



60 YEARS OLD

The older one gets, birthdays become not only occasions for celebration, but for reflection as well. So it is with our firm's 60th birthday on September 1, 2005. We will celebrate the event in the usual ways. But for those of us who have been with the firm awhile, we also take the occasion to reflect on the reasons why we have been able to reach this milestone. These reflections yield a simple and straightforward answer. Our success and longevity is attributable to one reason: great people. Throughout our 60 years, Carr McClellan has been home to some wonderfully intelligent, dedicated attorneys who have applied their considerable talents to take on and solve the challenges brought to them by our clients. They have worked, and continue to work, quietly and diligently without fan-fare or fame. Often the causes that they champion are not front-page news, but they are the causes of our clients, so they are of the utmost importance.

All of us at Carr McClellan chose to build a career in law in an environment that allowed us to practice at often the highest levels of legal sophistication while at the same time building life long relationships with each other and with clients and the members of the communities that we serve. Many of my colleagues could have chosen other paths that perhaps would have led to fame and fortune. Instead they chose the Carr McClellan path. I was struck by this fact as I flipped through the most recent edition of the Stanford Alumni magazine that featured on its cover Supreme Court Chief Justice Rehnquist and one of his Stanford Law School classmates, fellow Supreme Court Justice, Sandra Day O'Connor. As I scanned the picture of the members of the 1950-51 Law Review, standing shoulder to shoulder with two present members of the United States Supreme Court, was our own Albert J. Horn.

Yes, great people who are great lawyers are why Carr McClellan can celebrate 60 years of service. It is also why I am confident that it will celebrate many more well into the future.

Mark Cassanego, President of Carr McClellan.

NAVIGATING THROUGH INTERNATIONAL ESTATE PLANNING WATERS

By Golnar Yazdi, Esq. and
Laurelle Gutierrez-Lundquist, Esq.

We are fortunate to live in an area where cross-cultural and cross-national boundaries have blurred. Multigenerational families who are citizens of a variety of countries around the world are typical in the San Francisco Bay Area. In most areas of the law a person who is a permanent United States resident but not a United States citizen is treated the same as a citizen. However, in the area of estate and gift tax, these international contacts or relationships create surprising tax issues.

If you are a person who might fall into this category, you should pay careful attention to the tax rules that govern gifts and bequests between U.S. citizens and non-U.S. citizens. In particular, there are restrictions on gifts and bequests to a non-citizen spouse, tax consequences of naming a non-U.S. person or entity as the trustee of a family trust, as well as reporting requirements for gifts received from non-U.S. persons or trusts.

The Non-Citizen Spouse

Under the United States estate and gift tax laws, subject to certain requirements, spouses who are U.S. citizens can give to each other during life or at death an unlimited amount of assets without being subject to estate or gift tax. This is known as the "unlimited marital deduction." However, assets passing to spouses who are not U.S. citizens do not qualify for the normal unlimited marital deduction.

Instead, lifetime gifts to a non-citizen spouse are limited to \$114,000 per year (this number is indexed for inflation) regardless of whether or not the donor spouse is a U.S. citizen. If the cumulative value of gifts made to a non-U.S. citizen spouse in any one year exceeds this amount, it will be subject to gift tax which can either be paid by the donor spouse in the year following the year the gift was made, or the donor spouse can allocate a portion of his or her \$1,000,000 lifetime gift tax exemption amount to the gift. Any such gift can be made outright or in trust for the benefit of the non-citizen spouse.

If you intend the gift to qualify for the unlimited marital deduction, it must be made to a Qualified Domestic Trust ("QDT"). A QDT is a trust that is created for the sole benefit of a non-citizen
see NAVIGATING, page 7

2 EXEMPT ORGANIZATIONS

CONVERTING PRIVATE
FOUNDATIONS INTO
PUBLIC CHARITIES

3 BANKRUPTCY LAW

SWEEPING CHANGES TO
BUSINESS BANKRUPTCY
PROVISIONS THAT GO INTO
EFFECT IN OCTOBER

4 CARR McCLELLAN'S HISTORY

GIVING VISION
TO THE FUTURE

6 PRIVATELY HELD CORPORATIONS

HOW TO MINIMIZE
SHAREHOLDER DISPUTES
AND THEIR CONSEQUENCES



TO BE OR NOT TO BE

By Penelope Greenberg, Esq. and Quynh Tran, Esq.

