

## PRESIDENT'S MESSAGE

Since our last publication of *Perspectives* - a relatively short period of time - our world, our country and our state have all undergone tremendous changes, political and economic. Change presents our personal and business lives with challenges, but also opportunities.

In this, our first *Perspectives* edition of 2009, we present several articles which address some of these challenges and opportunities. In *Silver Linings in Dark Clouds*, **Steve Anderson** describes the opportunities that the current economic environment presents for intergenerational estate planning. In *Implementing Smart Alternatives to Lay-Offs Under California Law*, **Valerie Menager** outlines what choices businesses have in managing their workforces while weathering the economic storm that is whirling around them. **Kendall Patton's** article, *The Non-Binding Letter of Intent*, addresses another challenge of our times, the increasing complexity of business transaction documents. Kendall prescribes clear guidelines for reducing the complexity of these transactions by focusing first on fundamentals. And finally, **Brendan Lund**, of our tax group, and **Jeremy Burns**, of our litigation group, provide advice regarding new tax limitations on the sale of personal residences and how Carr, McClellan lawyers can use their judgment and experience to help resolve financial conflicts short of litigation.

Although the uncertainties of our economy will undoubtedly remain with us for longer than we would like, please know that our 38 attorneys will remain focused on providing cost effective, practical solutions to both the challenges and opportunities that you will face. Our solid tradition built over the last 65 years has helped us guide our clients through many ups and downs during many economic cycles. While it is unfortunate that many of our colleagues in larger firms have seen layoffs, dislocations and even evaporations of their partnerships causing severe disruptions for clients, we at Carr, McClellan are quietly confident that we will be here to provide the first rate service and expertise that we always have. We are well aware that now, more than ever, our clients and their other advisors are seeking solutions to their legal issues that need the judgment and experience of value focused professionals. Lawyers in our business, real estate, intellectual property, creditors' rights, litigation and estate and trusts groups are ready to assist our clients and the clients of our colleagues in other professions deal with the challenges and take advantage of the opportunities our economic times present.

Mark Cassanego  
President, Carr McClellan

## SILVER LININGS IN DARK CLOUDS

### ESTATE PLANNING OPPORTUNITIES IN DIFFICULT TIMES

By Steven D. Anderson, Esq.

The new year delivered a new administration, a new political party in control of both Congress and the White House, a continuing dismal economic environment, and the long-awaited increase in the federal estate tax exemption amount to \$3.5 million per person.

The news about the economy continues to be very bleak, with each day headlining some new negative statistic or distressing event. But there is a silver lining in these dark clouds in the form of some highly attractive opportunities for intergenerational gifts. In addition, expected legislation relating to federal estate taxes furnishes yet another reason to consider wealth transfers at this time.

In response to recent decisions by the Federal Reserve Bank, our economy currently enjoys a very low interest environment. The Treasury rate applicable to related-party transfers - the Applicable Federal Rate (AFR) - is at or near historic lows. The rate for short term (three years or less) obligations for February 2009 is 0.60% and for midterm obligations (over three years but less than nine years) is 1.65%.

This very low AFR makes intergenerational loans extremely attractive, particularly if the next generation borrower uses the loan proceeds wisely to invest in assets which have been beaten down by the current market but have solid prospects for recovery. The intergenerational transfer can be further strengthened by forgiving part of the loan each year by taking advantage of the annual gift tax exclusion. This exclusion increased to \$13,000 effective January 1, 2009. (The annual gift tax exclusion allows a taxpayer to give up to \$13,000 per year to as many different persons as desired without any kind of gift tax consequences).

Another advantage of the very low AFR rates for intergenerational wealth transfers is in the area of sales of assets to the next generation, or to trusts for the benefit of the next generation, on an installment payment basis.

Current interest rates also make a favorite device, the Grantor Retained Annuity Trust (GRAT), used by very wealthy individuals to transfer future appreciation to younger generations, even more attractive.

