

The Baucus Proposal

By [Michael D. Short](#) on January 22, 2014

In our recent travels and meetings with clients, we have been trying to gauge each firm leader's interest/concern/anxiety related to The Baucus Proposal – a proposed change to tax laws that would require all professional service firms with greater than \$10 million in revenue to change from cash to accrual accounting to determine taxable income. The target implementation date is at the end of 2014.

For details, please read the attached [issue summary document](#) from The Law Firm Services Group at PriceWaterhouseCoopers.

When we first heard of this potential change and then read the PwC summary, we wondered if this proposal has a *real* chance of passing – particularly given stated opposition from the AICPA, the ABA, and (we're assuming) most U.S. based law firms currently reporting on a cash basis. We asked our friend Stanley Kolodziejczak – co-author of the PwC document – if this is much ado about nothing? He assured us that – as of right now – this has *real* potential for becoming law.

So...if this has a real chance of passing, what would be the impact on a typical law firm? Per PwC, this proposal will “generate significant complexity for law firms going forward as well as potentially harsh financial consequences. Most notably, the conversion from a cash method to an accrual method for tax purposes likely will generate an unexpected, front-loaded income tax liability that must be paid by law firm partners over a proposed four-year period.” Furthermore, consider for a moment the alignment of internal accounting and reporting systems, the incentives within the partner compensation system, overall capitalization, the timing of compensation dollars from the firm to the owners, and the way partners think about cash flows within the contexts of their clients, practices and the ownership of their law firms...just to name a few related issues. All of these will change and those changes will not come without hefty internal price tags – out of pocket cash and productive time lost to managing change. Finally, with respect to the associated tax liability, Stanley observed during our conversation that any law firm with very high debt levels may not be able to withstand this additional burden. (More on the details related to this proposal in a future blog posting.)

So...given the magnitude of the likely impact, we return to our opening premise – what is each firm leader's interest/concern/anxiety related to The Baucus Proposal? The responses range from a few that are already evaluating the impact at a very detailed level to many that are simply monitoring the situation.

We don't think that “monitoring” is sufficient here. This potential law's impact on most law firms will be in the “material” to “significant” range, with a few rising to the level of “devastating”.

To be clear – we are not against accrual based accounting for law firms. In fact, there is great value in accrual-based financial reports. Even for cash basis firms, we favor reviewing accrual-based reports on a regular basis to ensure that the firm's ongoing production of client services is at a healthy level that is consistent with even cash flows. We are, however, against the act of changing the basis for accounting – particularly if we cannot see a compelling, long-term reason to support the change.

Finally, this is not an anti-change position. We are huge proponents of meaningful, strategic, logical, forward-looking

change. This bill, unfortunately, doesn't appear to measure up to any of these standards.

Call your representatives on Capitol Hill and urge the defeat of this bill.