Clients create private foundations for many different reasons: to educate succeeding generations in philanthropy, to create a project that multiple generations can enjoy together, to address a need not being met by existing charities, to be able to control all aspects of the charitable entity, to honor a family, or to remember a departed loved one. However, families and circumstances evolve, and the day may come when the existing private foundation no longer serves the founders' goals - perhaps because younger generations do not share their elders' charitable interests, because the assets of the foundation have dwindled, because the more restrictive tax laws applicable to private foundations are hampering the foundation's activities, or simply because the administrative requirements of the foundation are becoming burdensome. If these problems emerge, one solution may be a voluntarily termination of the foundation.

A voluntary termination is instituted at the discretion of the foundation and involves no termination tax. Commonly, voluntary termination is accomplished either by distributing all of the foundation's assets to a qualifying public charity or by converting the foundation itself to public charity status.

If the foundation truly wants to go out of business, distributing all of the assets to a qualifying public charity offers that solution. In general, the qualifying public charity must have been in existence for at least 60 calendar months before it receives the foundation's assets, and the public charity must be free to use the transferred assets as it sees fit to accomplish its charitable purpose. If the private foundation tries to impose any conditions or restrictions on the use of the transferred assets, such impositions may not rise to the level of interfering with the public charity's control and authority over the assets. The IRS has provided a number of examples of what are and are not acceptable transfer terms and reservations of rights.

If, on the other hand, the foundation would like to stay in business but wants to shed the limitations applicable to private foundations, it is possible to do that - if the organization has increased its source of support well beyond just the donations of its founders (or, less likely, if the foundation becomes one of certain other types of public charities). In fact, even if the private foundation has not yet acquired a broad base of donors, it could embark on such a program if it decided that was feasible. The public charity support tests are complex, but briefly put: If an organization receives at least 10% and preferably 33 1/3% of its support from a wide range of donors, it can qualify as a publicly supported charity.

"Many benefits flow from converting to public charity status. The formerly private foundation can receive grants and support from public foundations or even other private foundations. ..."

Many benefits flow from converting to public charity status. The formerly private foundation can receive grants and support from public foundations or even other private foundations that do not, whether by law or policy, make grants to private foundations. The formerly private foundation will be more attractive to potential donors because it affords donors higher tax-deductible donation limits for cash or appreciated property (50% and 30% of the donor's adjusted gross income, essentially, vs. 30% and 20%). Likewise, appreciated assets such as real estate or partnership interests are deductible at current fair market value if donated to a public charity instead of being limited to the asset's cost basis if donated to a private foundation.

Conversion to a public charity will probably not be possible for private foundations whose funding has come and will continue to come totally or largely from the founders, but in some instances, it may be worth considering. The process is as follows:

The private foundation files a Notice of Termination with the IRS listing the foundation name, address, intention to terminate, and so forth. For the 60-month period beginning with the start of the foundation's next fiscal year, the foundation must operate as a public charity - meaning, usually, that the foundation must continue to fundraise from a broad base of donors.

At any time before the expiration of the 60-month period, the private foundation may seek an advance ruling from the IRS stating that the organization is expected to satisfy the requirements of a public charity. Such a ruling may be desirable if, for example, a sizeable grant could be received once the advance ruling is obtained. The advance ruling filing fee is \$2,570, whereas the Notice of Termination filing fee is \$0. A foundation will want to weigh the value of an advance ruling against its cost. Advance Rulings are discretionary with the IRS, which considers such factors as the entity's organizational structure, proposed programs, intended method of operation, and projected sources of support.

The Notice of Termination should include Form 872-B, by which the private foundation elects (i.e., agrees) to extend the period of time for which the IRS may assess certain excise taxes (the standard 2% excise tax or other applicable alternatives). With this election, the private foundation will not have to pay the excise taxes otherwise due during the 60-month qualification period. Without the election, the foundation would have to continue paying and then file for a refund upon successful completion of termination of private foundation status.

Until the 60-month period is successfully completed, the private foundation will continue to be treated as a private foundation and *must comply with all private foundation requirements*. For example, the foundation must continue to spend or distribute for charitable purposes an amount equal to five percent of its investment assets annually. For the first four years of the five-year period, the foundation will continue to file Form 990-PF, the annual informational return for private foundations. For the fifth year, the private foundation will file Form 990, see FOUNDATIONS, page 8



The Act of 2005

By Michael J. McQuaid, Esq.

On April 20, 2005 President Bush signed into law The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("Act"). With most of its provisions going into effect October 17, the Act is the most comprehensive change in the bankruptcy laws in 25 years. Although the changes affecting consumer debtors have received more publicity, there will also be significant changes relating to business debtors as well. Following is a summary of some of the Act's provisions affecting business bankruptcies.

