provided by the Internal Revenue Service and welcome the opportunity to assist you.

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