For at least the last two decades, law firms have continually expanded their operations across state lines (and national boundaries as well). Even with the current downturn, this trend may slow down, but it most certainly will not abate. Thus, much like any other multistate enterprise, today’s law firms have to confront the intriguing and difficult questions of the power of the several states to tax operations that extend across state lines. The controversy is magnified because these are no mere issues of rates and calculations; rather, they take on great significance because they raise constitutional questions. See Sabino, “For Whom The South Central Bell Tolls,” 189 Journal of Accountancy 73 (January 2000) (Alabama’s uneven taxation of an out-of-state enterprise violated Commerce Clause of the U.S. Constitution).

The U.S. Supreme Court recently added another crucial landmark on this constitutional quagmire, in the aspect of the “unitary business” taxation of a multistate enterprise. To be sure, this is only the newest in a long line of cases on the subject, but as such it makes fertile ground for discussion. With that in mind, let us turn to what the High Court now instructs us.

**The MeadWestvaco Corporation Facts**

The case is titled *MeadWestvaco Corporation v. Illinois Department of Revenue*, 128 S.Ct. 1498 (2008), and the opinion is authored by the High Court’s newest member, Associate Justice Samuel A. Alito, Jr. The unanimous opinion relates the following facts. MeadWestvaco is the successor of the Mead Corporation of Ohio, founded in 1846 as a paper, packaging, and school supplies manufacturer. Indeed, countless generations of American schoolchildren have carried around Mead notebooks. But the focus brings us to 1968, when Mead’s interest in acquiring a certain inkjet printing technology led it to acquire a smaller company. Included in the $6 million purchase price was an electronic information retrieval system developed for the U.S. Air Force.

In the first survey on this subject in 1993, law firms were almost evenly divided on prospective, retrospective, or combined approaches to when the compensation decision was made. Fifteen years later, a retrospective philosophy prevailed in 41% of the systems, while 35% adopted a mixed (prospective and retrospective) philosophy. The clear loser over time has been the purely prospective approach. This reflects a market-driven need to recognize individual performance more quickly in order to attract and retain quality people. It is too early to conclude if this trend will make firms more competitive in the long term, or possibly more fragile in a market dominated by shifting loyalties and an economy visiting shifting economic fortunes upon law firm practices.
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That supposed “throw in” turned out to be the far more valuable asset; over the years, Mead developed it into the now-ubiquitous LEXIS/NEXIS, well-known to the readers of this journal as a vital source of all types of legal and business data. Mead sold LEXIS/NEXIS in 1994 for $1.5 billion, and booked a handsome $1 billion in capital gains.

Mead did not report any of the gain on its Illinois tax returns for 1994, asserting that the money was non-business income, allocated solely to its domiciliary state of Ohio, and not taxable under Illinois’ own tax regulations. The tax officials of the Prairie State disagreed, issued a deficiency notice, and haled the taxpayer into Illinois state court.

Turning to the proceedings below, the Supreme Court relates that the controversy was subjected to a bench trial, and, most helpfully, the parties had put aside their differences to stipulate to most, if not all, of the pertinent facts. First launched in 1973, LEXIS initially lost money, but as more professionals began to use the latest electronic wonder, the service became remarkably profitable. Between 1988 and 1993 (the year before Mead sold LEXIS/NEXIS), the data retrieval service accounted for $800 million out of the $3.8 billion in income that Mead reported on its Illinois tax returns. Conversely, $680 million in business expense deductions was attributed to LEXIS, out of $4.5 billion in deductions Mead claimed to Illinois for those same tax years.

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Other facts pertinent to the case (and also benchmarks for future planning on this issue) reveal that LEXIS operated with a great deal of autonomy from its parent. Mead did not run LEXIS day-to-day from its Ohio headquarters; rather, the unit enjoyed a separate management team based in Illinois. Everything was separate; manufacturing, sales, and distribution operations, as well as (significantly) accounting, legal, human resources, credit, and marketing functions. Mead would bless its subsidiary’s annual business plan, approve extraordinary corporate transactions, and make a daily sweep of the unit’s cash into the parent’s bank accounts. But the dichotomy was such that Mead would lease new office equipment to LEXIS instead of buying it outright for the division. Finally, the gulf between the parent and subsidiary was such that LEXIS did not even buy its paper from Mead; ironic, since the latter has been primarily a paper company since before the American Civil War.