Real Property Leases

Under the current law, a debtor must file a motion to assume, assign, or reject an unexpired lease of non-residential real property within 60 days of the bankruptcy filing. However, this 60-day period may be extended for cause and in large, complex cases these extensions have been routinely granted, and courts have extended the period for years. No more! Under the Act, a debtor must assume or reject a lease in a maximum of 210 days absent written consent of the landlord.

Changes in Preference Law

If a creditor receives a payment from the debtor within 90 days prior to the filing of the bankruptcy, an action may be filed against the creditor that seeks the return (avoidance) of the payment. This is an action to avoid a preferential transfer. The Act makes a number of changes to this area of the law.

Modification of Ordinary Course Defense - One of the defenses available to a creditor who has been sued for a preferential transfer is the "ordinary course of business defense." The Act makes this defense easier to establish. Under current law, to qualify for an ordinary course of business defense, a creditor has been required to establish that the payment was made in the ordinary course of business and made according to ordinary business terms. Under the Act, the creditor need only establish either that the payment was made in the ordinary course of business or made according to ordinary business terms.

Minimum Requirements for Preference Recoveries - Under current law there is no minimum amount required for preference actions. Under the Act, a business debtor cannot avoid transfers of less than \$5,000.

Venue - Under current law, most preference actions may be filed in the bankruptcy court where the debtor's bankruptcy case is pending. A defendant/creditor wherever located, must defend in the debtor's home bankruptcy court. Under the Act, preference actions for a non-consumer debt of less than \$10,000 or a consumer debt of less than \$15,000 can only be commenced in the district in which the defendant/creditor resides.

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Extension of Time to Perfect Transactions -

Under current law, parties have 10 days to perfect transactions to protect them from becoming a preferential transfer. For example, a lien holder has 10 days from the date the lien is created to record the lien. Otherwise, the lien may be deemed to be a preferential transfer. The Act changes the ten-day grace period to a 30-day grace period.

Changes in Fraudulent Transfer Law

If a person or entity receives a transfer from the debtor and that transfer was made with the intent to hinder, delay or defraud a creditor, or was made for less than reasonably equivalent value, the transfer may be set aside as a fraudulent transfer. The Act bolsters fraudulent transfer law.

Increased Look-Back Period - The Act increases from one year to two years the period of time prior to the bankruptcy filing that a transfer may be set aside. This provision applies only to cases commenced one year after the enactment of the Act. This does not affect California's existing fraudulent transfer statute, which has a four-year look-back period.

Employment Contracts - The Act amends the fraudulent transfer statute to make transfers under employment contracts with insiders, such as board directors or other company leaders, expressly subject to avoidance, unless made in the ordinary course of business.

Reclamation

Under the current law, a seller of goods may seek to reclaim goods it shipped to the debtor. The seller must demand return of the goods in writing within 10, or in some cases 20, days after receipt of such goods. The Act basically expands the 20-day period to a 45-day period.

Employee Related Changes

Increased Priority for Wages - Under current law, employees are entitled to priority of payment among creditors if the wages were earned within 90 days of the bankruptcy filing, up to a maximum of \$4,925. The Act increases the amount to \$10,000 for a 180-day period.

Retention Bonuses - The Act limits use of retention bonuses for key employees.

Reorganization Changes (Chapter 11)

Small Business Cases - Under current law, a small business debtor (\$2 million or less in debts) can elect to be treated as a "small business." However, virtually no debtors elect to do this, as it has not been favorable to the debtor in most cases. Under the Act, the small business provisions are no longer optional where the creditor body is not active. In such cases, business debtors with less than \$2 million in debt must comply with the special small business provisions, which in general are more structured and speed the bankruptcy administration process by streamlining plan approval and imposing shorter deadlines for filing and confirming plans.

Single Asset Real Estate Cases - Under current law, if the value of the debtor's real property exceeds \$4 million, the case does not qualify as a "single asset real estate" case. Consequently, it has been a little used provision. Under the Act, the \$4 million cap will see BANKRUPTCY, page 8



THE PEOPLE AND EVENTS THAT HAVE MADE CARR MCCLELLAN WHAT IT IS AND WHAT IT WILL BE

PART II - GIVING VISION TO THE FUTURE (1970 TO 2005)

The first half of this article, which was included in the Summer 2005 issue, covered the firm's history from its founding up to 1970. If you did not receive our Summer 2005 issue and would like a copy, please contact Royal Simpkins at 650-342-9600.

In 1970 Carr McClellan began construction on the first of its two, three-story additions. Reflecting the ongoing commitment to Burlingame, the Peninsula and its businesses and residents, the 200 Park Road addition was designed to provide much needed space for a number of attorneys who had joined the firm in the late 1960s, such as Norman Book, and in anticipation of new arrivals in the coming decade, including Mike Telleen, Lage Andersen, Keith Bartel and Mark Cassanego.

