ATTORNEY MCBRIDE NAMED FELLOW OF THE WISCONSIN LAW FOUNDATION

Patrick G. McBride, shareholder in O'Neil, Cannon, Hollman, DeJong and Laing's Litigation Practice Group, was recently elected Fellows of the Wisconsin Law Foundation.

The Fellows organization was created in 1999 as a special means to honor members of the State Bar of Wisconsin who have achieved significant accomplishments in their career and have contributed leadership and service to their communities. Membership in the Fellows is limited to 2.5% of the State Bar of Wisconsin's total members.

The Fellows aims to energize its members to continue their efforts in the promotion of justice, advancement of the legal profession, and improvement of legal education. For more information on the Fellows click here.

TAX AND WEALTH ADVISOR ALERT: THE OBJECTIVES OF GOOD SUCCESSION PLANNING

This the 4th of 11 articles based on our firm's book *The Art, Science and Law of Business Succession Planning*.
In the last article we discussed the five essential objectives a good succession plan needs to address. In this article we will discuss the first objective in more detail–maximizing the value of the business.

Number 1: Maximize and Protect the Value of the Business

Every business– no matter how large, small, or financially sound– becomes vulnerable to losing value during a change of leadership. Thus, your first goal with succession planning should be to enact a strategy that enables the company to preserve its value and continue to grow after the transfer is complete.

For our discussion, we will assume you've already built a profitable family business that remains on a growth trajectory. The guiding principles that have built your success won't change; the primary variable is the transfer itself. Thus, your best strategy for maximizing company value is to protect its value during the transition. For that reason, this article focuses mainly on protection strategies.

Developing and Retaining a Trusted Management Team

Your best defense against losing company value is to assemble a strong management team well in advance. This team may consist of family members or key associates or managers you trust.

For any key management people who are non-family, it is wise to incentivize them by giving them some financial stake in the company's operation. Consider the following examples.

Minority Stock Ownership

One of the more common methods of sharing a financial stake with key management personnel is to grant them a minority interest in the company through stock ownership. Though if you do so, bear in mind that, by taking this action, you're giving these managers more than just a vested interest–you're also granting them specified rights and legal access to the company as minority stockholders. Let's address some of these in turn.

Right of Inspection

At any time, stockholders have the right to inspect and make copies of some corporate documents, including the list of stockholders, the stock ledger and some financial records. To view or copy these documents, the stockholder must make a written demand stating a "proper purpose" for doing so. In Wisconsin, state law defines "proper purpose" as "a purpose reasonably related to such person's interest as a stockholder."

In plain English, the law requires you to make these records available to minority stockholders if the stockholder provides a specific reason why it's pertinent to their investment. This does not mean you have to automatically open all of your books for every request. If a stockholder requests to see the corporation's books and records, the burden of proof is on the stockholder to demonstrate why this information is needed.

On the other hand, stock ledgers and stockholder lists are more in the stockholder's domain, and the burden of proof would be on you to show why that member does not have a "proper purpose."

Right to Bring a Derivative Suit

If a minority stockholder believes it necessary, he may have the legal right to file a "derivative lawsuit"—that is, to sue a third party on behalf of the institution in which he owns stock. These suits don't happen often, but you need to know they can happen.

Derivative suits are intended to let a stockholder to protect his investment in the corporation in the event that the firm's leadership fails to do so.

Thus a third party defendant may be any entity who poses a perceived threat to the company's well-being. That includes its executive officers and directors. In an extreme application, if you make a key employee a stockholder while you remain in an executive position, that employee could subsequently sue you on behalf of the company, if he believes you breached your duties in some way (such as by using corporate property for personal gain).

In most cases, the stockholder can only bring a derivative claim if the following conditions are met:

• The stockholder must meet the minimum standing requirements as a stockholder, based on applicable laws. (For example, he must own a specified number of shares or be a stockholder at the time of the alleged offense.)
• The stockholder must have already made a written demand to the board of directors to take action, and the board either refused or failed to act.

Because the derivative claim is filed on company's behalf (rather than the individual stockholder's), if he wins the case, any financial award goes to the corporation, and not directly to the stockholder.

Right to Protection Against Shareholder Oppression

This provision protects minority stockholders against financially oppressive or harmful actions by stockholders with a controlling share in the corporation. Examples include:
• Controlling shareholders buy more shares below fair market value
• Forcing minority shareholders to sell their shares below market value
• Taking actions that cause minority shares to drop in value significantly

If a minority stockholder believes controlling stockholders are committing shareholder oppression, he may file a direct suit against the corporation itself, as opposed to a derivative suit.

When you maintain good relations with key employees, and when your company conducts business in an upright manner (even in your absence), chances of a minority stockholder invoking these rights are greatly reduced. But because you grant these rights to anyone who has stock ownership, choose your stockholders wisely.