With regard to tax planning, LEXIS was incorporated as one of Mead’s wholly owned subsidiaries until 1980, when it was merged into the parent. Mead so engineered this change in order to exploit the division’s net operating loss carry-forwards. LEXIS was reincorporated separately in 1985, merged back into Mead in 1993, and then sold in 1994. Tax considerations motivated each and every one of these moves, and Mead also treated LEXIS as a unitary business on its consolidated Illinois returns for 1988 through 1994, albeit to avoid a lawsuit with an insistent state tax authority.

PROCEDURAL HISTORY

The Illinois trial court held that LEXIS and Mead did not constitute a unitary business, primarily because Mead and LEXIS were not functionally integrated, centrally managed, nor did they enjoy economies of scale. Nevertheless, the trial judge found that the unit factored into the parent’s strategic planning, particularly in the allocation of resources. Holding that LEXIS served an “operational purpose” in Mead’s business, the court ruled that Illinois could tax Mead’s entire LEXIS profits.

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Inventory Management

What Opportunities Remain?

By Bo Yancey

As many of us are painfully aware, the credit crisis in the financial markets has resulted in downstream effects for almost all businesses, both in the United States and abroad. Law firms have not been shielded from the downside. Not only have clients provided less work as the economic slowdown has worsened, but they have also been more reluctant to part with cash, and some have increasingly used vendors and accounts receivable as sources of financing. None of this is good news for law firms that measure both their income and profitability on a cash basis. Clients withholding payments directly impacts partners’ bottom lines. As such, law firms are always focused on billing and collecting as much as they can in the last quarter of the year. The current crisis has trumped even the most diligent efforts of law firms to bring in cash, and it illustrates the importance of having sound inventory management practices that are followed throughout the year.

Just how much of an impact was felt in 2008? At Redwood Analytics, we routinely collect and analyze data to monitor firm inventory management trends. At a high level, our benchmarking output does not appear to indicate anything to worry about. Collect speed, or the number of days between the date of billing and the date of collection, was stable compared to the prior year (57 days). The same goes for bill speed — both 2007 and 2008 reflected 55 days between date of work and date of billing. But analytics need to be taken past this high-level review. There’s more to the story.

Look Beneath the Trends

Taken in the context of today’s economy, perhaps it is concerning that the average bill speed is 55 days. First of all, 55 days on average leaves lots of room for improvement. Consider what 55 days means in terms of a normal billing cycle. As an example, consider an attorney who enters time for work on March 15. An efficient billing practice would reflect this time on an invoice in the first week of April, resulting in a bill speed for this time entry of approximately 20 days. An average bill speed of 55 days means that the majority of time does not get billed the month after it is worked.

Secondly, billing practices are activities that generally are controllable by law firms, and we would expect them to receive greater scrutiny in the face of declining economic conditions. A client can’t pay an invoice it hasn’t received, and it’s surprising that in 2008 there wasn’t a bigger emphasis on improved billing practices. Given that billing is usually an internal function, it represents an area where many firms can focus on improved efficiency. It remains to be seen, but this may have been a missed opportunity by firms in 2008. It will be more difficult for firms to maintain strong inventory turnover results as clients continue to face tightening credit.

Time Matters

It shouldn’t be news to firm managers that there are sound financial reasons to bill and collect as quickly as possible. Of course, it’s critically important to the cash cycle, even more so now than during economic growth periods. But many firms lose sight of the primary reason to manage inventory efficiently: Inventory becomes less valuable as it ages. This is as true in professional services as it is in industries dealing in tangible goods, and it has been proven time and again through the use of forward realization curves. Every firm’s curves look exactly the same — the realization on both unbilled time and receivables declines the longer it takes to bill or collect. Typically, a firm’s realization rate on one-year-old invoices is only about 15-20%.

What else did we see in 2008? Larger firms tended to do the best job of managing WIP and A/R. They tended to have fewer days of unbilled and uncollected time on the books than mid-sized or smaller firms.

Our analysis tracked collection of invoices that aged to 60, 90, and 180 days, and under all three cutoffs, the larger firms outperformed (i.e., collected a greater percentage of aged invoices). For instance, invoices that aged to 90 days in large firms resulted in a 67% realization, but in smaller firms, only 60%.

The distinction among results of different sized firms may be a valuable benchmarking data point, but the bigger take-away is that the realization rates themselves, even for the large firms, are not good. Losing 33 cents on the dollar in 90 days shows how quickly losses can accumulate. While we could point to best practice firms, the “best, best practice” is to avoid allowing accounts receivable to age significantly in the first place.