Planning ahead, members of the firm had purchased the necessary property at the corner of Park and Howard a few years earlier and the gas station that was located on the lot. So, for at least a few years, attorneys at Carr McClellan were in the gas station business. The construction of this addition meant the tearing down of the gas station and the end of pumping gas for Carr McClellan.

1973 saw the completion of the firm's final expansion, which included construction of a second, three-story structure with ground-level parking topped by two floors of offices. Providing yet more room for Carr McClellan to grow, the addition also supplied expansion space for the Burlingame Police Department, which was headquartered in the building just east on Howard Avenue. The two buildings were connected by a staircase, and up until the early 1980s when a new Burlingame police station was built, Carr McClellan attorneys were literally working side by side with members of the police force.

During this time, the ongoing commercial and residential development on the Peninsula in communities such as Foster City was keeping Carr McClellan's Real Estate practice very busy. Carr McClellan's reputation for serving privately held, often family-owned businesses continued to grow. The quantity and complexity of legal issues that clients brought to the firm was also on the rise, supplying the firm's corporate, estate planning and litigation attorneys with a swelling stream of engagements.

One such engagement from the time demonstrates both the firm's commitment to its clients and the changes in the way business is conducted. Through the course of representing one client, a dispute arose with relatives over control of a large family-owned business. The two sides reached a settlement and the terms were drafted into final documents. One of the documents required the signature of Carr McClellan's client by a specified date but was sent to the firm only 24 hours in advance of the deadline and while the client was out of the country. This was before the days of FedEx, faxes and emails, and the options were very limited. United Airlines had just begun offering

a service that provided shipping of small packages on specific flights. The attorneys at Carr McClellan were able to get the document to the plane and delivered to Miami. The client flew from the Caribbean to Miami to meet the plane, sign the document and place it on a return flight, just beating the deadline and outsmarting the client's relatives.

The firm grew at a gradual pace until the late 1970s when there was a concerted effort to bring on additional attorneys. The firm's commitment to providing the same level of expertise that large firms in San Francisco offered required it to seek out the best legal talent, but according to Albert Horn, Chairman Emeritus of the firm, they sought out additional qualities in the attorneys they hired.

"Then and now we look for lawyers who are bright and who can empathize with people," said Horn. "However, we also



A 1976 photo of the named partners: Bob Thompson, Luther Carr, Frank Ingersoll, Jed McClellan and Albert Horn.

look for professionals with a fire in the belly - a real desire to succeed, and help build and provide leadership to the community."

It was during this time that many of the firm's current leaders joined Carr McClellan, including Mark Cassanego, who has served as the firm's President for the past 10 years, and Keith Bartel who serves on the Executive Committee and heads the firm's Civil Litigation & Dispute Resolution Group.

As the firm increased in size there was also a purposeful effort to remain true to another firm core value - absence of pretension both internally and in the development of client relationships. From its founding, Carr McClellan avoided the stuffiness and formality often found at larger firms of similar quality. This attitude created a two-class system among attorneys at these firms and tended to place attorneys on a pedestal, creating a divide between them and the clients they represented.

"One large firm went so far as to keep partners and associates physically separated by a door," remembers Horn. "We never wanted that kind of atmosphere at Carr McClellan. We have worked to maintain a sense of collegiality amongst all our attorneys and to cultivate a team approach to working with clients, so many of whom are sophisticated professionals and business people themselves."

"One of the reasons I joined Carr McClellan was because the level of sophistication in the legal work the firm handled was just as high as in large firms, but it did not have the politics and bureaucracy of the large firms," said Cassanego.

This sense of collegiality still fostered by the firm's leaders was supported by the traditions that were started decades ago. These included many traditions that added to both the attorneys' feeling of camaraderie and their waistlines - jars of candy in every department, Friday morning pastries, Saturday burgers for weekend workers from Vince's in San Mateo, and group

lunches during the week with all the attorneys at neighborhood restaurants.

Some firm customs avoided the added calories while still affirming Carr McClellan's emphasis on a more relaxed law firm hierarchical structure. When an attorney applied for a position with the firm, all the attorneys would interview the candidate. At the next weekly attorney meeting each person was given an opportunity to provide feedback on the candidate, starting with the opinions of the youngest associate.

