

## Can Wall Street Reform?

By Jack Butler

While most of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”), recently signed into law by President Obama, relates to financial services companies and consumer protection, two sections of the Act relate to “conflict minerals.” According to the Act, conflict minerals include columbite-tantalum (coltan), cassiterite, gold, wolframite, or their derivatives originating in the Democratic Republic of the Congo (“DRC”) or an adjoining country. A product may be labeled DRC conflict-free if it does not contain conflict minerals that directly or indirectly finance or benefit armed groups in the DRC or adjoining countries (the Republic of the Congo, the Central African Republic, Sudan, Uganda, Rwanda, Burundi, Tanzania, Zambia and Angola).

The provisions of the Act relating to conflict minerals, many of which are routinely used in the manufacture of electronics, are designed to stem the exploitation and trade in conflict minerals from this region, used to finance extremely violent world conflict. Many of these minerals are mined illegally and smuggled over the DRC’s borders by militias and are a major source of their income. As a result, conflict minerals coming from adjoining countries are suspect.

The Act directs the Securities and Exchange Commission (“SEC”) to issue regulations requiring public reporting companies to disclose annually whether conflict minerals that are necessary originated in the DRC or an adjoining country. If conflict minerals originated in any such country, the company must submit a report to the SEC specifically describing the due diligence measures taken on the source and chain of custody of such minerals, which includes an independent audit of such report, the products manufactured or contracted to be manufactured that are not DRC conflict free, the entity that conducted the independent audit, the facilities used to process the conflict minerals, the country of origin of the conflict minerals and the efforts taken to determine the mine or location of origin.

Coltan is used to make tantalum capacitors used in electronic devices such as cell phones, DVD players, video game systems and computers. Because of the many uses of conflict minerals and the need to track their sources and chain of custody, both public reporting companies and private companies should adopt measures to comply with the forthcoming regulations. A public reporting company incorporating a tantalum capacitor manufactured by a private company in its product will need to obtain assurance of the source and chain of custody of the base mineral. For more information on tax and estate planning suggestions, please contact Jane Higgins Marx or your CPM attorney.

As we approach the close of another year, this is a critical time to review tax strategies with your business lawyer. Here are a few items to consider:

**15% Tax on Dividends.** Current law subjects most corporate dividends from C-corps to a flat 15% federal tax (0% for certain taxpayers, depending upon filing status), but this rate is about to sunset. If Congress does not act to extend rates and amend the tax code, dividends will revert to pre-Bush rates and be treated as ordinary income. As such, they would, when received, be taxed at federal rates of up to 38% (and over 40% with the alternative minimum tax). The recent elections have created uncertainty as to how dividends will be treated in 2011, and while the Obama administration has previously signaled

it would support taxing dividends at 20% and has more recently expressed willingness to compromise on extending some of the Bush tax cuts, the shift in Congress leaves unanswered questions.

So, should C-corps with retained earnings declare and pay dividends before year end? Hedging against possibly higher dividend tax rates next year, paying dividends before yearend may be advisable. On the other hand, if one believes the tax rate will stay the same (or that changes made in 2011 will not be retroactive, as Congress has been known to do in the past), then holding off on paying dividends from a purely tax strategy perspective seems reasonable. Dividends can be paid until December 31, 2010, so be attentive of Congress' actions in the coming weeks.

But what if a corporation wants to pay dividends and has retained earnings, but does not want to distribute cash on hand? The corporation could secure a loan to source the dividend. Alternatively, if it does not want to borrow money, dividends can be paid with property. This is best done if a corporation distributes high cost-basis property as the dividend because the property will, for tax purposes, be deemed to be sold by the corporation at its fair market value (FMV), with the result that any gain on such deemed sale will be taxed to the corporation. Because much property today has a lower value than before the recent economic difficulties, if a corporation wants to distribute property to shareholders at today's value believing that such property has good appreciation potential for the shareholders, distributing it now may make sense.

If the C-corp has current or carry-forward net operating losses (NOLs), it can shelter gain triggered by the distribution of property by use of its NOLs. The shareholder-recipient of the property receives the property and is taxed on its FMV, and the property takes on a cost basis equal to such FMV. The shareholder can then sell the property for cash, borrow money from the corporation to cover the dividends tax, lease the property back to the corporation with some pre-paid rent, license it to the corporation if it is intangible property like intellectual property, or use the property as the shareholder otherwise desires. Since the property takes on a new cost basis, that basis will be used to determine depreciation if the property is depreciable (i.e., used by the shareholder in a trade or business, such as leasing it back to the corporation). Further, and subject to an analysis of passive losses of a shareholder, if the shareholder has unused passive losses, such losses may be offset against rental income received by the shareholder as the result of renting the property back to the corporation.

If the corporation needs cash for an equipment purchase, the cash distributed as a dividend can be used by the shareholder to purchase the equipment and then lease it to the corporation. Depreciation and other equipment deductions (e.g., Section 179) may be more valuable or desirable to the shareholder than to the corporation.

There are other good strategies for a corporation and its shareholders, depending on the particular facts of the corporation, and these should be reviewed with counsel in light of your unique circumstances.

#### **Exclusion of 75% of Gain on Investment in "Small" Corporation.**

Section 1202 of the Internal Revenue Code allows for reduced tax on capital gain arising from an investment in a C-corp that is not a "personal service" corporation, financial organization, farm, restaurant, hotel or similar business. If the new investment is made before December 31, 2010 and is held for 5 years, only 25% of the future gain would be subjected to tax when the investment asset (stock received by investor) is sold or exchanged in a taxable transaction after the 5-year holding period. There are some limits on the size of the C-corp (\$50 million in assets) and on the amount of gain subject to the special "relief" rule (\$10 million and potentially more, based on the cost basis of the stock issued). The exclusion of gain translates into a significantly lower capital gain tax, and, if applicable, alternative minimum tax.

If an S-corp desires capital infusion, often the “deal” will result in loss of S-corp status if the investor takes an equity position (i.e., second class of stock or non-qualifying shareholder issue). The S-corp can set up a related C-corp in which the S-corp owns less than 80%, with the investor coming in to the C-corp and the S-corp contributing assets (tangible property, cash, know-how, etc.).

### **Time to Liquidate Your C-Corp?**

If a C-corp wants to be a pass-through entity for tax purposes (e.g., LLC) and does not want to elect subchapter S status and wait for the 10-year bleed-out of built-in gains, now might be a good time to liquidate the C-corp into an LLC owned by current shareholders. Why? The current capital gain rate is 15% (or zero for certain taxpayers, depending on filing status) and asset values of the liquidating corporation may be lower now than in the future. The rate on capital gain is scheduled to go to 20% without a Congressional extension. It is important to note that liquidating the corporation before year-end may be a tax-triggering event for the corporation and its shareholders, so an analysis should be done. The corporation can use its NOLs to reduce its taxable income. Shareholders get a new cost basis for depreciation and can offset future capital gain rates that are likely to increase in the future (and they may have unused capital loss carryforwards). It’s a matter of doing the math and having the cash for any corporate-level and shareholder-level tax liability. And if the company envisions a sale in the not-too-distant future, possibly as an asset sale, getting to “one level of tax” by shedding the C-corp status may be quite beneficial, as a buyer will often pay more in an asset purchase than in a stock purchase transaction.

For more information about these and other tax-minimizing strategies, or to discuss business sales or acquisitions please contact Jack Butler or your CPM attorney.