Monitor in 2009

Keeping in mind the level of loss associated with aged receivables, we stress the importance of understanding how much of a firm’s monthly billings are collected within 60 days, 90 days, etc. For the invoices of 2008, we found that 70% of total bill value was collected within 60 days, 82% within 90 days, and 92% within 180 days. In the case of these metrics, there was little difference by size of firm. For firms that track the forward collection progress of the bills of a period, using the 70% in 60-day benchmark is a good gauge for increasing levels of risk.

When firms cannot count on rate increases or maintaining levels of productivity they have become used to, the fundamentals of rate retention, billing procedures, and collection management become much more important. In any industry, as margins become compressed, more problems are exposed. We foresee billing and collections fundamentals, and their corresponding metrics, becoming much more important to overall profitability and a critical early warning indicator for firms over the next 24 months.
Compensation
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The Two Most Important Criteria

The two most important partner compensation criteria in law firms remain the ability to bring new clients to the firm and to be personally productive as measured by fees collected as a working lawyer, according to the survey. This is consistent with the inescapable truth that successful law firms have consistently high and profitable utilization across all timekeepers. Further, it is imperative that law firm owners possess a keen and well-developed ability to attract profitable business opportunities consistent with the firm’s strategic vision. Both of these imperatives are under siege in this economy, depressing law firm profits and in some cases the ability to continue as a viable business.

Although business origination is consistently ranked as the number one compensable factor, only 56% of the law firms surveyed grant “formal” origination credits. Even though this is a mission-critical skill and the top compensation factor considered, scorekeeping origination continues to be difficult and divisive. Such scoring becomes even more difficult for larger firms where the nature of the client relationship expands across time zones/offices, client business divisions, and firm practice groups.

This year’s survey delved deeper into the origination credit practices at law firms as well as the issues of collaboration in the selling process. Strikingly few clients are “shared” for origination purposes, which brings into question efforts made to work together to sell services. Further, individual performance drives 64%

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of compensation decision-making. Next came overall firm performance at 27% (probably due to its effect on the size of the distribution pool at year-end). That leaves less than 10% weighting to teamwork in practices, departments, and offices. If the “talk” is collaborative and encouraging of team behaviors, then clearly the “walk” of compensation is not aligned with those aspirations.

Smaller law firms primarily use an evergreen approach to origination credits, with reallocation primarily to the ambiguous “firm” credit. Larger firms focus more on the connection between who is responsible for the relationship with the client and how that evolves over time. Reallocations are largely a matter of negotiations between partners. We view origination much as the market does — it follows the current relationship. The underpinning of partner mobility is the portability and profitability of the partner’s practice. Yet, there is room within the context of a firm to recognize the opportunities provided by others.

Subjectivity in compensation decisions generates polarized passions that are more typically reserved for political and religious discussions. Some firms embrace a qualitative approach, while others flatly reject such notions. Nearly one-third of the respondents indicated that no portion of owner compensation is subjective. In addition, just over one-third of respondents indicated that 76% to 100% of owner compensation is subjective. The responses of the remaining 35% of survey participants were scattered between 1% and 75% of compensation distributed on a subjective basis.

The purpose of a compensation program is to produce good decisions. How this is accomplished can and does vary from firm to firm. If there is a universal rule with respect to compensation, it is this: Every compensation program works — and every compensation program fails. Programs run the spectrum from objective to subjective, from participatory to dictatorial. What works well is a program that fits the culture and strategy of the particular firm. The decisions should be consistently and fairly applied (identifying and considering anomalies on a case-by-case basis); reflect overall merit (a basic tenet of any well-functioning pay program); and provide for competitive pay relative to the marketplace. Done properly, a compensation program should assist in attracting and keeping the right people in your firm.

The Makeup of Compensation Committees

Compensation decision-making is generally an annual and open process. This year’s study ventured deeper into the makeup of compensation committees to determine how much representational democracy was in play. While the majority answer to whether the compensation committee had proportional representation was consistently “no,” there were some interesting differences among the constituencies studied (office, practice area, age tiers, compensation tiers, ownership tiers).

The partner compensation process is a participatory event. Personal interviews are the most common means partners have to provide input. All other forms of input trailed personal interviews. Larger firms are far more likely to have a multi-faceted partner input process that is more fitting to the challenges faced in such large organizations. Larger firms are also more likely to have a special process for firm leadership compensation decisions, again befitting the specialized and unique roles.

