

Tax-Related Developments And Reporting Requirements To Address Now

Although 2009 is now behind us, there are tax-related items that either need attention before the end of this month or need to be considered by your company for 2010.

1. ISO / ESPP Reporting Requirements

Employers must report the exercise of options by employees pursuant to an ISO



("Incentive Stock Option) Plan or ESPP ("Employee Stock Purchase Plan") to those employees (but not to the IRS) on or before *January 31, 2010*.

Reportable information for ISOs includes the name, address and employer ID of the transferring corporation and of the company whose stock is transferred; the name, address and partial social security number of the transferee; the date of the ISO grant; the price, date, and fair market value of the stock at exercise; and the number of shares transferred.

For ESPP transfers, if the purchase price was less than fair market value on the grant date

or was not determinable on that date, then the written statement to the employee must include the name, address and social security number of the transferor; the name, address and employer ID of the corporation whose stock is transferred; the date of the grant of purchase right; the fair market value of the stock on the grant date; the price at which the shares were purchased under the ESPP; if the price per share is not fixed or determinable, the price per share determined as if the shares were purchased on the grant date; the date the shares were purchased by the transferor; the fair market value of the shares on the date of purchase by the transferor; the date legal title was transferred; and the number of shares to which legal title was transferred.

2. IRC Sec. 409A Status / Remedial Program

Internal Revenue Code §409A is now in full effect and the Service has begun auditing private companies for compliance. The penalties for non-compliance are severe in 2010 under the recently promulgated IRS Notice 2010-6.

However, the Service has recognized that there are still many compensation programs that do not conform to §409A and are allowing certain remedial actions. You should review those programs to determine whether any further action is appropriate to bring your company in compliance.

3. Estate and Gift Tax Update / Capital Gains Exposure

It appears that the Federal Estate (and Generation Skipping) Tax will not apply in 2010. The House Ways and Means committee chairman has indicated that the issue of replacement estate tax legislation will not be passed until later this year and Congress will not attempt any retroactive application.

It is important to note, though, that capital gains taxes may be applied to inherited assets. Under the pre-2010 approach, the tax basis of the inherited property generally was its fair market value at the date of the decedent's death (basis step-up). This was a major benefit to any beneficiary of estate distributions. However, because of the removal of the estate tax, as of January 1, 2010, the tax basis of an inherited asset will be the same as it was in the hands of the decedent. The gift tax continues to remain in effect in its pre-2010 form and the exemption of \$1 million remains the same along with the marginal tax rate of 35%.

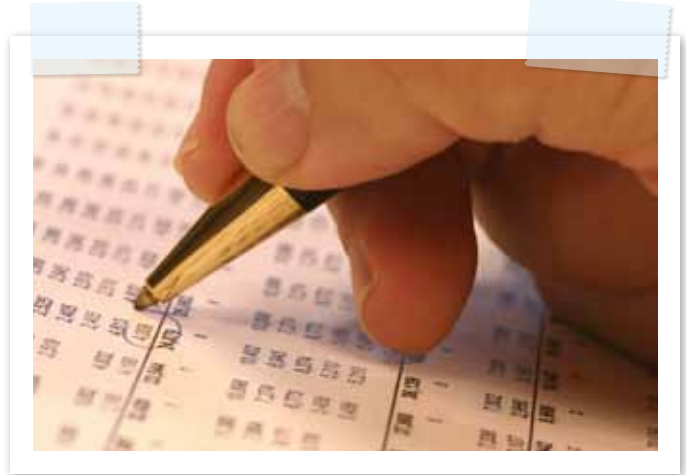
For the immediate future, it would be wise to document the basis of any significant, potential estate assets. The outlook for new legislation is murky for now, but there will likely be a new law in place for 2011. It is widely believed that new exemption levels will be set at \$3.5 million per decedent.