A GRAT is usually designed so that publicly traded or closely held stock which is expected to appreciate will be paid back to the grantor as an annuity over a period of time through in kind transfers at then current market values. If the stock has appreciated during the term of the GRAT there should be stock left over at the GRAT's termination

WINTER 2009



- 1 SILVER LININGS IN DARK CLOUDS**  
WEALTH TRANSFER SOLUTIONS
- 2 THE NON-BINDING LETTER OF INTENT**  
A MEANS OF STREAMLINING BUSINESS TRANSACTIONS
- 3 IMPLEMENTING SMART ALTERNATIVES TO LAYOFFS UNDER CALIFORNIA LAW**  
ALTERNATIVE MEASURES FOR CALIFORNIA EMPLOYERS
- 5 NEW LIMITATIONS ON THE SALE OF A PERSONAL RESIDENCE EXCLUSION**  
THE HOUSING ASSISTANCE TAX ACT OF 2008
- 7 EMPLOYMENT LAW ALERT**
- 8 NAVIGATING TROUBLED WATERS: BUSINESS NEGOTIATIONS AND LITIGATION IN A DOWN ECONOMY**



## THE NON-BINDING LETTER OF INTENT

*By S. Kendall Patton, Esq.*

With each passing year the complexity of documentation for relatively standard business transactions seems to increase. By way of example, where in 1987 a standard landlord's lease form for a 5,000 square foot premises was often less than twenty (20) pages in length, it is now not uncommon to see a lease for a 2,000 square foot premises exceed 90 to 100 pages. Naturally enough, with dense, longer and more complex legal documents, the time both parties and their attorneys put into negotiating and redrafting documents has markedly increased, and with such increased time has come larger legal bills.

One means of keeping legal fees at a manageable level at the inception and early stages of a business transaction, where each side is "testing the waters" to see if a deal can be struck, is to set forth the parameters of the client's basic business terms in what is known as a "Non-Binding Letter of Intent."

A well drafted Non-Binding Letter of Intent can be relatively substantive as to "non-binding basic business terms" on which the parties reach an initial understanding and yet also be relatively concise. This author's letters of intent generally range from three to five pages in length and set forth basic terms in bullet point fashion. This enables the principals to hash through, and hopefully agree upon, most major business points before becoming entangled in lengthy purchase or lease negotiations.

Why do we keep referring to *Non-Binding* Letters of Intent. The overriding reason is that, while a Letter of Intent will contain most of the major salient business terms of the transaction, a Letter of Intent generally will not cover the following: specific representations and warranties of a seller under a purchase agreement, remedies upon a default, return of cash deposits and other essential terms of the purchase contract. Neither will a letter of intent for a commercial lease cover the myriad of economic, repair, restoration, assignment, subletting and other terms between the parties. If the parties are not careful to ensure that a Letter of Intent is non-binding, it may be construed as an enforceable, if deficient, contract, with potentially dire very costly consequences for one or both parties.

What is the worth of a Non-Binding Letter? With very few exceptions, sophisticated business men and women stand by their Non-Binding Letters of Intent and honor their terms as the deal progresses through the documentation and execution stages. Countless wasted hours and legal fees are saved if a deal cannot be structured at the Letter of Intent stage. Put another way, the Letter

which will go tax free to the remainderman (the next generation). The low interest environment reduces the required payback to the grantor, thereby increasing the chances of a substantial tax free transfer.

The bruising that even the best of the blue-chip stocks have taken in the very difficult markets of the past few months has made it possible to transfer substantially more shares of particular stocks within the annual gift tax exclusion of \$13,000. If a stock was at \$25 in mid 2008 only 480 shares could be given away within the then annual exclusion of \$12,000. With the same stock now at below \$13 more than a 1,000 shares can be given away within the current annual exclusion of \$13,000. Even a small recovery will have a significant wealth transfer effect.

The biggest elephant in the room of wealth transfer is the question what will happen to estate taxes in 2009. As already noted, the present law increased the basic federal estate tax exemption to \$3,500,000 for 2009. On January 9, 2009, Representative Earl Pomeroy (D), a senior member of the House Ways and Means Committee, introduced H.R. 436 which would make the \$3,500,000 unified credit permanent and would also make the current 45% federal estate tax rate permanent. That is the good news.

The bad news is that the bill also proposes to do away with minority interest valuation discounts in family controlled entities and would also disallow fractional interest discounts with respect to certain non-business assets in some entities. In addition, the bill also proposes the phaseout of the unified credit for estates in excess of \$10,000,000.

