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Big Tax Win for S Corporation and QSub Banks in the *Vainisi* Case

On Wednesday, March 17, 2010, the federal appeals court rendered its opinion in the case, *Vainisi v. Commissioner of Internal Revenue*. In a resounding victory for subchapter S and QSub banks, the Seventh Circuit Court of Appeals in Chicago reversed the Tax Court and held that the TEFRA (Tax Equity and Fiscal Responsibility Act) interest expense disallowance rule does not apply to these banks after the first three years of S Corporation or QSub status.

Debra Koenig, Mike Apfeld, and Sarah McNally of Godfrey & Kahn, S.C. in Milwaukee, Wisconsin, represented Mr. and Mrs. Vainisi in the appeal. Their efforts were funded by a consortium of banking organizations and individual banks, including the Independent Community Bankers of America (ICBA), the Wisconsin Bankers Association, the Community Bankers of Wisconsin, and community banking associations in Texas, Iowa and Illinois. These efforts were coordinated by the Subchapter S Bank Association in San Antonio, Texas, which sent letters to every S Corporation and QSub bank in the country asking for support.

If an S corporation or QSub bank took the TEFRA interest expense disallowance after three years had elapsed from the S Corporation or QSub election, the bank should consider filing an amended return for each affected year, and encourage its shareholders to file for refunds (which will include statutory interest). Banks may want to consider whether their accountants can help facilitate the refund process on behalf of a bank's individual shareholders by preparing a form amended return that can then be customized to each individual shareholder's circumstances. Unfortunately, we believe each shareholder, not the bank, must file the refund claim.

What's next? The action will now shift to the Treasury Department and Congress. While Mrs. Koenig feels that only Congress can overturn the result in this case, the Treasury Department may try to do so by regulation. The ICBA, other banking associations and the Tax Section of the American Bar Association have already commented on proposed Treasury regulations which would effectively reverse *Vainisi*, and all agreed that Treasury did not have this power given the plain language of the statute.

If you have any questions or need assistance, please contact Debra Koenig, Michael Apfeld or Sarah McNally of Godfrey & Kahn.

The following is based on a summary of legal principles. It is not to be construed as legal advice. Individuals should consult with legal counsel before taking any action based on these principles to ensure their applicability in a given situation.