Deferred Compensation/Bonuses

If you don't want to face the complexities involved with minority stock ownership, deferred compensation can also be an excellent way to give a financial stake to non-family members of your management team.

Deferred compensation is additional income paid out over time, based on profits or other identifiable goals. This gives your key employees a great incentive to stay with your company post-succession. You can implement deferred compensation in a variety of ways; we generally review four of the most common types below.

Deferred Bonus Plans

Bonus plans provide excellent incentives to work hard and grow the company, because the workers receive a share of the additional profits. When bonuses are deferred, they can incentivize staff to remain with the company as long as possible. For example, if you calculate bonuses annually, an employee could receive 50 percent up front, 25 percent in year two and 25 percent in year three, with additional annual bonuses adding to the amount each year. With this in place, employees know they will forfeit a portion of their bonus if they leave the organization.

Non-Qualified Retirement Plans

Unlike the standard plans defined by the Employee Retirement Income Security Act (ERISA), a non-qualified retirement plan is a tax-deferred instrument designed for the specific retirement needs of key employees.

Under this structure, an institution agrees to pay specified additional compensation to the employee upon retirement, and this amount is calculated according to a vesting schedule. Thus, the longer the employee stays with your company, the larger this retirement bonus will be, up to a fixed amount.

Stock Appreciation Rights (SARs)

With stock appreciation rights (SARs), your key employees receive additional deferred compensation tied directly to firm growth. As your business increases in value, your employee’s financial stake grows proportionately in the form of ownership shares, based also upon the employee’s tenure with the company. These shares are given to the employee upon one or more “triggering events,” such as when the employee retires, or if the business is sold.

Phantom Stock Plans

Phantom stocks are similar in nature to SARs, with the main exception that they aren’t actual stock, but instead stock “units” that parallel the value of real stocks. Upon a triggering event as described above, the non-family employee receives a dividend or cash bonus for her phantom stocks, proportionate to the increased value of the actual stock.

Non-Compete Agreements

When a key employee leaves, your company's value may become vulnerable. This is especially true if that employee has knowledge of your client base or trade secrets. To preserve your business interests, you'd be wise to have these employees sign a non-compete agreement of some sort. These agreements occur in two basic forms:
• *Non-compete Clause (or, Restrictive Covenant)*: Under this agreement, the employee promises that if she leaves the organization, she will not perform similar work that might compete with your business within a defined geographic range, for a set period of time.
• *Nonsolicitation Agreemen*t: This agreement specifies that an employee leaving the company will not attempt to solicit your clientele away from you.

Non-compete agreements are validated by some sort of valuable consideration— that is, an added value to the employee as an incentive to sign. For an employee just coming on board, the valuable consideration may be the job offer in itself; however, if you ask existing key personnel to sign a non-compete, you'll need to include additional incentives, such as a bonus, a raise or increased benefits.

It is important to note that in Wisconsin, the validity of non-compete agreements is determined on a case-by-case basis, so it's critical to consult with an employment lawyer regarding the specifics of these contracts.

As the owner of your business, you've already developed habits that encourage company growth. By utilizing tools such as those we've described here, you're building a trusted, motivated management team and laying important groundwork for continued growth of your business after you leave it.

EMPLOYMENT LAWSCENE ALERT: BREAKING NEWS: DOL SETS OVERTIME SALARY EXEMPTION THRESHOLD AT $35,568

On September 24, 2019, the U.S. Department of Labor announced a final rule to increase the salary threshold necessary to exempt executive, administrative and professional employees from the Fair Labor Standard Act's (FLSA) minimum wage and overtime pay requirements. The final rule raises the annual salary threshold from $23,660 (or $455 per week) to $35,568 (or $684 per week). The FLSA requires covered employers to pay employees a minimum wage and, for employees who work more than 40 hours in a week, overtime premium pay of at least 1.5 times the regular rate of pay. Section 13(a)(1) of the FLSA, commonly referred to as the "white collar" or "EAP" exemption, exempts from these minimum wage and overtime pay requirements “any employee employed in a bona fide executive, administrative, or professional capacity.” Now for an employee to qualify for one of the EAP exemptions, generally, that employee has to be paid on a salary basis and earn at least $35,568 per year or $684 per week. The final rule becomes effective January 1, 2020.

The final rule also allows employers to use non-discretionary bonuses and incentive payments (including commissions) to satisfy up to ten percent of the standard salary level as long as such payments are paid annually or on a more frequent basis. In addition, if an employee does not earn enough in nondiscretionary bonus or incentive payments in a given year (52-week period) to retain his or her exempt status, the employer may make a “catch-up” payment up to ten percent of the total salary level for the preceding 52-week period. This “catch-up” payment must be paid within one pay period following the end of the 52-week period. In plain terms, each pay period an employer must pay the EAP employee on a salary basis at least 90 percent of the standard salary level and, if at the end of the 52-week period the sum of the salary paid plus the nondiscretionary bonuses and incentive payments (including commissions) paid does not equal the standard salary level for the 52-week period, the employer has one pay period to make up for the shortfall (up to 10 percent of the required salary level). Any such catch-up payment will count only toward the previous 52-week period’s salary amount and not toward the salary amount in the 52-week period in which it was paid.