It is important to note that those taxpayers who plan early and give often, and who employ a special type of trust known as a "grantor trust" (essentially enabling beneficiaries to enjoy transferred assets income-tax free), can reap significant long-term benefits even absent valuation discounts. Recent legislative proposals have *not* suggested the elimination of benefits associated with such grantor-trust planning.

The changes enumerated in the Pomeroy bill have been introduced at least twice before, albeit in an entirely different fiscal and political environment. Another proposal that garnered some interest last year included permanently fixing the estate tax exemption at \$2.0 million, indexed for inflation. This same proposal also included a unification of the lifetime gift tax exemption amount (currently, \$1.0 million), so that the federal gift tax and estate tax exemptions would be equalized at \$2.0 million.

It is too early to tell what the final legislation will look like, but any intergenerational transfers involving closely held entities should be made sooner rather than later. Virtually everyone assumes that new legislation will be enacted to avoid the complete suspension of the estate tax in 2010.

Wealth transfer always presents interesting challenges, never more so than at this time of economic dislocation and legislative uncertainty. But the present low interest environment creates great opportunities for those who believe that the future will be brighter than the present.

*Steven D. Anderson is Chair of the firm's Estate Planning, Trusts & Wealth Transfer group.*

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of Intent forces the parties to focus on the business points driving the transaction early on.

So what typically goes into a Non-Binding Letter of Intent? As an example, let's briefly analyze a Non-Binding Letter of Intent for the sale of a \$20 Million Office Building. The letter opens with a statement that:

"Seller proposes that the following non-binding basic business terms and conditions be included in a Purchase and Sale Agreement for the Property (Purchase Agreement). The first draft of the Purchase Agreement would be prepared by Seller's counsel. The Purchase Agreement would incorporate the terms of this letter of intent and other terms and conditions to the purchase and sale transaction, each party acknowledging that there are many other essential terms and conditions which have not yet been discussed or agreed upon."

Major business terms are then set forth, including:

- Purchase Price.
- Any Financing Contingency.
- The amount and timing of Deposits toward the Purchase Price, and a statement of when the Deposits become nonrefundable (absent a Seller default or failure of a closing condition not caused by Buyer).
- Review of title to the Property, whether a survey will be required, and the procedures for approval of title matters.
- The Due Diligence Period, duration of the same, physical inspections and the like, Buyer's indemnity with respect to Buyer's entry onto the Property for inspections and Buyer's commercial general liability insurance in favor of Seller.
- A statement that Property is being sold "AS-IS and WITH ALL FAULTS."
- The Closing Date and any extensions of the same.
- The parties' willingness to participate in a 1031 Tax Deferred Exchange.
- Closing Costs, Prorations and Payment of Brokerage Commission.
- Confidentiality.

In certain instances, the parties promise in the Letter of Intent to negotiate exclusively and in good faith with one another for a limited and finite amount of time (thus creating one binding provision in the Letter).

The well drafted Non-Binding Letter of Intent closes by confirming that it is non-binding and does not create any contractual rights of any nature whatsoever between the parties. This author closes his letter of intent along the following lines:

"This letter of intent is merely an expression of the basic business terms and conditions which might be incorporated into a formal and binding Purchase Agreement between Seller and Buyer for the purchase and sale of the Property. This letter of intent is not an offer, contract, option or commitment and creates no legal rights or obligations of any nature whatsoever between the parties, and no binding rights or obligations of any nature whatsoever with respect to the Property shall be created unless see LETTER OF INTENT, page 8



## IMPLEMENTING SMART ALTERNATIVES TO LAY-OFFS UNDER CALIFORNIA LAW

*"One means of keeping legal fees at a manageable level ... is known as a 'Non-Binding Letter of Intent.'"*

*By Valerie Menager, Esq.*

Does it always make sense for a Company to terminate employees when revenues are decreasing? As the economy slows down, the first impulse of many companies is to lay-off employees in order to reduce costs. The savings from a lay-off of employees may be offset by other costs, including severance pay, increased exposure to lawsuits from terminated employees, increased unemployment insurance tax rates, and costs associated with remaining employees' bad morale, poor productivity, and higher attrition rates. A severely downsized Company may be less agile in responding to increased demand for services when the economy improves, and experience high recruitment and training costs in ramping up its workforce again.

