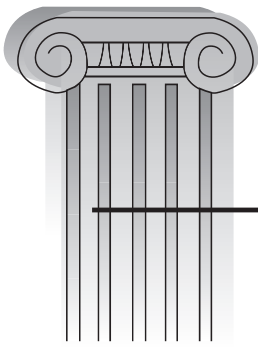

Fine **Print**

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BUSINESS SUCCESSION: THE NO TAX SOLUTION

By Tim Jochim

Can the owners of a closely held corporation sell their stock without paying taxes on the gains? Furthermore, can the corporation and its new owner obtain an exemption from U.S. and Ohio income taxes? How true it is!

A series of federal tax acts enacted between 1984 and 2001 permit closely held U.S. corporations and their owners to obtain the following benefits:

■ Owners of "C" corporations who sell their stock to a qualified employee stock ownership plan (ESOP) can defer gains taxes to the extent the proceeds are re-invested in the securities of U.S. operating companies. Under certain circumstances, the taxes may never have to be paid. Most national brokerage firms have established programs that allow selling shareholders to borrow against nearly the entire re-investment portfolio.

■ In the tax year after the stock sale to the ESOP, the shareholders (i.e., the trustee of the ESOP and other qualifying shareholders, if any) can elect to be taxed as an "S" corporation. Thereafter, the owners of the corporation, and not the corporation itself, will be subject to taxes on the profits.

■ An ESOP is a tax-exempt S-corporation shareholder. Therefore, to the extent the corporation is owned by the ESOP, the owners pay no U.S. income taxes (nor Ohio income taxes if an Ohio corporation). Other qualified plans, such as 401(k) plans, are not tax exempt.

Because of the magnitude of the tax benefits, certain conditions and restrictions apply to the transactions listed above. One condition requires that an independent valuator must determine the fair market value of stock bought or sold by an ESOP. Also, restrictions on how stock may be allocated in the ESOP prevent major individual shareholders or "selling" shareholders from getting double or unfairly high benefits.

These business succession tools, when properly and expertly applied, can provide owners of closely held corporations with a no-tax business succession plan.

From the perspective of company owners, business succession does more than help them cash out tax-free. Business succession also involves management succession and estate taxes.

■ First, to attract a quality successor management team, a company must be profitable. An ESOP company tends to be more profitable, and therefore more attractive to professional managers.

■ Second, it is not necessary to wait for 2010 to reduce or eliminate federal estate taxes (the Economic Growth and Tax Relief Reconciliation Act of 2001 eliminated federal estate taxes

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ANTI-HARASSMENT POLICIES KEY TO LIMITING EMPLOYER LIABILITY

By Bradd Siegel

Sexual harassment claims and lawsuits continue to multiply throughout Ohio and the nation. Under both Ohio and federal law, however, unlawful workplace harassment is not limited to claims based on sex. Harassment on the basis of race, religion, color, national origin, age or disability is also prohibited. Businesses may be held liable not only for harassment by supervisors and managers, but also for harassment by co-employees, or,

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even, customers. To combat unlawful harassment, and to minimize their potential liability for such claims, employers should develop and implement effective anti-harassment policies and complaint procedures.

Unfortunately, no anti-harassment policy or complaint procedure will relieve an employer from liability for harassment by supervisors or managers that takes the form of a "tangible employment action," such as firing, demoting or denying a raise to an employee who resists his or her supervisor's advances. Under these circumstances, the employer will be held strictly liable for the supervisor's actions. Even here, however, the presence of a well-publicized and consistently enforced policy against harassment may at least limit or preclude the employer's liability for punitive damages.

On the other hand, where the harassment does not involve a "tangible employment action" by the employee's supervisor, but merely creates a "hostile environment," an appropriately designed and implemented anti-harassment policy and complaint procedure may allow the employer to avoid liability completely for such "hostile environment" claims.

According to recent federal and state decisions, even in cases where it is the employee's supervisor or manager who is creating the unlawful hostile environment, the employer will not be held liable for such harassment if it can prove:

- the employer exercised reasonable care to prevent and promptly corrected any harassing behavior; and
- the complaining party unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise.

The presence of a well-publicized and consistently enforced policy against harassment may at least limit or preclude the employer's liability for punitive damages.

Nevertheless, an employer may be held liable if the harassment incident is severe (such as a sexual assault), even if the incident happened only once and the employer had a policy against sexual harassment and responded immediately and effectively to the employee's complaint. Still, the existence of an appropriate policy and complaint procedure should at least limit the employer's liability for punitive damages in such a circumstance.

Although the law in this area is still evolving, an employer with an effective anti-harassment policy and complaint procedure may enjoy greater protection from liability in cases involving co-employee or customer harassment than in cases of supervisory harassment. Prompt and effective action in response to an employee's complaint of harassment by a co-worker or customer may completely insulate the employer from any type of liability. Indeed, some courts have held that the employer may be liable for co-worker or customer harassment only if it knew or should have known of unlawful harassment, and its actions upon learning of the harassment were so inadequate as to show indifference to that harassment.

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for the year 2010, but not thereafter). Subject to certain conditions, owners of closely held corporations can contribute their stock to a charitable remainder trust (CRT) which, in turn, can sell the stock to the ESOP at fair market value and re-invest the proceeds. A selling owner obtains a current income tax deduction plus income for life from the re-investment portfolio and, upon death, the remainder is transferred to the named charitable organization. The owner can use some or all of the income from the portfolio to establish an irrevocable life insurance trust (ILIT) for children or beneficiaries. Generally, the proceeds of the ILIT are not subject to estate taxes.

Thus, all of these business succession tools, when properly and expertly applied, can provide owners of closely held corporations with a no-tax business succession plan while helping to attract and retain high-quality successor management.

Tim Jochim, a Columbus attorney, is also an adjunct professor of corporate finance at the Capital University School of Law. He is the author of a book and numerous articles on business succession and ESOPs and is a member of the legal advisory committee of The ESOP Association,

Web site resource for small businesses:

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