Today’s final rule is the product of the Trump administration’s efforts to reset the Obama administration’s 2016 final rule that had established the salary threshold at $47,476 per year or $913 per week. The Obama administration’s controversial final rule was struck down on November 22, 2016 by a federal district court in Texas because it “makes overtime status depend predominately on a minimum salary level, thereby supplanting an analysis of an employee’s job duties.” An appeal of that decision is still pending before the United States Court of Appeals for the Fifth Circuit. However, given the release of today’s final rule, the DOL will rescind the Obama administration’s 2016 final rule making the pending appeal moot.

The final rule also raises the total annual compensation requirement for “highly compensated employees” (HCE) from the currently enforced level of $100,000 per year to $107,432 per year. The HCE salary level of $107,432 is set at the 80th percentile of full-time salaried workers nationally using updated 2018/2019 salary data. However, Wisconsin employers should note that Wisconsin law does not recognize the HCE exemption, and, as a result, Wisconsin employers should not rely or utilize this exemption when classifying employees for wage and hour purposes.

Finally, the DOL’s proposed rule published on March 7, 2019 rejected the Obama administration’s 2016 rule that provided for automatic adjusting every three years of the salary threshold for the EAP exemptions. Instead, the DOL’s March, 2019 proposed rule rejected automatic adjusting and favored that the Secretary of Labor review the salary threshold every four years preceded by a period of public comment. The DOL's final rule, however, reaffirmed the DOL's intent to update the standard salary level and HCE total annual compensation threshold more regularly in the future using notice and comment rulemaking, but declined to make a commitment to do so every four years believing that prevailing economic conditions, rather than fixed timelines, should drive future updates.

TAX AND WEALTH ADVISOR ALERT: PROPOSED BIPARTISAN BILL TO EXPAND RESEARCH AND DEVELOPMENT TAX CREDIT

Late July, Senator Maggie Hassan (D-NH), a member of the Senate Finance Committee, and Senator Thom Tillis (R-NC) introduced the bipartisan Research and Development Tax Credit Expansion Act that aims to double the refundable research and development (R&D) tax credit and increase the alternative simplified credit rate for new and small businesses. If enacted, the bill would provide additional cash savings for eligible businesses that perform qualified R&D activities.

Background

While the R&D tax credit has been around for a while, historically, many small businesses and start-up companies could not immediately benefit from the R&D credit as they were not generating income in early years and thus they had no regular tax for the R&D credit to offset. Noticing this limitation, the PATH Act of 2015 added new IRC Sections to allow qualified small businesses to apply the R&D credit against their employer's payroll tax liability (up to $250,000 annually). For these purposes, a "qualified small business" is generally defined as a corporation, partnership or sole proprietorship with: (1) gross receipts of less than $5 million for the tax year and (2) no gross receipts for any tax year before the five tax years ending with the election year.

New R&D Credit Bill

The new bill aims to double the amount of R&D credit that can be used to offset an employer's payroll tax liability by increasing the annual cap from $250,000 to $500,000 and then automatically indexing for inflation. In addition, the bill would expand the number of eligible businesses that qualify for the credit by raising the maximum amount of gross receipts from $5 million to $10 million per year. It would also allow the R&D credit to offset *all* payroll taxes so businesses can apply the credit against Medicare and unemployment taxes, in addition to Social Security taxes. Lastly, the bill would increase the alternative simplified credit rate (a method used to calculate the R&D credit), which provides a credit of 14% for research that exceeds half of the average research spending from the last three years. The bill would increase the alternative simplified credit rate from 14% to 20% for new and small businesses that qualify for the credit.

Implications

If enacted, eligible taxpayers would doubly benefit by both generating a higher credit amount and being able to apply more of the credit generated against their payroll tax. Additionally, the bill would increase both the availability of the payroll offset option as well as the ability to generate cash tax savings for eligible taxpayers. The proposed Act certainly removes many of the barriers that limit a new or small businesses' ability to claim the credit. Nevertheless, while we wait to see if Congress will approve the Research and Development Tax Credit Expansion Act, we will continue to advise our clients to ensure their R&D tax credit compliance and counsel on effective tax planning opportunities should the Act go into effect.

If you are interested in learning more about your eligibility or effective tax planning opportunities for the current and/or proposed R&D tax credit, please contact Attorney Britany E. Morrison at O'Neil Cannon to discuss how we are able to assist you in your needs.