Other firm traditions were being left by the wayside, although not without a fight. The signal that the times were changing for one law firm custom came in an incident that would come to be known as the Great Cardigan Sweater Massacre of 1980. Lage Andersen, a firm director who might fairly be described as a tax law genius with an independent spirit, had taken it upon himself to begin wearing a sweater around the office. According to Andersen, the sweater was nothing garish but rather a conservative, navy blue cashmere cardigan that he would wear around the office with a tie. Months later at the firm's annual retreat, after a series of issues were addressed by the gathering, firm leader Horn rose to discuss a serious topic - the flouting of the jacket and tie dress code as manifested by some lawyers within the firm wearing sweaters around the office. While Andersen's immediate days of sweater wearing ended, the shift to business casual dress both at Carr McClellan and in law firms in general was unstoppable, and today even blue jeans can sometimes be seen on casual Fridays. By sometime in 2002, 22 years after the Great Cardigan Sweater Massacre, Andersen worked up the courage to retrieve his beloved cardigan out of mothballs and wear it once more. However, Andersen still carries the scar from the sweater



Carr McClellan's Executive Committee (Left to Right): Golnar Yazdi, Ed Willig, Jan Mendez, Steve Anderson, Keith Bartel, Lisa Stalteri and Mark Cassanego.

rebuke and today is almost always seen wearing a suit at work, and on rare occasions a tuxedo.

In addition to the changes in workplace dress codes, the 1980s witnessed more significant changes in the health care delivery system that were brought about by increasing competition among health care providers. These changes included a shift away from the model of health care district owned and operated hospitals that was common up until that point. Carr McClellan, through the course of its long-term relationship with the Peninsula Hospital District, was positioned to help health care districts and emerging HMOs transition to a system of nonprofit hospitals. Throughout the 1980s and into the early 1990s, the firm worked with a variety of health care districts and hospitals throughout California, setting up nonprofit

organizations to run the hospitals and working with the districts that owned the facilities.

The firm continued to add one or two attorneys a year up until the late 1980s, when after deciding against a merger with a Los Angeles-based firm that had approached it, Carr McClellan acquired the old line San Francisco bankruptcy and creditors' rights firm of Phelan, Stuppi & McQuaid. Tracing its roots back to the 1930s, Phelan had a long history of its own, and its merger reaffirmed Carr McClellan's commitment to its Bay Area clientele while immediately diversifying the firm's service offerings. Through the past two decades the firm's service offerings have continued to develop into the 11 it has today. In addition to the Bankruptcy & Creditors' Rights Group brought on through the Phelan merger, the firm has added Employment and Intellectual Property Groups, and grown the existing Trust, Estate & Fiduciary Litigation Group into one of the most active and respected in the state.

Through the 1990s and into the 21st century, the description of Carr McClellan's core clientele has largely remained the same - privately held companies, and prosperous individuals and families. However, the diversity of those clients' businesses has increased as the region has continued to grow. These include major manufacturers, food distributors and retailers, construction and real estate development companies, nonprofit and governmental entities, software and computer companies, investment and consulting firms, and professional service providers, among many others.

So what does the future hold for Carr McClellan? According to Cassanego, the firm will continue to grow in a controlled fashion by building on its strengths.

"Our success has been based on the development of personal relationships, where our attorneys know our clients, their families and their businesses," said Cassanego. "The structure of our firm that permits high-level attorneys to establish those relationships while performing the work themselves will enable us to maintain the success we have enjoyed. Larger firms rely on a different structure where much or most of the legal work is performed by junior attorneys while a senior attorney maintains the client relationship. Smaller firms often don't have the required experience or bandwidth to provide clients with the services they need. Carr McClellan provides customized, one-on-one service by specialized professionals, combining the best of large and small firms."

Carr McClellan's evolution into the 30-attorney firm it is today has necessitated the exchange of new traditions for some of the old. Gone are the days when all the firm's attorneys could have lunch together on a regular basis. However, the philosophy of the firm has remained the same: offer clients the highest level of legal expertise with integrity and without pretension, provide excellent service that confirms for each client their importance to the firm, and commit time and resources to the community both as individual attorneys and as a firm. These were and continue to be the core values on which the firm measures its success. It is these values that have united its members and serve as the foundation for their many achievements since the firm's origins 60 years ago. And, it is these values that will carry Carr McClellan forward for many decades to come.



AVOIDING SHAREHOLDER DISPUTES

By Mark Cassanego, Esq.

Among the principal planning issues often ignored, or at least not given enough attention at the time of formation of a new corporate venture, are the mechanisms that can be put in place to avoid or reduce the risk of future shareholder disputes. When several entrepreneurs come together to launch a new corporate business venture, much time is appropriately devoted to developing the business plan, honing the financial model, analyzing needs for facilities and personnel, and establishing ties with potential customers, clients, vendors and consultants. What should be given equal consideration is the possibility that at some time in the future one or more of the shareholders in the corporate venture may have a falling out with the other shareholders. By considering the mechanisms that are triggered when such a dispute occurs, the owners of privately held corporations can reduce the cost, stress and time that otherwise might be sunk into dealing with the problem, and in many cases, avoid the demise of the corporate business venture.

