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SENSIBLE SOLUTIONS

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We are comprised of seasoned and dedicated professionals who familiarize themselves with our clients' industries as well as their legal issues. We strive to maintain long-term client relationships by keeping our clients fully informed and respecting their time and business resources.

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- Condo-Community Association Representation
- Corporate and Other Business Transactions
- Defamation, Privacy and First Amendment
- Employee Benefits
- Employment Law
- Estate Planning, Probate and Trust Administration
- Health and Fitness Industry
- Independent Sales Representatives
- Intellectual Property Law
- Litigation and Alternative Dispute Resolution
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Putting the "Success" into Succession Planning

Finding, grooming, and ultimately selling your business to one or more key employees is a process that typically takes several years. Once you have found the right successors, proper succession planning often involves two additional steps. The first step is often to give the successor owners some initial equity in your company. This not only offers him or her some "pride of ownership," but it also provides the existing owner(s) someone to continue to operate the business. When transferring an ownership interest to your successor(s) the transfer should be accompanied by an agreement among the company and all of its owners regarding the disposition of each owner's interest in the company upon the occurrence of certain events, such as an owner's death, permanent disability, or retirement (with the restrictions on transfer noted on the stock certificate).

For purposes of this article, we will assume that the business is a corporation. Although the following discussion generally applies to other types of entities as well, it is important to note that the tax treatment can vary substantially depending on how the entity has elected to be taxed.

There are typically two ways to provide key employees with stock. The company can either (a) sell stock to the key employees, or (b) issue stock to the key employees as compensation for services. An employee who owns stock will have all of the rights of a stockholder in the company, including the right to vote (if the stock is voting stock), and the right to examine the books and records of the company for any proper purpose. In addition, to the extent that the company pays dividends, such dividends must be paid pro rata to all of the company's stockholders within the same class of stock.

(a) Selling Stock. This is very straight-forward, but often not very appealing to many employees. The amount received by the company from the sale of its stock is a capital contribution to the company and not income to the company. A purchase of stock by an employee will not result in income to the employee except in the case of a bargain sale, i.e., where the purchase price is less than the fair market value of the stock. In the case of a bargain sale, the employee will realize ordinary income equal to the excess of the fair market value of the stock over the price he or she paid for the stock.

(b) Issuing Stock as Compensation for Services. Stock issued by a company as compensation for services represents ordinary income to the employee in an amount equal to the fair market value of the stock. This same amount is also fully deductible by the company as an ordinary business expense for the same year in which the employee takes the value of the stock into income. The employee can defer taking the value of the stock into income if the stock is subject to a substantial risk of forfeiture, as, for example, where the employee's right to the vesting of the stock is conditioned on the performance of services for some period of time. Once the stock is no longer subject to a substantial risk of forfeiture, however, the employee must then recognize its then fair market value as ordinary income. Since this may result in a significant tax liability, companies often also pay a cash bonus to the employee to cover his or her tax liability.

(c) Shareholders Agreement. When your company is transferring some of its stock to one or more key employees, it is important that the company and all of its stockholders enter into an agreement which governs what happens to a stockholder's stock in the company upon the happening of certain events. The typical stockholders' agreement will cover all of the following:

(1) Restrictions on Transfer. The stockholders' agreement should restrict a stockholder's right to sell his or her stock in the company. The typical ways of accomplishing this include the right of first refusal, right of first offer, or the requirement that the other stockholders consent to the transfer. Keep in mind that the complete prohibition upon transfer is likely to be unenforceable.

(2) Death. Death will give rise to the obligation of the deceased stockholder's estate to sell, and the company to buy, the stock of the deceased stockholder. This is done in order to provide the estate with liquidity and to prevent a deceased stockholder's heirs from owning stock in the company. The purchase price in the case of death should be the fair market value of the stock, with such fair market value to be determined based upon the formula or methodology set forth in the agreement. The purchase price can be funded wholly or in part by life insurance maintained by the company on the lives of its stockholders, assuming that it is not cost-prohibitive to do so. The company need not maintain life insurance on all of the stockholders. If there is life insurance on a deceased stockholder, the purchase price will be paid out of the policy proceeds, with the balance, if any, paid over time. If the proceeds exceed the purchase price, the excess belongs to the company.