Depending on your Company's situation, there may be a smarter way for businesses to save costs in a slowing economy. Implementing alternative cost cutting measures can yield initial cost savings and, if lay-offs become necessary in the future, may further reduce the costs of eventual lay-offs as well. Treating employees as a team that together shoulders the burdens of a downturn can result in strong loyalty to your Company and higher productivity. Before embarking on a mass reduction in force, companies should carefully consider alternatives to lay-offs.

The following is a discussion of alternative measures for California employers, and legal considerations in implementing them. This discussion assumes that employees are employed on an "at-will" basis and are not subject to employment contracts or collective bargaining agreements.

### Temporary Company Shutdowns

Shutting down your company for a week or two or shrinking to a skeleton staff during slow periods is an effective way to reduce costs. It also encourages employees to reduce the vacation pay reserve on your company's books, while minimizing lost revenues from customers. Many companies take advantage of the week between Christmas and New Year's Day to shut down their business, although the appropriate timing of a temporary shut down depends on particular circumstances of your company.

When planning a temporary company shut-down, it is extremely important to keep in mind the differences between employees who are classified as exempt and non-exempt under the Federal Labor Standards Act ("FLSA"). Non-exempt employees are paid on an hourly basis, are eligible for overtime pay

if they work more than 8 hours in a day or 40 hours in a week and are usually only eligible to be paid for the hours that they actually work. Exempt employees are paid a salary on a weekly basis, are not eligible for overtime, and are usually entitled to their entire weekly salary for any week in which they perform work, regardless of the number of hours they actually work. This makes the definition of your Company's "work week" extremely important in determining when to schedule the timing of a temporary shut down in order to maximize cost savings for the company.

For example, let's assume that a company's work week runs from Sunday to Saturday, and that Christmas and New Year's Day are each on a Thursday. It may seem like the common sense plan is to have the company shut down from the Thursday of Christmas to the Thursday of New Year's Day. This would be fine for the non-exempt employees since they are only eligible to be paid for the hours that they actually work. In contrast, exempt employees are paid a salary on a weekly basis regardless of how many hours they actually work. Since exempt employees will work Monday through Wednesday on Christmas week, and on Friday on New Year's week, the Company will still have to pay them their full salary for both weeks! This means that the Thursday to Thursday shutdown will reduce a company's obligation to pay its non-exempt employees, but will not reduce its obligation to pay exempt employees. However, if the company carefully schedules its shutdown week to match its work week (in this example, Sunday to Saturday), then the company would not have to pay its entire workforce, including exempt and non-exempt employees, during the temporary shutdown period.

In planning company shutdowns, a company should carefully consider how it has defined its "work week" in policy and in practice, and should review the exempt and non-exempt classification of each of its employees. When a company is considering not including all of its work force in a company shutdown, management needs to carefully choose those employees who will work during the shutdown period in a way that will not subject the company to exposure for a claim of discrimination based on a protected class under civil rights laws. Finally, any company considering a temporary shut down in excess of ten days and/or without a definite return to work date should consult with legal counsel since this may be considered employment termination and trigger immediate termination pay or other requirements under state and federal employment laws.

#### **Utilization of Accrued Vacation During Shutdowns and Slowdowns**

Under California law, an employee's accrued, unused vacation time is considered earned wages. Usually it is not possible to require employees to utilize their accrued vacation time during a temporary shutdown or during periods of reduced work ("slowdowns") unless this has already been specified in a long established company vacation use policy or if the company provides employees with at least 90 day notice that the use of vacation will be required during a temporary shut down or slowdown. Now may be the

*"Depending on your company's situation, there may be a smarter way to save costs in a slowing economy."*

time to consider amending your company's vacation use policy if temporary shutdowns or slowdowns may be a cost reduction option that your company may consider utilizing in the future. Prospective reduction in vacation accrual rates may also be a cost savings alternative to consider, along with prospective reduction in other employee benefits.

