



Business Brief

Business and Client Advisory

THE IMPORTANCE OF CORPORATE MAINTENANCE

All corporations, regardless of the number of employees or annual revenues, should maintain complete and accurate corporate records. Annual meetings of shareholders and directors are required under California law and should be held within three (3) months of a California corporation's year end, or on such date and time as stated in the corporation's bylaws.

Shareholders, directors and officers of a California corporation are permitted to review the corporation's records and minutes upon request. In the event of an income tax audit, lawsuit, or major business transaction, a corporation may be required to produce photocopies of all of its records and minutes to an outside party. For example, the Internal Revenue Service (IRS) is permitted to review corporate minutes dating back six (6) years.

Under some circumstances, a party to whom the corporation is liable may attempt to "pierce the corporate veil." This legal term is used to describe an action to have the corporation set aside so that personal liability attaches to its shareholders, directors or officers and personal assets can be reached. In such circumstances allegations that a corporation is a "sham" – not a distinct entity, but a mere "alter ego" of its shareholders - being used to advance their private interests or to perpetrate fraud are not uncommon.

When evaluating if a corporation is legitimate, a major factor the courts and the IRS consider is whether the corporation follows proper procedures; for example, in its appointment of directors and officers, the issuance of stock, the holding of its annual meetings, the filing of annual reports with the state, and the maintenance of its property, financial books and accounts. They will also examine whether the corporate finances are commingled with those of its shareholders.

Annual shareholder's and director's minutes are "evidence" that a corporation is a valid entity, distinct from its shareholders, directors and officers. If loans between the shareholders and the corporation, the purchase and sale of corporate assets, and the corporation's payment of officer compensation are properly documented and approved in the minutes, it is less likely that an outside party could "pierce the corporate veil" and find its shareholders, directors or officers individually liable. It is important to note that there may be circumstances under which "special meetings" of shareholders and directors are required.

All corporations should consider participating in a corporate maintenance program with an attorney to maintain the integrity of the corporation's business and its shareholders. For more information about our program, please contact this office.

A SEVERANCE AGREEMENT MAY HELP YOU AVOID LITIGATION

Terminating employees isn't pleasant, but sometimes, you know that terminating a particular employee may be extremely difficult and could even result in a lawsuit. If the employee stirs up trouble in the workplace, or if you believe you may have made some mistakes in managing him or her and are concerned about the court reviewing the matter further, you may want to consider asking the employee to sign a release: an agreement not to sue you in exchange for receiving certain benefits from the company.

Whether your reasons for requesting that a departing employee sign a severance agreement are routine (as a condition of receiving any severance package) or more specific (when an employee may have a legitimate legal claim against the company or seems especially motivated to sue), you should consult an attorney regarding the specific language requirements for a release under federal and state law before presenting the request for release or a severance agreement to any employee.

Some general points to consider are:

- You must give the employee something in exchange for the release. You are asking the employee to waive the right to sue you, and that right is worth something. This means that if you ordinarily offer a severance package to those employees who are not asked to sign a release, you will have to give something extra to employees who do sign. Specify what you will provide (typically, a sum of money) in the release.
- Be clear about the rights the employee is waiving. You might state that the employee is waiving any right to sue you for claims arising out of the employment relationship, including the termination of that relationship. In any case, make sure the release is specific enough to forestall any later claim that the employee did not know what it covered -- and comprehensive enough to cover every claim the employee might conceivably raise.
- Give the employee plenty of time to decide whether to sign. It is reasonable for an employee to take a week or two to decide whether to give up the right to sue you. You should suggest that the employee consult with a lawyer to review the agreement.
- Avoid any hint of coercion. An employee's decision to sign a release must be voluntary, or courts will not enforce the release. Don't threaten or talk tough with your employees to convince them to sign; you won't be gaining anything if your release gets thrown out of court.

For more information about severance agreements and releases, termination procedures, or other employment-related issues, please contact this office.