(3) Permanent Disability. Permanent disability will give rise to the obligation of the disabled stockholder to sell, and the company to buy, the stock of the disabled stockholder. This is done in order to provide the disabled stockholder with liquidity, and to prevent a disabled stockholder from owning stock in the company, since the disabled stockholder is no longer capable of rendering services to the company. The purchase price in the case of permanent disability should be the same as that used in the case of death. The proceeds of any disability insurance received by the disabled stockholder does not typically reduce the purchase price, however, since this is intended to compensate the disabled stockholder for lost income. Accordingly, the entire purchase price is typically paid over time.

(4) Retirement. Retirement will give rise to the obligation of the retired stockholder to sell, and the company to buy, the stock of the retired stockholder. This is done in order to provide the retired stockholder with liquidity, and to prevent a retired stockholder from owning stock in the company, since the retired stockholder is no longer rendering services to the company. The purchase price in the case of retirement should be the same as that used in the case of death or permanent disability. Retirement is typically defined as a stockholder's voluntary resignation as an employee of the company after having reached a certain age and after having given the company sufficient notice. Again, the entire purchase price is typically paid over time.

(5) Divorce. Divorce may give rise to the obligation of the affected stockholder to sell, and the company to buy, the stock of the affected stockholder. This is done in order to prevent a stockholder's former spouse from owning stock in the company, though the stockholders agreement will restrict this type of transfer. The purchase price in the case of divorce should be discounted from the fair market value of the stock, with such discount being set forth in the agreement. The purchase price should be paid over time.

For questions about succession planning, please contact Len Gambino at leonard.gambino@sfbbg.com or at 312-648-2300.

The Corporate Transparency Act: What Business Owners Need to Know

Welcome Aboard!

The Firm is proud to announce two new attorneys joining us: Marc Pawlus and Caleb Haydon. Marc joined SFBBG's litigation practice group and Caleb works with our corporate group.

Published Articles

The *Chicago Daily Law Bulletin* published an article written by Norm Finkel and Bob Goldberg on August 29. The article "NLRB Turns Up the Heat in Debate over Employee Noncompete Pacts" was featured in our last newsletter.

The *Law Bulletin* also published an article written by Adam Maxwell entitled, "Holy Hurdles: How to Follow Religious Accommodation Rules."

"Thoughts on Succession Planning," an article written by Dan Beederman, was featured in the October issue of *Agency Sales*. *Agency Sales* is a magazine published by Manufacturers' Agents National Association (MANA).

Adam Glazer was published ("The 'Windfall Gals' Reject Manufacturer's Contention That Paying the Rep Was a Windfall") in *The Representor,* a publication offered through the Electronics Representatives Association. Also published in this edition was an article by Bruce Bell: "Maximizing the Qualified Business Income Tax Deduction for Sole Owner/ Sole Employee Businesses."

Presentations

On October 9, Dan Beederman presented to MANA "Rep Succession Planning—- Why it is Important for Reps and Their Manufacturers."

Dan also presented a MANAcast teleforum on October 18 to manufacture members of MANA entitled "Agreements from Your Manufacturers' Representatives' Perspective."

On October 12, Mike Kim was a co-panelist on a nationwide webinar presented by HOA Leader, an online guide to homeowner association management. With over 200 registrants, the topic of the webinar was "Enforcement of Your HOA's Rules: How to Create Enforceable Rules, Effective Fines and a Fair Violation Process."

Cook Co. Second Installment Property Tax Bills Now Available

Visit www.cookcountytreasurer.com to find your second installment property tax bill. These bills will be mailed out on November 1 and will be due December 1.

The Corporate Transparency Act ("CTA") was enacted in 2021 to improve transparency in order to prevent bad actors from engaging in money laundering, tax fraud, and other illicit activities from exploiting US companies. Beginning January 1, 2024, the CTA requires "reporting companies" to report information about the individuals who own or control the company to the Financial Crimes Enforcement Network ("FinCEN"). Failure to comply with the CTA carries stiff penalties, and failure to timely submit a BOI report will result in fines accruing at $500 per day and up to $10,000. Willful noncompliance or fraudulent reporting to FinCEN may result in up to a two-year prison sentence.

What is a reporting company?

Both domestic and foreign entities must submit beneficial owner information ("BOI") reports to FinCEN. Domestic "reporting companies" are limited liability companies, corporations, and any entity created through the filing of a document with the secretary of state or similar state office or Indian tribe. Foreign "reporting companies" are entities formed under the laws of a foreign country and registered to do business in the United States. BOI reporting regulations can be found at 31 CFR §1010.380(d)(1). Based on the sheer number of foreign and domestic entities covered by the CTA, over 30 million reporting companies will be required to submit BOI reports when the CTA goes into effect.

