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Subject: Matter of the Summons Issued to Ernst & Young, LLP
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To Our Clients and Friends:

Attached is a copy of a recent North Carolina Court of Appeals ruling, Matter of the Summons Issued to Ernst & Young, LLP, No. COA07-1219, August 5, 2008. The case is illustrative of the danger taxpayers face with respect to the potential disclosure on audit of FASB Interpretation No. 48 ("FIN 48") workpapers.

By way of background, FIN 48 interprets FASB Statement No. 109, and requires taxpayers to analyze their uncertain income tax filing positions and disclose certain potential tax liabilities on their financial statements. A taxpayer's FIN 48 workpapers generally describe in detail the taxpayer's most vulnerable tax filing positions, and highlight weaknesses in such filing positions.

FIN 48 disclosures and workpaper details may serve as a roadmap for tax authorities in a corporate tax audit. At a minimum, FIN 48 reserves mitigate a taxpayer's negotiating leverage with respect to the taxpayer's vulnerable tax filing positions. Moreover, with information sharing, FIN 48 information obtained through an audit inquiry may end up in the hands of multiple taxing jurisdictions.

In this regard, taxpayers are closely monitoring two federal cases (Textron and Regions Financial) that address whether company workpapers are within the purview of IRS scrutiny. While each taxpayer won at the district court level, the IRS has appealed both cases. It remains to be seen whether these cases will ultimately provide taxpayers with any protection against FIN 48 workpaper requests at the state and local level, especially since the cases are fact intensive and address years prior to the adoption of FIN 48.

The attached case addresses whether documents prepared by the taxpayer's accountant relating to tax restructuring are protected as privileged or subject to the state's summons. The case analysis is mostly procedural, and the matter was remanded back to the trial court for further evaluation. Nevertheless, the case foreshadows what may become a crucial point of contention (i.e., whether FIN 48 workpapers are discoverable by the states) once tax years subsequent to the adoption of FIN 48 hit the audit cycle.

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If you have any questions regarding the state and local tax implications of FIN 48 to your company, or any other state and local tax matters, please do not hesitate to contact me.

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