EMPLOYMENT LAWSCENE ALERT: EIGHTH CIRCUIT HOLDS THAT AN SPD CAN FUNCTION AS A PLAN DOCUMENT

A federal appellate court has ruled, in *MBI Energy Services v. Hoch*, decided in July 2019, that a single document may serve as both the summary plan description (SPD) and the formal plan document for an ERISA welfare benefit plan.

In this case, the plan sponsor of a self-insured group health plan paid benefits on behalf of a participant for medical injuries sustained in an accident. Subsequently, the participant settled a tort claim with a third party who allegedly caused the accident. The settlement amount exceeded the amount of the plan-paid medical expenses and the plan sponsor sought reimbursement.

ERISA Requires a Plan Document

Under ERISA, the requirement that "every employee benefit shall be established and maintained pursuant to a written instrument" is understood to mean that the terms of each benefit program must be memorialized in a written plan document. ERISA further requires the plan sponsor to provide to each plan participant an SPD that briefly and clearly summarizes the terms of the plan document.

In some cases, plan sponsors do not offer two separate documents (a plan document and an SPD), but rely, instead, on a single combined document that purports to function both as the plan document and as the SPD.

Several courts have argued that a combined Plan document and SPD is unacceptable on the grounds that it is not possible for a document to summarize itself. Nonetheless, in the self-insured medical plan context (where coverage exclusions and limitations are difficult to summarize), it is common to have a single document that serves as both the plan document and the SPD.

Where's the Plan?

While the employer in the *MBI Energy Services* case could point to no document clearly identified as the "plan," there was an administrative services agreement (ASA) between the employer and the plan's claims administrator indicating that the plan benefits, terms, and conditions were set forth in an attached exhibited – the SPD. Along with the benefit provisions and ERISA-mandated language, the SPD contained sections addressing the rights of subrogation, reimbursement, and assignment. The SPD stated, in part, that if a participant "makes any recovery from a third party . . . whether by judgment, settlement or otherwise," the participant must reimburse the plan sponsor "to the full extent of any benefits paid" by the plan.

The Arguments

The participant argued that the SPD was not a valid plan document and that the employer therefore had no right to reimbursement. Instead, the participant asserted that the SPD was only a summary of, and in conflict with the terms of, the ASA, which the participant contended was the controlling plan document. The participant's argument was rooted in the Supreme Court's reasoning, in its 2011 *CIGNA v. Amara* ruling, that "'summary documents, important as they are, provide communication with beneficiaries *about* the plan, but that their statements do not themselves constitute the *terms* of the plan."

The plan sponsor, on the other hand, argued that the SPD functioned as both the SPD and the plan document and that the SPD's reimbursement language gave the plan an equitable lien on the participant's recovery proceeds.

The Ruling

The Eighth Circuit disagreed with the participant's contention that the SPD was unenforceable because it conflicted with the ASA, pointing out that the ASA was silent as to reimbursement and expressly incorporated the terms and conditions of the SPD. The court thereby joined other circuits in distinguishing *CIGNA v. Amara* (a retirement plan matter in which both a plan document *and* an SPD were present) and concluding that, absent a formal plan document, the SPD may function as the plan document.

Specifically, the court rejected as "nonsensical" any interpretation that renders no plan document at all under the terms of ERISA and concluded that the label of SPD is not dispositive. Where no other source of benefits exists, the SPD *is* the formal plan document.

The court also pointed out that it would be inequitable to allow the participant to receive benefits according to the SPD but not hold him to the reimbursement responsibilities set forth in that same document. It concluded that, since the SPD was the plan's written instrument, the participant was bound by its terms and obligated to reimburse the plan.

As a result, the participant was required to reimburse the self-funded employee benefit plan for $45,474 in medical benefits the plan had paid.

Implications

Since the U.S. Supreme Court's *CIGNA v. Amara* ruling, plan sponsors of self-insured plans have wondered whether the common practice of using a single document as both the plan and the SPD may permissibly continue. The Eighth Circuit's *MBI Energy Services* ruling adds to a growing list of cases finding that an SPD can function as an enforceable ERISA welfare plan document in the absence of a separate additional document.

Plan sponsors should take note that identifying the controlling language relevant to a given employee benefit plan is not always clear cut. In some cases (as here), the plans terms may be contained within a single document. In other instances, the terms of an ERISA plan may be inferred from a series of documents, none of which is clearly labeled as a plan.

Do your Plan's Documents Protect You?

All plan sponsors are advised to review whether their documents for ERISA welfare plans (such as group health, dental, vision, disability, and life plans) not only comply with ERISA, but also whether they reflect the employer-specific disclosure requirements and employer-protective statements, which are typically *not* included in documents prepared by insurers or third-party administrators.

In many cases, it is advisable to streamline multiple separate ERISA benefits into a single so-called Wrap Plan document, which 'wraps around' and supplements the other documents to become the SPD. A Wrap Plan can help employers to minimize the risk of financial penalties and lawsuits and streamlines certain reporting and amendment requirements.