Before discussing some of the planning considerations in forming a new corporate venture, I would be remiss if I did not mention that there is one guaranteed mechanism to avoid shareholder disputes: have only one shareholder! Although it is often difficult, if not impossible, to launch a start-up corporate venture without the capital contributed by multiple owners, there are some ventures that can be owned by a sole shareholder. Often the entrepreneurs who start these ventures are quickly motivated by many factors to bring in additional shareholders. Typically these new shareholders are employees or consultants who are invited to join the enterprise as owners either as an incentive for future performance or as a reward for past contributions. However, there are alternative mechanisms to ownership that can be employed to reward these individuals, including performance based bonus plans, phantom stock plans, and profit sharing or other deferred compensation plans. If the motivation to bring in new shareholders is not based on a need for additional capital, the sole shareholder/entrepreneur should seriously consider these alternatives.

Duty to Shareholders

Privately held corporations with multiple shareholders, however, must navigate the sometimes complex duties to and rights of shareholders. Business owners often fail to appreciate the legal obligations created when a majority owner brings in minority shareholders. California and most states' laws have clearly established that shareholders owning the controlling block of stock owe a fiduciary duty to the minority shareholders. This means that the majority shareholders must use their power of control for the benefit of all the shareholders proportionately and not just for the benefit of the majority shareholders alone, and that the majority shareholders must act in good faith and with inherent fairness toward the minority shareholders.

Rights of Shareholders

Once shareholder status is established a number of statutory rights are generally triggered. These often include the right to annual financial information, to attend and vote at shareholder meetings, to inspect corporate books and records and

to obtain and copy the list of other shareholders. In one example from 1994, a 1% minority shareholder was even given the right under the federal Freedom of Information Act to obtain the consolidated tax returns of a parent corporation and its controlled subsidiaries.

Although many of the rights of shareholders exist regardless of the percentage of ownership held by a shareholder, a number of them come into existence once a certain percentage threshold has been reached. Accordingly, in cases in which one shareholder is the controlling shareholder of a California corporation, the percentages of 5%, 33.33% and 50% should be paid particular attention. As stated above, controlling shareholders owe a fiduciary duty to a minority shareholder regardless of how small a percentage of ownership they hold. However, if a shareholder has 5% or more of the corporation's stock, the shareholder has an absolute right to inspect and copy certain corporate records and may obtain quarterly financial information without having to state a purpose reasonably related to the shareholder's interest in the corporation.

A shareholder, or group of shareholders, owning 33.33% or more of a corporation's stock have the right to commence involuntary proceedings to dissolve a corporation by filing a complaint in superior court. While the controlling shareholder can halt the proceeding by initiating a court supervised buy-out of the minority shareholders, the right to force this action through an involuntary court proceeding is a powerful tool in the hands of the minority shareholders. Therefore a controlling shareholder is well advised to avoid, if possible, permitting minority shareholder groups to own 33.33% or more of the corporation's stock.

Equal shareholders should realize that a mere 50%, rather than more than 50%, gives a shareholder of a California corporation an absolute right to elect to dissolve the corporation in voluntary dissolution; i.e., one that avoids the necessity of initiating a lawsuit. As in the case of the involuntary dissolution involving a 33.33% or more shareholder grouping, the non-electing shareholder has the right to avoid the dissolution by invoking the "fair value" buy-out right. Again, this right is an effective tool that some would argue works to reduce the likelihood of a dispute since it gives each of the equal shareholders the right to "get out" under a statutory scheme that is intended to promote fairness. On the other hand, from the controlling principal's planning perspective, maintaining control of the corporation by owning as much of the stock as possible is a more effective method of preventing future disputes that could impact the operations of the corporation.

Dispute Avoidance Planning

The most effective means of avoiding shareholder disputes is to put in place mechanisms that clearly delineate the rights and obligations among the corporation and each of the shareholders. Disputes can be avoided if all the "rules of the game" are known ahead of time. It is only when material uncertainty exists that disputes have fertile ground in which to grow.