#### **Reduction in Pay Rates and Reduction in Work Schedules**

**Reducing Pay Rates:** Reducing pay rates prospectively of employees is a viable alternative to terminating a portion of a company's work force. Care should be taken not to reduce the hourly pay of non-exempt employees below the relevant state and local minimum hourly wage (\$8.00 per hour in most California localities), and the weekly salary of exempt employees in California may not be reduced below \$455 per week without jeopardizing their exempt classification. The potential impact of compensation reduction on stock option agreements or any contracts with these employees should also be reviewed. An additional benefit to reducing employee pay rates is that it reduces employer costs for accrued vacation time and could also result in lower severance costs if the employer must eventually resort to a reduction in its work force.

In reducing employees' pay, employers are frequently tempted to promise bonuses or higher wages in the future (e.g. when revenue goals are achieved) in return for the retention of employees during the period of pay reduction. However, employers must be extremely careful in making promises about future wages to make sure that do not violate California wage and hour law regarding the timing of the payment of "earned" wages or new regulations concerning the payment of "deferred compensation". Also, please note that counsel should always be consulted if a reduction in compensation is 50% or more since it could trigger state and federal requirements for larger employers under the Worker Adjustment and Retraining Notification Act ("WARN Act").

**Reducing Work Hours:** Any consideration of reducing employee's work hours should start with a review of what the impact a reduction of work hours will be on employees' eligibility to Company benefit plans. For example, eligibility for health care coverage is usually limited to employees regularly scheduled to work a certain number of hours each week. Other benefits such as participation in 401(k) plans and stock option plans may be effected by a reduction of hours.

As discussed previously, it is important to consider an employee's FLSA classification in considering a reduction of work schedules. With non-exempt employees, the work schedule may be reduced prospectively. However, in determining how to schedule reduced work schedules, a review should also be made of non-exempt pay policies to determine if they provide for show up premiums, split shift premiums, and/or the use of vacation or paid time off during partial days of work. In addition, if there is a reduction of at least 10% of compensation for at least 10% of employees, there is the possibility of non-exempt

employees being eligible for unemployment insurance coverage for a portion of their loss of wages under the California Employment Development Department (“EDD”) workshare program.

Work schedules for exempt employees may also be reduced, but if coupled with a reduction in pay should be discussed with legal counsel since it may effectively convert exempt employees to non-exempt status. If employers are considering a long term reduction of work schedules of 50% or more, they should also consult with legal counsel due to the possibility of triggering state and federal WARN Act laws.

#### Leave of Absence

Companies anticipating investor funding or companies trying to retain their uniquely skilled work force during bad economic times have provided employees with the option of a paid leave of absence at a percentage of their base salary rather than termination as part of a reduction in force. Any extended leave of absence needs to be carefully reviewed with regard to whether it triggers COBRA or Cal-COBRA, and whether it impacts stock options and equity award vesting. In particular, a leave of absence over 90 days could result in options failing to qualify as Incentive Stock Options. Employees who are working on temporary work visas may also still be entitled to pay during leaves due to Immigration and Naturalization’s Act’s “no benching” rule.

An interesting variation on paid leaves of absence which may avoid some of these benefits issues is temporarily assigning the employees earning reduced pay to work for non-profit organizations providing community service. This idea is truly making lemonade out of lemons since some employees participating in these temporary work programs with non-profits actually view such reassignments as a company benefit!

#### Advance Planning for Reduction in Force Events is Crucial

Alternatives to lay-offs should always be considered, but the use of these alternatives should not unduly delay adequate planning for a mass lay-off, permanent plant shutdown or company dissolution. A plant shutdown or mass lay-off for a larger employer can require a 60 day notice to employees and government entities under the WARN or Cal-WARN Acts. In addition, publicly traded companies may be required to file notices with the SEC regarding a reduction in force.

Lack of planning may also result in a Company simply running out of revenue adequate to pay earned wages and payroll taxes, or for contributions to and administration of benefit and retirement funds. Such a scenario could lead to personal liability for unpaid wages and benefits on the part of the Company’s officers, directors and even investors. A prudent company using cost saving alternatives during a down cycle in the economy should always project its workforce needs at least one quarter in advance.