The attorneys of the Employment Law Group of O'Neil, Cannon, Hollman, DeJong and Laing can assist in reviewing and providing counsel relating to the documentation and operation of all employer-sponsored employee benefit and compensation plans.

ARETHA FRANKLIN'S ESTATE: ARE HANDWRITTEN DOCUMENTS VALID WILLS?

Aretha Franklin's heirs are embroiled in a court battle due to several handwritten documents that the Queen of Soul wrote before her death. The issue at hand is: Are these handwritten documents valid wills under Michigan law?
Shortly after Aretha's death in August 2018, no will could be found, which meant that Aretha's assets would be distributed to her next of kin via Michigan's intestate law. Later, three separate handwritten wills were found in Aretha's home, leading to a dispute between Aretha's children in the Michigan probate court. One will was found in a notebook stashed under some couch cushions in Aretha's living room. The attorney for Aretha's estate submitted these handwritten wills to the probate court, even though he questioned whether these handwritten wills were valid under Michigan law. The documents lack the usual formalities of a Last Will and Testament–some of the handwriting is difficult to read, some verbiage is crossed out, and some notes are penned in the margins of these documents.

The validity of handwritten wills is often questioned because it is difficult to know whether the decedent really did write the document, whether that document truly conveys the decedent's last wishes, and sometimes, what the decedent's last wishes were.

<u>Michigan Law May Honor Aretha's Handwritten Will</u>

In Michigan, the general rule is that a will is valid if it meets three requirements: (1) it is in writing; (2) it is signed by the testator or, while the testator is present, by another at the testator's direction; and (3) it is signed by at least two witnesses within a reasonable time after seeing the testator sign or after the testator acknowledges the signature. At first glance at this statute, it would appear the handwritten wills of Aretha drafted in private do not comply with the Michigan statutory requirements.

However, Michigan recognizes an exception to the will requirements under what is known as a "holographic will." A holographic will is an informal will that is handwritten and signed by the testator, but there is no witness requirement or the need for lawyer involvement, thereby forsaking some of the execution formalities required under Michigan law. Michigan simply requires a holographic will to be dated, signed, and that the material terms of the will are in the testator's handwriting.

For any of Aretha's holographic wills to be upheld the proponents of her will need to establish she intended these documents to be her last will and testament. Michigan courts will declare a holographic will valid only if it can be demonstrated by "clear and convincing evidence" that the testator intended the document to be the decedent's will. Aretha's intent can be proven by using outside evidence such as the nature of the relationships with her sons or even portions of the documents not in her handwriting. Aretha's intent may be difficult to prove, because of the informal and secretive nature of the handwritten wills. Even if Aretha's intent can be shown and a handwritten will is upheld by the court, a long and expensive court battle among her children will likely follow.

Wisconsin Law Does Not Allow Holographic Wills

Unlike Michigan, Wisconsin has taken a firm stance against holographic wills and will not uphold them as valid. In Wisconsin there are nearly identical will requirements to those in Michigan: (1) it must in writing; (2) the will must be signed by the testator or in the presence of the testator at the testator's direction; and (3) the will must be signed by at least two witnesses within a reasonable time after witnessing the signing of the will, after the testator's acknowledgment of their signature on the will, *or* after the testator's acknowledgement of the will. What is not identical is Wisconsin's acceptance of holographic wills. If the controversy was taking place in Wisconsin, Aretha's handwritten documents would not be held to be valid wills and Aretha's estate would be distributed to Aretha's next of kin via Wisconsin's default intestate rules.

Estate planning can be a challenging and stressful process that all too often ends in disputes such as this. Wisconsin residents should meet with an experienced estate planning attorney to ensure his or her will is valid under Wisconsin law.

For estate planning assistance contact Kelly M. Spott at 414-276-5000 or kelly.spott@wilaw.com.

EIGHTEEN OCHDL ATTORNEYS NAMED 2020 BEST LAWYERS IN AMERICA®

O'Neil Cannon is pleased to announce that eighteen lawyers have been named to the 2020 Edition of *Best Lawyers*, the oldest and most respected peer-review publication in the legal profession.
Best Lawyers has published their list for over three decades, earning the respect of the profession, the media, and the public as the most reliable, unbiased source of legal referrals.

Its first international list was published in 2006 and since then has grown to provide lists in over 75 countries.

"For more than a third of the century," says CEO Steven Naifeh, "Best Lawyers has been the gold standard of excellence in the legal profession." President Phil Greer adds, "We are extremely proud of that record and equally proud to acknowledge the accomplishments of these exceptional legal professionals."

Lawyers on *The Best Lawyers in America* list are divided by geographic region and practice areas. They are reviewed by their peers on the basis of professional expertise, and undergo an authentication process to make sure they are in current practice and in good standing.