The deadlines to submit BOI reports differ based on the date a reporting company was formed. Those entities formed or registered before January 1, 2024 must submit the BOI report by January 1, 2025, while entities formed after January 1, 2024 must submit the report within 30 days of registering with the secretary of state or similar office. However, FinCEN has recently proposed to extend the initial filing deadline for beneficial ownership reports from 30 to 90 days for entities created or registered on or after January, 1, 2024 in order to give reporting companies more time to understand the new obligations created by the CTA.

Not all companies fall under the umbrella of the CTA. Companies already subject to regulatory oversight are exempt from the CTA's reporting requirements. The CTA identifies twenty-three entities that are exempt. This includes but is not limited to large operating companies (defined in 31 CFR §2020.380(c)(2)(ixx), but generally includes companies with over 20 employees and more than $5 million in gross receipts from US sources, banks, insurance companies, financial advisers, securities brokers, and pooled investment companies. A complete list of the exemptions can be found at 31 CFR §2020.380(c)(2).

Who is a beneficial owner under the CTA?

Under the CTA, a beneficial owner may or may not have actual ownership of the company. The CTA requires reporting companies to file BOI reports for all individuals who own or control at least 25% of the ownership interest in the reporting company or who exercise substantial control over the reporting company. The BOI report discloses an individual's full name, date of birth, residential address, and an identifying number, such as a passport number or driver license number.

Ownership interests include both traditional equity interests and nontraditional interests that otherwise entitle someone to a company's profits, such as a convertible security. The CTA considers the following to determine if an individual exercises substantial control:

- The individual serves as an important decision maker;
- The individual is a senior officer of the company, such as a chief financial officer of chief technology officer;
- The individual holds authority to appoint or remove senior officers or important decision makers;
- The individual exercises control over major expenditures, reorganizations, or entry into and termination of major contracts; or
- The individual holds any other form of substantial control over the report company.

The "substantial control" provision may require a detailed analysis of all senior level employees and governing documents to determine which individuals' information must be reported under the CTA. Existing reporting companies with complex and sophisticated ownership and operating structures should update internal protocols to identify beneficial owners prior to the reporting deadline.

Not all beneficial owners must be included in the BOI report. The CTA includes five exemptions for individuals who would otherwise be considered a beneficial owner including: (i) minor children; (ii) an individual acting as an agent on behalf of another individual; (iii) an employee whose substantial control or economic benefit is derived solely from the employment status of the employee and is not a senior officer; (iv) an individual whose only interest is a future interest via some type of inheritance; and (v) creditors.

The CTA's new reporting requirements will likely not present significant difficulties for reporting companies with easy access to an individual's BOI and straightforward ownership and operating structures. However, reporting companies with complex corporate and organizational structures will likely require a detailed analysis of all relevant governing documents and senior officer job functions to file accurate and complete BOI reports.

Where do I submit a BOI report?

FinCEN has created the Beneficial Owner Secure System ("BOSS") to facilitate filing and storage of BOI reports. The BOSS is expected to open on January 1, 2024. FinCEN identifier numbers will be available upon request by submitting the same information that must be reported in a BOI report. Reporting companies may then use an individual's FinCEN identifier number in lieu of the information required in the BOI report. BOI reports submitted to the BOSS must be verified as true, correct, and complete.

BOI reports must be updated after a change in beneficial owners, i.e., new ownership or a new senior company officer. All reporting companies must update company and BOI within 30 calendar days of any BOI change and reports must be corrected within 30 calendar days of any knowledge or notice of any errors or inaccurate reporting information. In the event a reporting company inadvertently submits an incorrect initial BOI report, the CTA provides a safe harbor provision that allows corrected reports to be submitted within 90 days of the original submission.

What can reporting companies do to prepare for the CTA?

Looking forward, reporting companies must evaluate currently existing corporate compliance plans. While FinCEN will likely issue additional guidance and reporting procedures, companies should implement internal protocols to compile and update reporting information to ensure compliance with the CTA's requirements. This includes identifying who is responsible for compiling beneficial owner information and submitting the report. Reporting companies should also create a system to track changes in senior level positions or changes in ownership to ensure accurate BOI reports are timely submitted. FinCEN has published resources, including a frequently asked questions page, available via its website to help reporting companies understand the new obligations created by the CTA.

For more information or any questions, please contact Marc Pawlus at marc.pawlus@sfbbg.com or at (312)648-2300.