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## NEW LIMITATIONS ON THE SALE OF A PERSONAL RESIDENCE EXCLUSION

*By Brendan T. Lund, Esq.*

What Congress giveth, Congress can taketh away. Over the past ten years, taxpayers could exclude up to \$250,000 of gain (and up to \$500,000 for married couples) on the sale of a principal residence, provided the taxpayer both owned and lived in the house for two out of the five years before the date of sale. Taxpayers could take advantage of this rule by buying, living in and selling a new principal residence every two years and receive up to \$500,000 of tax-free cash each time they sold their residence. This past summer Congress reduced a taxpayer’s ability to exclude gain on the sale of a principal residence, effective on January 1, 2009. The Housing Assistance Tax Act of 2008 (“Housing Act”) introduces the concept of “nonqualified use” and requires taxpayers to prorate their exclusion for periods of nonqualified use. Nonqualified use is any period after January 1, 2009, during which the property is not used as the principal residence of the taxpayer or spouse.

To understand the new restrictions imposed under the Housing Act, it is helpful to consider the pre-Housing Act rules applied to a simple example. Section 121 of the Internal Revenue Code (the “Code”), under the pre-Housing Act, allowed an individual to exclude from their gross income up to \$250,000 of gain (\$500,000 on a joint income tax return) realized on the sale or exchange of a principal residence. In order for the exclusion of gain to apply, homeowners had to live in the property and use it as their principal residence for two out of five years. The five year period ended on the date that the house was sold. Short temporary absences for vacations or other seasonal absences were counted as periods of use. Homeowners who failed to meet the ownership and use requirements under the old law or satisfy the minimum two-year time period for claiming the full extension were still eligible for a partial exclusion if the sale of the home was due to (1) a change in the place of employment, (2) health reasons or (3) unforeseen circumstances. The following example illustrates section 121 under the pre-Housing Act:

**Example 1:** Taxpayers own two properties in San Francisco: one property is in Pacific Heights and is worth \$2,000,000 and the second property is in North Beach valued at \$1,000,000. Taxpayers decide to use the Pacific Heights property as their principal residence as of January 1, 2004, and they rent the North Beach property to tenants. On June 30, 2006,

the Taxpayers sell the Pacific Heights property for \$2,500,000 and exclude \$500,000 of gain from their gross income because they satisfy all of the requirements of Section 121. Taxpayers move into their North Beach property on June 30, 2006. Their tenant vacated that property the month before. Taxpayers use their North Beach property as their principal residence for the next two years and sell it on September 30, 2008 for \$1,500,000. Taxpayers can fully exclude the \$500,000 gain on the sale of their North Beach property because they satisfied the requirements of Section 121. In less than five years, Taxpayers sold two principal residences and were allowed to receive \$1,000,000 of tax-free cash.

The nonqualified use concept implemented under the Housing Act restricts a taxpayer's ability to use the full exclusion amount (\$250,000 for an individual and \$500,000 for a married couple) for periods when the property is not used as a principal residence (e.g., rental property or vacation home). Under the Housing Act, gain is prorated between periods of qualified and nonqualified use based on the amounts of time the property is utilized for qualified and nonqualified uses. The amended Section 121 requires the taxpayer to set up a proportion. The taxpayer includes the aggregate periods of nonqualified use in the numerator, and the total period of time the property was owned by the taxpayer in the denominator. A taxpayer then applies this proportion to the \$250,000 or \$500,000 exclusion amount to determine the amount of excludable gain.

Nonqualified use does not apply to periods prior to January 1, 2009. In addition, the Housing Act includes several exceptions to the general definition of nonqualified use.

- **Post-principal residence use:** This exception allows the taxpayer a five-year period in which to sell the principal residence after moving out of it, without having to count this time as nonqualified use.

- **Qualified official duty:** Nonqualified use does not include any period that the taxpayer or spouse is serving on "qualified official extended duty" for the armed services, foreign service, or intelligence community. This exception cannot exceed an aggregate of ten years.

- **Temporary absence:** Nonqualified use does not include periods of temporary absence (not to exceed two years in total) because of a change of employment, health conditions or other unforeseen circumstances.