The mechanisms for creating certainty are most often contained in a shareholders agreement. The principal purpose of these agreements is to set out the parameters of each shareholder's and the corporation's rights and obligations. Although the focus of shareholders agreements is often to address business succession, valuation and funding mechanisms for liquidating corporate ownership interests, the agreement should also answer questions such as: "What happens if an employee shareholder leaves the employment of the corporation voluntarily or otherwise?" or "What happens if one of the

spouse during his or her lifetime where at least one trustee must be a U.S. citizen or U.S. corporation. The rules pertaining to QDTs require that all of the income of the trust be paid at least annually to the non-citizen spouse. Any distribution of principal to the non-citizen spouse, other than in the case of hardship, will be taxed at the applicable gift tax rates.

Furthermore, the manner in which you take title to property with your non-citizen spouse can have significant tax consequences. If one spouse contributes more to the acquisition of property than the other, there may be a deemed gift either at the time of acquisition, upon sale of the property or death of one spouse. If the non-contributing spouse is a non-citizen, the gift may not qualify for the unlimited marital deduction. Real property and intangible personal property (e.g. stocks, bank accounts, etc.) titled in joint tenancy do not result in a gift unless the property is sold and the proceeds distributed to the non-citizen spouse, or upon a withdrawal of funds or stocks from an account by the non-citizen spouse. Tangible personal property on the other hand, will result in a gift upon creation of a joint tenancy between the citizen and non-citizen spouses.

As in the case of lifetime gifts to a non-citizen spouse, bequests made at death to a non-citizen spouse will not qualify for the unlimited marital deduction unless the property is held in a QDT. Generally, the estate planning documents of the deceased spouse will provide for the creation of the QDT. However, if they do not, the non-citizen surviving spouse may create the QDT and transfer the assets to that QDT within a specified period of time after the death of the deceased spouse. Similar distribution and trustee rules apply to these QDTs as to the QDTs used for gifts to the non-citizen spouse, discussed above. For instance, all income must be distributed to the spouse and any distribution of principal, except in the case of hardship, will be taxed at the estate tax rate in effect at the death of the first spouse. You should note that if the asset you intend to leave to your non-citizen spouse is a retirement plan benefit, there are complex rules beyond the scope of this article that must be followed in order for the asset to qualify for the unlimited marital deduction.

If these rules prove too onerous for the non-citizen spouse, he or she can become a U.S. citizen, at which time the QDT will convert to a standard irrevocable trust for his or her benefit. Care must be taken to notify the IRS of the termination of the QDT by April 15th of the year after citizenship is obtained, otherwise the QDT cannot be terminated until the second spouse dies.

Notwithstanding the above, if the assets passing to the non-citizen spouse do not need to qualify for the unlimited marital deduction (e.g. because the value of the assets in the deceased spouse's estate are less than the federal estate tax exemption amount - currently \$1,500,000), the assets can pass to that spouse without the creation of a QDT.

The Non-U.S. Person Trustee

When choosing a person or entity to act as trustee of your trust, be mindful of the tax consequences of your choices. For example, for a QDT

“The manner in which you take title to property with your non-citizen spouse can have significant tax consequences.”

to qualify for the unlimited marital deduction, one of the trustees must be a U.S. citizen or U.S. corporation. The U.S. citizen does not need to reside in the U.S. in order to qualify the trust as a QDT.

With respect to any other trust, if the trustee is a non-U.S. person or entity, the trust may become a “foreign trust” for federal income tax purposes. In simple terms, a non-U.S. person for federal income tax purposes is neither a citizen nor a resident of the U.S. The most common situation where this becomes an issue is when you name a non-U.S. person as successor trustee of your revocable trust. Upon your death when that successor trustee takes office, the trust may be considered a foreign trust by the IRS. As a result, all of the assets therein will be deemed to have been sold to the trust at your date of death and be subject to capital gains tax. Although the foreign trust will no longer be subject to U.S. federal income, estate or gift tax laws, any distribution of income from that trust to a U.S. beneficiary will be subject to federal income taxation. In some instances, this may be a desired result if the beneficiaries no longer wish to reside in the U.S. and be subject to U.S. income tax laws. However, since the assets in your revocable trust generally receive a new tax basis equal to their fair market value on your date of death, there may be no capital gains tax due. If a trust unintentionally becomes a foreign trust, the trust has 12 months to cure this situation by replacing the trustee.

Gifts Received from Outside the U.S.

Gifts and bequests received by U.S. residents or citizens from persons or trusts who are neither citizens nor permanent residents of the U.S. are not subject to federal gift or estate tax at the time of the transfer. However, if the recipient still owns the assets at his or her later death, they will be included in the estate of the recipient for federal estate tax purposes. For this reason, it is advisable that if the gift is substantial, it should be made to an irrevocable trust that can be held for the benefit of the beneficiary and his or her descendants for multiple generations without the imposition of federal estate or gift tax.