Law is a competitive profession. When coupled with a depressed economy, significant likelihood of legislative reforms and wary clients, lawyers struggle with the challenge of dividing a pie that may not be sufficiently large to satisfy everyone. When dollars are plentiful, it is easy to be generous to all and to satisfy the high producers, but when dollars are tight, internal equity and external competitiveness become increasingly difficult to achieve, especially when the high producers make subtle (and often not so subtle) comments about the inadequacy of their compensation. This is the true test of the firm’s values and culture. Unfortunately, in challenging times we all too often find that the bedrock of the firm’s
Some Highlights of The Recently Enacted Stimulus Bill

By Richard H. Stieglitz and Tamir Dardashtian

On Feb. 17, 2009, the newly elected President Obama signed into law the colossal $800 billion American Recovery and Reinvestment Act of 2009. This 1,000-plus-page piece of legislation contains many important tax breaks and enhancements that can benefit law firms and their clients, as well as individual attorneys and staff members and their families. This article addresses several of these key tax provisions included in the new act that may be advantageous.

FOR BUSINESSES
Depreciation Changes

Under the 2008 Economic Stimulus Act, the Section 179 expense deduction limit increased to $250,000 and the investment amount at which the Section 179 deduction begins to phase out increased to $800,000 in order to encourage law firms to invest in certain business assets and capital improvements. The new act extends the increased Section 179 limit through 2009. The Section 179 expensing election allows law firms to take a current deduction for newly acquired assets that otherwise would have to be depreciated over a number of years. This election can be claimed only to offset the business net income, not to reduce net income below zero.

The new act also extends the first year 50% bonus depreciation to certain property acquired and placed in service in 2009. This is in addition to any such property that qualifies for Section 179 expensing. The following types of property are qualified for this special bonus depreciation:

- Tangible property with a recovery period of 20 years or less;
- Computer software purchased by the business;
- Water utility property; and
- Qualified leasehold improvement property.

Because both the Section 179 limit increases and the 50% depreciation allowance can provide larger 2009 deductions, law firms may want to consider making major asset purchases this year if their business would qualify for these breaks.

In a February 2009 article in the Law Firm Partnership & Benefits Report (“The Housing Assistance Tax Act and the Emergency Economic Recovery Act”), we discussed how attorneys’ corporate clients were also allowed a new option to swap otherwise allowable bonus depreciation for immediately refundable alternative minimum tax (“AMT”) and research and development (“R&D”) credits under the Housing Assistance Act of 2008. According to the new act, that option has been extended through 2009. Corporations that elect to accelerate AMT or R&D credits in lieu of bonus depreciation will be able to increase the limit (subject to the cap discussed below) on the credits they can claim by an amount equal to 20% of the bonus depreciation they forgo. (Credits can be more valuable than depreciation deductions because they reduce your tax bill dollar for dollar, rather than just reducing the amount of income that is taxed.)

The allowable credit is capped at the lesser of $30 million or 6% of an amount that’s determined using a complex formula based on certain prior or R&D credit carry forward amounts and certain minimum tax credits.

Deferral of Certain Income from Discharge of Indebtedness

Under the new act, certain cancelation of debt (“COD”) income realized on account of a taxpayer’s or a related person’s reacquisition of a debt instrument during 2009 or 2010 would be, at the taxpayer’s election, deferred until 2014 and then included in income ratably over five years (2014 to 2018). This relief provision applies to debt repurchases for cash, debt-for-debt exchanges (including modifications), debt-for-equity exchanges, contributions to capital and complete forgiveness by the holder of the instrument. COD income is the excess of the old debt’s adjusted issue price over the repurchase price.

For example, assuming on Jan. 1, 2009, a business client recognized $100,000 of COD income and qualified for deferral, then it could defer reporting the income until its 2014 tax return. If it were in the 35% tax bracket, this would provide the business with $35,000 in tax savings for 2009. The client would then report $20,000 of income per year for 2014 through 2018. Assuming it remains in the 35% tax bracket, the total tax liability would remain the same, but in essence the client would be getting an interest-free loan on the tax liability.

S Corporation Built-in Gains Relief

When a C corporation converts to an S corporation, it generally must hold on to its assets for 10 years to avoid tax on any built-in gains that existed at the time of the conversion. The S corporation built-in gains tax applies a 35% tax when an S corporation takes built-in gains into income. Built-in gains are items for which a former C corporation had accrued economic benefit on the day its S corporation took effect, but which had not been recognized for tax purposes. For example, if the corporation had a piece of real estate worth $120,000 on the day it became an S corporation, and the property had a basis of $90,000, there would be a built-in gain of $30,000.