FIX ESTATE TAX VALUE OF A CLOSELY HELD BUSINESS WITH A "BUY-SELL" AGREEMENT

A common source of controversy between taxpayers and the Internal Revenue Service (IRS) is the valuation for estate tax purposes of a decedent's interest in a closely held business. Different valuation approaches can yield widely disparate results. The IRS favors the approach that yields the highest value for estate tax, while taxpayers logically prefer that which yields the lowest value for estate tax.

Over the years, the courts have established that, if properly structured, owners of closely held businesses can enter into agreements that will fix the value of the business for estate tax purposes. Such agreements are typically called "buy-sell" agreements and are entered into among the business owners and sometimes, the entity itself. Such agreements often provide that, upon the death of an owner, his or her estate must sell his or her interest either to the entity or its owners. The remaining owners or the entity are also required to purchase said interest. The sale price is often determined by a formula in the agreement.

In order for an agreement to effectively fix the value of interest for estate tax purposes, courts have required that: (1) the price must be fixed and determinable under the agreement; (2) the agreement must bind the parties during life and at death; and (3) the agreement must have been entered into for bona fide business reasons and not just as a way to pass the business to family members at a low valuation. Section 2703 of the Internal Revenue Code (IRC) added an additional requirement that the terms of the agreement be comparable to similar arrangements that would be entered into by people dealing at arm's length.

Unfortunately, a sole shareholder will not be able to enter into a buy-sell agreement with his/her corporation that fixes value in this manner. Value can only be fixed by agreement where you have at least two shareholders or owners dealing at arm's length. For example, in *Estate of Blount v. Commissioner*, the buy-sell agreement was between the decedent and a closely held corporation of which the decedent owned 83% of the stock. The balance of the corporation's stock was owned by an employee stock ownership plan (ESOP) that was not a party to the agreement. The court determined that, although the agreement was, by its terms, binding during the decedent's lifetime, due to the fact that he owned 83% of the corporation, which was the only other party to the agreement, the decedent had the power to change the value, at will. The court ignored the value set by the agreement and determined a higher value for estate tax purposes. It is possible that if the ESOP or another shareholder had been a party to the agreement, the court may have upheld its terms.

For more information about a buy-sell agreement for your business, please contact this office.

MY INTERNSHIP AT VOGT & RESNICK, LLP

BY

RALUCA ANDREI, ATTORNEY AT LAW
DRAGOMIR & ASSOCIATES, LAW OFFICES
BUCHAREST, ROMANIA

When the partners of Dragomir & Associates presented me with the opportunity for a two-week internship at Vogt & Resnick, I got scared. It seemed to me like a trip to a world which, besides being very far away, was very different from mine. However, I decided that visiting a U.S. law firm would be a good experience, so I took the opportunity. This proved to be a very good decision. I learned a lot; not only about what it takes to be an attorney in the U.S., but also about the people. Americans are warm, open, and hospitable. I immediately felt at home.

Working with Vogt & Resnick confirmed to me that it takes more than solid, legal knowledge to be a good attorney. A good lawyer is also a good “psychologist,” who must understand, counsel and be a friend to his client. I’ve also learned that a successful business lawyer understands his client’s business, both from a legal and an economical standpoint, so he can find solutions which are in accordance with the law, but also satisfy his client’s financial interests.

Finally, my internship at Vogt & Resnick showed me that the team is the most important asset of any law office. Vogt & Resnick has an organized team of people who work hard, but also enjoy being together. After all, if you have to “work your fingers to the bone,” at least you can do it in an enjoyable way.

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VOGT & RESNICK LLP

ATTORNEYS AT LAW

4400 MACARTHUR BOULEVARD, NINTH FLOOR

P.O. Box 7849

Newport Beach, CA 92658-7849

(949) 851-9001 • facsimile (949) 833-3445

www.vogt-resnick.com

law@vogt-resnick.com