

November 2, 2006

ALERT: Expanded reporting requirement for S corporations, partnerships and limited liability companies requires Schedule M-3 for 2006 returns

Effective for tax years ending December 31, 2006 or later, the following types of business entities will be required to provide more extensive information on their 2006 tax return through completion of Schedule M-3, "Net Income (Loss) Reconciliation."

- S corporations with assets of more than \$10 million
- Partnerships and limited liability companies (LLCs) with assets of more than \$10 million OR total receipts of \$35 million or more
- Partnerships and LLCs with assets of less than \$10 million, but which are owned 50% or more by partners required to file Schedule M-3

Our records indicate that your assets equal or exceed \$10 million; thus, you will be required to file tax Schedule M-3 for your 2006 returns. The current Schedule M-1 that it replaces simply reconciles your financial accounting income or loss with your taxable income or loss reported on Form 1120. For those required to file Schedule M-3, you may also have to complete Form 8916-A, "Reconciliation of Cost of Goods Sold Reported on Schedule M-3." Schedule M-3 and Form 8916-A are intended to identify and resolve potential audit issues more promptly by providing the IRS with additional details about differences between your tax and financial reporting.

The detail of transaction-level reporting required for the Schedule M-3 significantly increases the hours required of your accounting staff to accumulate the information necessary to prepare your tax return, and will increase the time spent by your tax return preparer in organizing, reconciling and reporting that information. We will make every effort to keep the fee increases to a minimum, but this is a significant change to the tax-return preparation, and failing to accumulate and report the information accurately brings a risk of substantial penalties, even in instances where no tax is due.

For example, the Federal penalties for failure to disclose a reportable transaction are \$50,000 per transaction per year not reported, and a listed transaction is \$200,000 per transaction per year not reported.

If you have any questions about filing Schedule M-3, please contact our office at your convenience.

Note: Pursuant to federal regulations imposed on practitioners who render tax advice ("Circular 230"), we are required to advise you that any tax advice contained herein is not intended or written to be used for the purposes of: (i) avoiding tax penalties that may be imposed by the IRS, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein

This information is provided to you as a courtesy. It is not intended to be advice specific to your situation. For further guidance, please contact your AGH tax professional.

AGH endeavors to keep clients informed of changes in the financial and regulatory environment. However, we cannot be sure that all matters will be brought to the attention of all clients for whom the matter might be pertinent.