4. IRS Employee Audits – New Emphasis in Early 2010

The IRS has begun an extensive audit examination process that will be ongoing throughout 2010 reviewing the employee/independent contractor classification of workers. Failure to properly classify an individual service provider could result in the assessment of additional withholding, FICA and FUTA taxes; require their participation in other employee

benefit programs; and give rise to penalties for failure to withhold sufficient payroll and trust taxes. The audits will begin in February of this year and will involve approximately 6,000 U.S. employers. If you “employ” any “independent contractors” you should have your payroll practices reviewed.

You should also be aware that

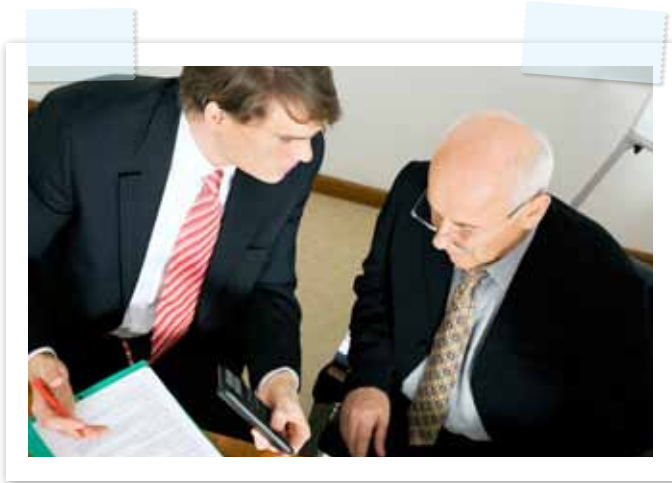


Massachusetts has a very strict definition of employee that severely restricts the characterization of any individual service provider as an independent contractor.

5. FIN 48 Tax Disclosure Requirements

FIN 48 – Accounting for Uncertainty in Income Taxes, now applies to private companies. One of the primary goals of FIN 48 is to require companies to make fairly detailed disclosures relating to their tax positions. It is intended to decrease the abilities of some companies to manage earnings through tax reserves and increase investor awareness of tax risks that were previously unknown. The FIN 48 work papers may be subject to discovery by the IRS and other tax authorities. Those work papers may provide tax authorities with a roadmap to the company's most vulnerable tax positions and to the company's evaluation of the legal merits and settlement prospects for those positions.

An important collateral issue is the necessity for, and the extent of, involvement by a company's board of directors in the evaluation of FIN 48 disclosures and an understanding of the standard "substantial authority" to support



the FIN 48 disclosures. The FIN 48 analysis is not one that is made solely by the company's accountant but one that will be the responsibility of the entire board.

You should immediately discuss with your accountant how he or she intends to deal with this issue

6. Director's Duty to Withhold Income Tax

A recent Court of Appeals case (*Erwin vs. United States*, January 13, 2010) emphasizes the danger of a director becoming too involved in the day to day operational responsibilities of running a company. A director should always be wary of inserting himself (or the Board) in the prioritization of payment of outstanding liabilities, especially when the IRS is a creditor. One can all too easily become a target for the IRS (defined in the Code as a "responsible person") if the company defaults on its withholding and trust tax payment and become personally liable for those payments, and so care should be

taken in establishing the contours of directors' responsibilities.

7. New Revenue Recognition Rules

In the technology or biotechnology industry or even business conducted by many standard equipment manufacturers, hardware, software and professional services may be sold together as part of a single customer arrangement

New accounting rules that will be transitioning through 2010 and which will be fully in effect by 2011 allow the independent pricing and separate revenue recognition of the various elements of what has been previously viewed as a consolidated transaction. You should check with your accountant to see how these rules may impact your financial reporting requirements.

8. Transfer Pricing Considerations

Any U.S. company with foreign subsidiaries needs to become increasingly sensitive to commercial and corporate transactions with those subsidiaries. The transfer of technology to a foreign subsidiary is often times treated as a sale of the technology requiring the parent to recognize phantom income. You should review intercompany loans, loan guarantees, etc. to avoid unpleasant tax consequences. This is an area of increasing scrutiny by the IRS and one that may also be significantly altered in the near future as a possible revenue enhancement scheme for the federal government.

This is a summary of some of the issues we believe are important to consider for the new year.

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