Under the new act, for tax years beginning in 2009 and 2010, no tax is imposed on the net unrecognized built-in gain of an S corporation if the seventh tax year in the recognition period preceded the 2009 and 2010 tax years. This will benefit law firms and their corporate clients that were C corporations that converted to an S corporation in 2001 and 2002 if they sell any assets that would have been subject to this tax.

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Net Operating Loss (‘NOL’) 

Carryback

Under the new act, businesses with gross receipts of $15 million or less will have the option to carry back NOLs either three, four or five years (instead of the two-year carryback provided under old law). The five-year carry back is effective for NOLs generated in tax years beginning or ending in 2008.

Any loss not absorbed in the carryback period can be carried forward up to 20 years. Businesses also have the option to waive the carryback period and carry the entire loss forward. This may be beneficial if your marginal tax rate in the carry back years is unusually low or if the alternative minimum tax (AMT) in prior years makes the carry back less beneficial.

COBRA Benefits

The new act contains a significant COBRA revision that will apply to every law firm that is subject to COBRA. Under the new act, a former employee would pay a portion of the COBRA premium (35%) and the former law-firm employer would pay the remaining portion (65%) of the premium for nine months. The law firm would be able to credit its share of the subsidy against wage withholdings and payroll taxes (subject to income thresholds). It is therefore recommended that law firms examine their cash flow needs and contact their COBRA administrators and payroll vendors to discuss the steps required.

Incentives to Hire Unemployed Veterans and Disconnected Youth

Law firms are allowed to claim a work opportunity tax credit equal to 40% of the first $6,000 of wages paid to employees of one of nine targeted groups. The new act expands the work opportunity tax credit to include two new targeted groups: 1) unemployed veterans; and 2) disconnected youth. Individuals qualify as unemployed veterans if they were discharged or released from active duty from the Armed Forces during 2008, 2009 or 2010 and received unemployment compensation for more than four weeks during the year before being hired. Individuals qualify as disconnected youths if they are between the ages of 16 and 25 and have not been regularly employed or attended school in the past six months.

FOR INDIVIDUALS

Automobile Purchase Relief

The new act provides an above-the-line deduction to individuals purchasing a new car, light truck, recreational vehicle or motorcycle from Feb. 17, 2009 through Dec. 31, 2009 for state sales or excise tax paid on the purchase. The deduction applies to the tax attributable to the first $49,500 of purchase price and begins to phase out at AGI in excess of $125,000 ($250,000 for married couples filing jointly). This means that individual attorneys and staff members can benefit from the deduction even if they don’t itemize. While both foreign and domestic vehicles qualify, sales tax paid on a lease do not qualify.

Section 529 Plans

Under the old law, the definition of qualified education expenses did not include laptops and computers and therefore could not be purchased through Section 529 plan accounts tax free. The new act provides that expenses paid or incurred for the purchase of computer technology and equipment or Internet access qualify as qualified education expenses under Section 529 plans for tax years beginning in 2009 and 2010. Attorneys can use these tax-advantaged savings plans to fund college expenses for their family. In addition, other family members are allowed to use the technology as long as it is being used by the college student.

First-time Homebuyer Credit

In the February 2009 article mentioned above, we discussed how attorneys or their staffs could benefit from this essentially interest-free loan in the form of a refundable credit. Under the new act, the first-time homebuyer credit is extended to apply to homes purchased after Dec. 31, 2008 and before Dec. 1, 2009. The new act removes the repayment requirement for homes purchased during 2009 unless the home is resold within 36 months of purchase. It also increases the amount of the credit from the current maximum of $7,500 to up to $8,000.

Transportation Benefits

The new act increases the maximum monthly exclusion for employer-provided transit and vanpool benefits ($120 for 2008) to the same level as the exclusion for employer-provided parking ($230 for 2009) for 2009 and 2010. These benefits are a tax free fringe if provided by a law firm saving the law firm payroll taxes and the law firm’s employee’s payroll and income taxes.

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an apportioned share of the parent’s capital gain from the LEXIS sale.

An intermediate court affirmed for the state, finding that LEXIS served an “operational function” within Mead’s business, for reasons that: 1) the parent wholly owned the subsidiary; 2) Mead exercised control over LEXIS via “manipulating” its corporate form, approving capital outlays, and “sweeping” its excess cash into the parent’s accounts; and 3) Mead described itself in its annual reports as the operator of the world’s foremost electronic retrieval service, i.e., LEXIS. To be sure, the appellate court disregarded the unitary business issue. When Illinois’ highest state tribunal refused to intercede, the matter found itself before the U.S. Supreme Court.

