CORPORATE CAPITAL RESOURCES LLC

Capital Notes

Quarterly Updates for Friends & Clients of CCR

First Quarter 2012

The New Year is Off and Running (We All Better Be ...)

Saying good-bye to 2011 was not all that difficult. In looking at the management, legal, plan compliance and financial challenges faced by dozens of clients last year, we have to recommend that flexible planning sooner-rather-than-later be a New Year's resolution.

Discussions with many clients revealed that those who took steps ahead of their fiscal and plan year ends to develop proper responses to corporate financial concerns, for example, left them much better positioned at year end to deal with a downturn (or significant upturn) in their operating results. If you would like further information on the CCR strategic support program, please contact Lisa at 540-345-4190.

Events and Appearances

Bill Gust and Michael Coffey will be in Scottsdale, AZ on January 29-31 to address the Bank Director Magazine's national conference: "Acquire or be Acquired." A copy of their presentation on flexible ESOP strategies for banks and bank holding companies is available from Cynthia Mendoza, either via email or as hard copy.

Lisa Tilley will be speaking at the ESOP Association Tri-State Conference at Pinehurst, NC, March 25-27. She will address issues related to ESOP plan distributions and strategies for managing participant expectations in light of IRS and DOL requirements, especially audit concerns.

Michael will also be at the same conference to deal with the proper management and funding of long term ESOP stock repurchase obligations. The Corporate Capital team will be available in break-out sessions to address your specific questions and we are always happy to schedule time for a conversation, if you can make the conference.

Bill and Michael will also be speaking at the Annual Conference of the National Center for Employee Ownership and the Beyster Institute in Minneapolis, April 25-27. They will address issues related to the sustainability of a mature ESOP. Once again, we will be available in break-out sessions to address your specific questions; please let us know if you would like additional

Quick Links

Check Out Our Website

Meet Our Professionals

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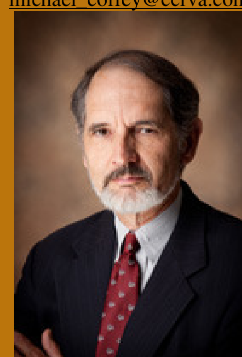

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information on this best-of-class national conference or would like to schedule some time to visit if you are there.

Publications

Michael and his co-author, Keith Apton, have just completed a chapter for the book, "Selling to an ESOP," being published by the National Center for Employee Ownership. The discussion of the IRC Section 1042 tax-free ESOP rollover is an important update of Michael's much earlier article, now reflecting strategies to deal with an increasingly volatile market.

The CCR team co-authored "The ESOP Handbook for Banks," which will be available later in the month of January. This 75 page book is both a strategic overview of how ESOPs function in the banking space and a more technical treatment of their effect on capital and leverage ratios, as well as stock valuation. Any Bank Board director or officer of a closely-held bank or bank holding company should have a copy, if for no other purpose than to understand the ESOP alternative to outside capital, which can compromise control and dilute shareholder value. This is especially true in the era of stress-testing and TARP.

Technical Corner

Considerations for C Corporations with ESOPs Converting to S Status

Over the years, many C corporations with ESOPs have converted to S corporation status. This can be especially helpful when the ESOP owns a majority of the company's stock. As an ESOP is a tax exempt trust constituting a single shareholder, S status can provide a substantial tax benefit, even reducing taxes on corporate earnings to zero where the ESOP owns 100% of the shares. It is arguably a duty of any Board of Directors (who are also ESOP fiduciaries) to consider the change.

Among issues to be considered (not an exhaustive list) before making such an election:

1. The election requires the consent of all shareholders. An ESOP Trustee votes the ESOP shares in this case as the legal owner of the stock in the ESOP Trust. The ESOP participants do not vote on the S election.
2. An S corporation can only have 100 shareholders (the ESOP counts as a single tax exempt shareholder).
3. S corporations can only have one class of stock, with the one exception that it can have voting and nonvoting common shares. No convertible preferred or super-common stock is allowed. Having preferred stock may or may not be sufficiently compelling to warrant remaining a C corporation.
4. After conversion to S status, corporations that were using last-in, first-out (LIFO) accounting are subject to a LIFO recapture tax of the difference between LIFO and FIFO (first-in, first out). This excess must be recaptured based on the FIFO value of inventory over the LIFO value at the

close of the C corporation's last tax year. In addition, appropriate adjustments are made to the basis of the inventory to take into account the amounts included in gross income. This could be substantial, especially in capital-intensive businesses.

5. For a 10-year period (7 or 5 in some years) after conversion, if the company sells any asset it held on the day of its S corporation election, it will have to pay "built-in gains" tax on that sale. This tax is in addition to taxes paid by shareholders.
6. The built-in gain or loss on an assets sale is calculated by comparing the fair market value of the assets on the effective date of the conversion from C to S corporation status with the basis of the assets on that day. That amount is the potential built-in gain subject to tax upon sale of the asset.

Lisa has a more detailed article which can be emailed upon request. As always, please call our offices with questions, since the correct and timely response to a corporate concern has often saved our clients not just dollars, but also headaches.