We would like to congratulate the following attorneys named to the 2020 *Best Lawyers in America* list:

- Douglas P. Dehler – Litigation – Insurance
- James G. DeJong – Corporate Law, Mergers and Acquisitions Law, Securities / Capital Markets Law
- Seth E. Dizard – Bankruptcy and Creditor Debtor Rights / Insolvency and Reorganization Law, Litigation Bankruptcy
- Peter J. Faust – Corporate Law, Mergers and Acquisitions Law
- John G. Gehringer – Commercial Litigation, Construction Law, Corporate Law, Real Estate Law
- Joseph E. Gumina – Litigation – Labor and Employment
- Dennis W. Hollman – Corporate Law, Trusts and Estates
- Grant C. Killoran – Litigation – Health Care
- Dean P. Laing – Commercial Litigation, Personal Injury Litigation – Plaintiffs, Product Liability Litigation – Defendants
- Gregory W. Lyons – Commercial Litigation, Litigation – Insurance
- Patrick G. McBride – Commercial Litigation
- Thomas A. Merkle – Family Law
- Chad J. Richter – Business Organizations (including LLCs and Partnerships)
- John Schreiber – Bankruptcy and Creditor Debtor Rights / Insolvency and Reorganization Law, Litigation – Bankruptcy
- Steven J. Slawinski – Construction Law

Since it was first published in 1983, *Best Lawyers* has become universally regarded as the definitive guide to legal excellence. *Best Lawyers* is based on an exhaustive peer-review survey. Over 54,000 leading attorneys cast more than 7.3 million votes on the legal abilities of other lawyers in their practice areas. Lawyers are not required or allowed to pay a fee to be listed; therefore inclusion in *Best Lawyers* is considered a singular honor. *Corporate Counsel* magazine has called *Best Lawyers* "the most respected referral list of attorneys in practice."

EMPLOYMENT LAWSCENE ALERT: DOCUMENTATION MATTERS!

If you call your employment lawyer and tell her that you want to terminate an employee for performance issues, one of the first questions will be "What documentation do you have?" Recently, the Seventh Circuit confirmed just how crucial documentation can be when defending an employment lawsuit.

In *Rozumalski v. W.F. Baird and Associates*, decided August 22, 2019, the employee had been sexually harassed by her supervisor, who was investigated by the employer and terminated once the investigation confirmed the allegations. However, after her supervisor's termination, the employee was eventually terminated from her job and filed a federal complaint alleging that she had been retaliated against for her original sexual harassment claim and for other complaints stating that her previous supervisor who had been terminated had negatively influenced her new boss in retaliation. The company testified that the employee was terminated for legitimate, non-discriminatory reasons, namely, performance issues. The company stated that the employee struggled with her business development responsibilities, submitted a report that was grossly below company standards and required significant reworking, and was consistently late to work. These performance issues were documented in her written performance evaluation and listed as "needs improvement." The employee then continued to receive negative performance evaluations, which provided specific examples to support the company's concerns about her work, and was eventually placed on an Employee Improvement Plan. When she violated a term of her Employee Improvement Plan, she was terminated.

The Seventh Circuit acknowledged that a prior complaint of harassment could impact a victim long after the incident. However, it found that the employee's new supervisor was not aware of her original harassment complaints until at least five months after the first negative performance review and, therefore, could not have been motivated by a retaliatory animus. Additionally, the individual who made the ultimate decision to terminate the employee's employment did not know about the original complaints and was motivated solely by the employee's violation of the Employee Improvement Plan. Finally, the Seventh Circuit observed that the employee's complaints that her new supervisor was negatively impacted by her previous supervisor could not have been a basis for retaliation because her documented performance issues predated her complaints.

This case stresses the importance of employers properly documenting employee performance issues and creating honest performance evaluations that accurately describe and document employee performance issues. Performance evaluations should be focused on critical performance issues measured against the employer's legitimate business expectations. When an employee fails to meet a legitimate business expectation, the performance evaluation should reflect that deficiency. Too often, employers want to terminate underperforming employees without supporting documentation. For example, when an employee's most recent performance evaluations are reviewed prior to termination and there is absolutely no indication or evidence of poor or underachieving performance, the company's business records do not match the reality of the employee's performance, and the termination decision becomes more problematic.

The Seventh Circuit's decision could have been much different for this employer if the employee's performance issues had not been documented or had not been documented accurately. As demonstrated, good and accurate documentation is vitally important—it may be the difference for your company in winning or losing a lawsuit.