THE SUPREME COURT DECISION

Justice Alito did not hesitate in acknowledging the constitutional implications of this controversy, doing so in the opening sentence of the opinion: “The Due Process and Commerce Clauses forbid the States to tax ‘extraterritorial value.’” See Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 164 (1983). Rather, the states are permitted to tax “an apportioned share of the value generated by the intrastate and extrastate activities of a multistate enterprise if those activities form part of a ‘unitary

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When, as is the case here, the taxpayer has done some business in the taxing state, the inquiry shifts from whether the state can tax to what it may tax. “To answer that question, we have developed the unitary business principle,” which provides that a state may tax an apportioned sum of the corporation's multistate business if the business is indeed unitary. Adjudicators must determine whether in-state and out-of-state activities were part of a single, unified endeavor. In contradistinction, if extrastate values are derived from a distinctive activity within a discrete business enterprise, then the state is powerless to tax revenue so gained from outside its borders.

Some 15 years ago, the High Court had traced the history of “this venerable principle” in the case of Allied-Signal, Inc. v. Director, Division of Taxation, 504 U.S. 768, 778-83 (1992), “and, because it figures prominently in this case, we retrace it briefly here.” Notably, the history of the pertinent legal axiom closely mirrors the nation's economic development. With the coming of the Industrial Revolution, the United States witnessed the emergence of its first truly multistate businesses, first and foremost among them the railroads. For the first time, the states confronted the dilemma of the value of an interstate business by simply taxing the capital within their own borders.

Recognizing this as early as 1876 in the State Railroad Cases, 92 U.S. 575 (1876), the Supreme Court devised the unitary business principle, which addresses the problem by shifting the constitutional inquiry from taxation based upon mere geography to assessments determined by the taxpayer's actual business. So, if a state wished to tax value rooted in a combined in-state/out-of-state enterprise, it could tax an apportioned share of the value of that unitary business (as opposed to artificially segregating the taxpayer’s intrastate operations). “Conversely,” Justice Alito carefully pointed out, “if the value the State wished to tax derived from a ‘discrete business enterprise,'
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economic woes continue, states suffering from decreasing tax revenues are more likely than not to be more aggressive in taxing anything and everything they can get their hands on. The instant case should give them pause, and compel greater adherence to legal principles already espoused.

Notwithstanding, we have to contrast how this multistate corporate entity did business with how a national law firm manages its own affairs. Crucial to the High Court’s decision was the high degree of autonomy LEXIS enjoyed during its life as Mead’s affiliate: independent management, separate facilities, minimal oversight, minimal cross-dealings. Again, the mere fact that the ostensible subsidiary did not even purchase its paper from a parent that has been a paper manufacturer for a century and a half speaks volumes that these businesses were truly divided.

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existence is compensation, and culture/values fall to the side. This is what is happening in too many law firms as this severe recession unfolds.

RECOGNIZING THE DANGERS

Firms evaluating their compensation programs recognize the dangers of simply maintaining the status quo. Key business generators may take their clients and leave; highly talented, technically skilled lawyers may be picked out of the firm; management may suffer, and the like. The effect is a loss to the organization and a disruption in the lives and livelihoods of the members. Many firms intuitively understand the risks, but few have the ability to assess that risk in a systematic way. Such risk-assessment tools are available, including one developed by the author’s firm, Altman Weil, Inc.

It is equally true that firms perceive danger in change. In any closed economic system, a change in the compensation program is likely to result in some people getting less, while others take more. This danger can block compensation reform within a firm. Prospective change and transition become key elements in the evolution of a compensation program. Change needs to be prospective, i.e., forward looking, and it is important to provide time for the players to adjust to a new rule book. Many firms also take specific action to prevent massive reductions in compensation due to implementation of a new program. Mitigation and minimums limit downward adjustments to protect individual personal economic circumstances. This step is a major consideration and selling point in marshaling support among partners for reforms. Generally, it will take two or three years to move from an existing system to a new one.

CONCLUSION

The nature of compensation makes selection of compensable criteria difficult. A successful law firm needs lawyers with all of the qualities that the various programs attempt to measure. As always, the individual characteristics of the firm dictate how to blend the ingredients into a successful compensation program. It is possible to reduce the emotion and the stress inherent in compensation matters by understanding that precision and absolute correctness are not attainable. At best, you can create a sense of rough justice wherein the partners are satisfied with the fairness of the system, appreciative of its simplicity, and content to contribute with the knowledge that the pay program will recognize merit.