Any gift made from a foreign person to a U.S. citizen or resident in excess of \$100,000 in any given year must be reported to the IRS by April 15 of the year following the gift. If the gift is not reported, the recipient will be subject to a penalty of up to 25%. In addition, any distributions from a foreign trust to a U.S. citizen or resident must similarly be reported, or be subject to a 35% penalty.

Conclusion

Although we have given you a brief overview of certain rules that apply most commonly to transfers between U.S. and non-U.S. citizens, the rules applying to such transfers are extensive and complex. If you are contemplating such transfers, it is very important that you seek the advice of an attorney.

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FOUNDATIONS, from page 2

the public charity counterpart to the 990-PF, if the private foundation has met the requirements of a publicly supported charitable organization during the 60-month period. The private foundation must also continue to allow public inspection of its annual informational returns at its principal office and comply with requests for copies of its Form 1023 and the three most recent annual returns (requirements that will continue even if the foundation becomes a public charity) and, upon request, the private foundation will be required to disclose to the general public the names and addresses of its contributors (a requirement that will no longer apply once the private foundation obtains public charity status). Even if the private foundation has obtained a favorable advance ruling, the foundation must continue to comply with the private foundation rules during the 60-month period. The main advantage of the advance ruling is that it allows donors to treat donations made to the private foundation as if made to a public charity.

Within 90 days after the end of the 60-month period, the private foundation must file information with the IRS establishing that the organization qualifies for tax-exempt status under IRC Section 509(a)(1), (2) or (3) as a public charity. There is no particular form for this filing.

If the termination is successful, the private foundation will be treated as a public charity retroactively for the entire 60-month period. If termination is not successful, the private foundation will be subject to the applicable taxes for any year during the 60-month period in which the private foundation did not meet the test to qualify as a public charity. This means that if the foundation met the test for one or more particular years, but not for all five, the foundation will not receive public charity status but will not be required to pay the otherwise applicable excise tax for the year(s) when the foundation met the support test.

The chief disadvantage of the conversion to public charity is the length of time it takes to accomplish. However, that same long period allows the converting organization time to develop the personnel and procedures that it will need to create effective fundraising and to become comfortable in its new role as public charity. There is no down side to trying to qualify for the conversion. Failure simply preserves the status quo, while success can bring new sources of funding, new interest in and awareness of the organization, and new friends and supporters to help the organization advance its philanthropic mission.

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BANKRUPTCY, from page 3

be eliminated. Thus, it will apply to almost all cases involving a single property or project, other than residential real property with fewer than four residential units. The designation as a single asset real estate case is important because, in such a case, the debtor will have to either file

a plan or make monthly payments to the secured creditor, or after 90 days from the filing of the case the creditor will be able to foreclose on the property.

Limitations on Ability of Debtor to Exclusively Propose a Plan - Under current law, a debtor has the exclusive right to propose a plan of reorganization for the first 120 days after filing bankruptcy. The debtor can request that the court extend this period, and some courts have done so for lengthy periods of time. Under the Act, a debtor is limited to a 14-month extension. Thus, a debtor will have a maximum of 18 months from the date of the bankruptcy filing to propose its own plan, and 20 months to confirm the plan.

Discharge - Under current law, a debtor in a Chapter 11 case can receive a discharge when the plan is confirmed. This discharge will be effective even if the debtor does not complete the plan. The Act will require that an individual debtor complete all payments under a plan before a discharge will become effective.

Conclusion

The intent of the Act is to close perceived loopholes in the bankruptcy process and speed the administration of bankruptcy cases. While there is little doubt that the changes that will go into effect in October will create a faster process, there is still the question of whether it will be a better process. The answer to that may be many years away.

This article has presented a summary of some of the provisions of the Act affecting business bankruptcies. The Act contains many more changes to bankruptcy law, including provisions specific to health care and nonprofit organizations, cross border bankruptcies, and numerous changes applicable to consumer bankruptcies that will significantly impact future cases. If you are seeking to recover from a bankrupt business or individual, or are yourself considering declaring bankruptcy, consult an attorney regarding the details of the 2005 Act and the other provisions of the Bankruptcy Code.

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DISPUTES, from page 6

shareholder employees gets divorced?" or "Do all shareholders, regardless of percentage ownership, position or age, have the same rights if an event triggers a buy-out?"

Although disputes among shareholders cannot always be avoided, planning prior to the formation of a corporate enterprise and creating a well crafted Shareholder Agreement that sets forth with clarity the mechanisms to follow if certain events occur, can significantly reduce the likelihood of disputes. If all shareholders understand their roles, rights and obligations from the start, all of them can more clearly focus on their collective goal of building shareholder value.

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