TAX AND WEALTH ADVISOR ALERT: TIME TO ACT ON ACT 368: WISCONSIN PASS-THROUGH ENTITY-LEVEL TAX ELECTION

In December of 2018, Wisconsin enacted tax legislation—Wisconsin Act 368—that specifically impacted LLCs, S-Corps, and partnerships ("pass-through entities"). The Act allows pass-through entities to make an annual election to be taxed at the entity-level, rather than at the individual level. This election may provide significant tax savings to Wisconsin businesses and their owners, but this election won't work for everyone. While the new Wisconsin law certainly brings some tax saving opportunities, there are election rules and potential issues that Wisconsin owners of pass-through entities must consider before deciding whether to make the election.

BACKGROUND

Historically, individuals were not limited in what they could deduct for state income and property taxes. However, starting in 2018, due to the Tax Cuts and Job Act, the deduction for state income and property taxes is now limited to $10,000. Wisconsin has attempted a creative approach with Act 368 to circumvent this limitation by allowing pass-through entities to be taxed at the entity-level. The idea is that the Tax Cuts and Job Act deduction cap applies to individuals and not businesses, so by allowing the pass-through entity to be taxed at the entity-level, the deduction is shifted from a capped deduction to an uncapped deduction.

TREATMENT

The new provision allows for pass-through entities to elect to be taxed at the entity-level which is a flat rate of 7.9% (the WI corporate income tax rate) rather than passing the income to shareholders to be taxed on their individual return (7.65% for individuals at the highest income tax rates). The entity-level tax would then be deductible by the pass-through on its Federal return resulting in a decrease of Federal income and corresponding Federal tax. Therefore, even though the entity-level rate is higher than the individual rate, this could still result in beneficial tax savings if pass-through owners were previously limited by the cap.

ELECTION

S-Corps can begin making the election beginning with the 2018 tax year, while partnerships and LLCs may make this election starting with the 2019 tax year. For S-corps, persons holding more than 50% of shares on the day of election must consent, while for partnerships, persons holding more than 50% of capital and profits interest on the day of election must consent. The advantageous feature about this election is that it is flexible, in that it can be made on an annual basis. Pass-through entities can opt in or out each year without limitation or penalty. Additionally, the election must be made on or before the due date or extended due date of the WI return.

POTENTIAL ISSUES

While this may sound like a straight forward decision to make the election for a Wisconsin owner of a pass-through entity, there are several potential issues to consider before making the election.

- *Tax Rate*: If taxpayers in pass-through entities are not subject to the top individual income tax rate of 7.65%, it is possible they may not receive enough of a benefit from the entity-level deduction to offset the cost of having to pay tax at a higher 7.9% rate.
- *Credits*: The only credit that pass-through entities may claim against the WI entity-level tax is the credit for income taxes paid to other states. The loss of the ability to claim manufacturing and agricultural credits in addition to research and development credits, for example, may outweigh the benefits of the election.
- *Loss Position:* The election would not be advisable for pass-through entities experiencing losses as there would be no deductible state taxes anyway and such losses would effectively be wasted.
- *Out -of-State Owners*: If the pass-through entities have a substantial number of out-of-state owners they may not benefit from the election if the owners are not allowed a corresponding exclusion or credit for the income tax being paid at entity-level in WI on their individual home state returns.

- *Lack of IRS Support*: There has been no guidance or reaction from the IRS yet, so there is a risk that future Federal laws or regulations could render this WI election ineffective. Other states have attempted workarounds and the IRS has made those ineffective by proposed regulations and notices. Although WI's workaround is a bit different than the state's that have tried, and there is support, there is still risk.
- *Legal Document Compliance*: The election may require amendments to the Wisconsin pass-through entities' operating agreement and formation documents. This should be discussed with legal counsel and the documents should be amended, if necessary, before the election is made.

Ultimately, pass-through entities in an income position that do not have any applicable WI credits or out-of-state owners have the best potential for tax savings. However, because the election does not have to be made until the extended due date, there is a real opportunity for Wisconsin owners of pass-through entities to analyze the above-mentioned issues with both tax advisors and legal counsel to determine whether the election is beneficial and/or worth the extra compliance costs before committing to the election.

If you are interested in learning more about Act 368 and WI's entity-level tax election or need assistance in tax and/or legal planning to take advantage of the election, please contact Attorney Britany E. Morrison at O'Neil Cannon to discuss how we are able to assist you in your needs.

IRS UNVEILS SIGNIFICANT VIRTUAL CURRENCY TAXATION ENFORCEMENT INITIATIVE

The Internal Revenue Service (IRS) recently announced that, by the end of August 2019, more than 10,000 taxpayers would receive mailed letters relating to virtual currency. The IRS is sending the letters to taxpayers who may have failed to report income, pay taxes, or properly report virtual currency transactions. For this purpose, virtual currency includes cryptocurrency and non-crypto virtual currency, including Bitcoin, Ether and JPM Coin.

There are three different types of letters being sent to taxpayers. Each of the three versions are intended to provide information to help taxpayers understand their tax and filing obligations and how to correct previous errors. However, the letters differ from one another in tone and in the response required by the recipient taxpayer.

Two of the letters invite taxpayers to voluntarily report and pay previously unreported virtual currency income, penalties, and interest. The other letter alleges likely noncompliance in stronger terms and requires specific action by a stated deadline. The text of this final letter indicates that the recipient should expect significant IRS scrutiny, as well as potential examination or enforcement action.

Three Letter Versions

- **Letter 6174** (available here) notifies a taxpayer that the IRS has information regarding a potential failure to report income from a virtual currency transaction. The letter provides information regarding the taxation and reporting rules which apply regardless of whether the taxpayer received a payee statement (such as a Form W-2 or Form 1999) for a virtual currency transaction. Taxpayers need not respond to the letter, but are advised to file amended tax returns or delinquent tax returns if a virtual currency transaction was not previously accurately reported on a federal income tax return.
- **Letter 6174-A** (available here) is worded nearly identically to Letter 6174. A key difference is that this letter informs the recipient taxpayer that the IRS is likely to send additional correspondence about potential virtual currency tax enforcement in the future.
- **Letter 6173** (available here) asserts that federal tax filing and reporting requirements appear to have been unmet by the recipient taxpayer for one or more of the tax years 2013 through 2017. The letter then directs the taxpayer to file amended tax returns. If the taxpayer believes that all tax reporting requirements have already been properly met, the taxpayer must formally respond to the IRS to attest to that position. Supporting detail and documentation must also be submitted. The taxpayer is required to sign the attestation under penalties of perjury that the submission, including all attachments, are true, correct, and complete. Any taxpayer-submitted information will be checked for accuracy against information received by the IRS from banks, financial advisors, and other sources. If a taxpayer does not respond to this letter within 30 days of the date on which the letter was mailed, the IRS will refer the account for audit.

Second Round of Additional Letters

In addition to the more than 10,000-letter initiative that the IRS publicly announced, as described above, some taxpayers are also reporting receipt of an apparent second group of letters in the form of a CP2000 Notice. The CP2000 Notice states that the IRS has received information from a third party that doesn't match information on the taxpayer's submitted tax return. The notices acknowledge that a virtual currency trading exchange, rather than the taxpayer, may have made the error. In any event, receipt of a CP2000 Notice indicates that the IRS is aware of a reporting discrepancy. A response to the letter is imperative and additional detail on responding is available here).

IRS Regards Virtual Currency as Property

The current IRS Virtual Currency enforcement initiatives conform to IRS guidance previously published in Notice 2014-21, which provides that virtual currency is treated as property for federal tax purposes. As is the case with any property, tax law requires reporting and taxation of amounts that are transferred for services or sold. Among other things, this means that:

- A payment made (or received) in virtual currency is subject to information reporting to the same extent as any other payment made (or received) in property.
- Payments using virtual currency made to independent contractors and other service

providers are taxable, and self-employment tax rules generally apply. Typically, payers must issue Form 1099-MISC.

- Wages paid to employees using virtual currency are taxable to the employee, must be reported by an employer on a Form W-2 and are subject to federal income tax withholding and payroll taxes.
- Certain third parties who settle payments made in virtual currency on behalf of merchants that accept virtual currency from their customers are required to report payments to those merchants on Form 1099-K, Payment Card and Third-Party Network Transactions.
- A taxpayer that successfully "mines" virtual currency (for example, uses computer resources to validate Bitcoin transactions and maintain the public Bitcoin transaction ledger) realizes gross income upon receipt of the virtual currency resulting from those activities.
- The character of gain or loss from the sale or exchange of virtual currency depends on whether the virtual currency is a capital asset in the hands of the taxpayer.

Expect Additional IRS Enforcement Efforts

The IRS has stated its awareness that because transactions conducted using the more than 1,500 known virtual currencies can be difficult to trace and have an inherently pseudo-anonymous aspect, some taxpayers may be tempted not to report virtual currency-related income to the IRS. The mailing of the more than 10,000 letters and the CP2000 Notices, to taxpayers believed to have engaged in unreported virtual currency transactions, is therefore likely to be only the first of many virtual currency enforcement actions. Additional IRS guidance is expected to be published on virtual currency reporting and taxation rules soon, updating the last official guidance issued in 2014

In the meantime, even taxpayers who do not receive a letter or notice should be aware that a failure to properly report the income tax consequences of virtual currency transactions could result in liability for tax, penalties, interest, and in some cases, exposure to criminal prosecution. Criminal charges could include tax evasion and filing a false tax return. Anyone convicted of tax evasion is subject to a prison term of up to five years and a fine of up to $250,000. Anyone convicted of filing a false return is subject to a prison term of up to three years and a fine of up to $250,000.

The attorneys of O'Neil Cannon can assist in reviewing, or responding to any of the three types of IRS Virtual Currency letters, the CP2000 Notices, and other tax-related notice or assessment letters received from the IRS.