The following example illustrates the restrictions imposed on property owners by the Housing Act:

**Example 2:** Taxpayers are married and buy a property on January 1, 2009, for \$400,000, and use it as rental property for two years. On January 1, 2011, the Taxpayers convert the property for use as a principal residence. Taxpayers move out on January 1, 2013, and sell the property for \$700,000 on January 1, 2014. Forty percent (40%) of the \$300,000 gain, (two years divided by five years), or \$120,000, is allocated to nonqualified use and is not eligible for the exclusion. Since the remaining gain of \$180,000 is less than the maximum gain of the \$500,000 that

*"While the impact of the Housing Act rules will not be felt for some time, taxpayers should be aware of the new changes and restrictions."*

may be excluded, the remaining gain of \$180,000 is excluded from gross income. (Joint Committee on Taxation, Technical Explanation of the Housing Assistance Tax Act of 2008 (JCX-63-08), July 23, 2008).

Taxpayers are required to prorate their exclusion because they used the property as a rental property as of January 1, 2009. Rental property is a nonqualified use under the Housing Act.

Despite the limitations illustrated above, the amended Section 121 may still contain planning opportunities. Commentators have identified the post-principal residence use exception discussed above as a potential method to maximize the full use of the exclusion. Under the new law, the full exclusion of gain should apply if:

- The taxpayer acquires and owns the property after January 1, 2009;
- Immediately makes use of it as a principal residence; and,
- During the next five years aggregates two years with the property as principal residence.

The following example shows how this can potentially work:

**Example 3:** Assume facts similar to those in Example 2, except that on January 1, 2009, Taxpayers buy a home for \$400,000 and immediately make it their principal residence. On July 1, 2009, Taxpayers move out of the home and rent it for three years. On July 1, 2012, Taxpayers again use the home as their principal residence until they sell it on January 1, 2014 for \$700,000. Because Taxpayers made the home their principal residence on purchase and aggregated two years of use during the five year period, they would be able to exclude all \$300,000 of gain.

The above example takes advantage of the post-personal residence exclusion contained under the new rules. When the taxpayer immediately uses purchased property as a principal residence, the taxpayer preserves flexibility over the next five-year time frame in order to try and satisfy the two-year personal residence use test within that period.

It is unclear whether Congress intended this potential treatment. The Internal Revenue Service could still issue a technical correction or ruling to clarify its intent and close this loophole. There are also practical limitations to this technique, as it involves the taxpayer moving several times in a relatively short time frame. For now, though, a strict reading of the new rules permits this type of transaction.

California has not conformed to the new rules under the Housing Act. Unless California adopts an amendment, California taxpayers will still be subject to the pre-Housing Act rules. In other words, the "nonqualified use" rules will not apply for California income tax purposes.

While the impact of the Housing Act rules will not be felt for some time, taxpayers should be aware of the new changes and restrictions. At a time when home prices are dropping precipitously, Congress has also restricted homeowner's opportunity to shelter gain on the sale of real property.

# EMPLOYMENT LAW ALERT

Below is a summary of changes to both state and federal employment laws to be effected in 2009:

- ADA Amendments Act (S 3406) expands coverage of Americans with Disabilities Act (ADA) in favor of broad coverage of individuals under this Act, to the maximum extent permitted by the terms of this Act.
- Genetic Information Nondiscrimination Act (HR 493), forbids genetic testing and bias in employment.
- Consumer Product Safety Improvement Act (HR 4040), prohibits retaliating against whistle blowers dealing with consumer products.
- Computer Professional Exemption Redefined (AB 10), redefines the duties and compensation requirements for exempt computer professionals, expanding the compensation test and changing the minimum hourly and salary requirements.
- Wage Adjustment for Hourly Exempt Doctors, changes the annual rate for hourly-paid exempt doctors.
- Employee Wage Protections, forbids deducting the costs to emigrate to the United States from wages (AB 1278) and requiring employees to sign false timesheets (AB 2075).
- Paying Temporary Services Employees (SB 940), adjusts payroll practices for temporary services employers.
- No Text-Messaging While Driving (SB 28), prohibits driving a motor vehicle while writing, sending, or reading text-based electronic communications such as text messages, instant messages, and emails.

*“Now, more than ever, savvy businesses rely on the wisdom of trusted advisers to wisely advocate, successfully negotiate, or ... vigorously litigate.”*

- Commuter Benefits for San Francisco Employees (SF Ordinance No. 199-08), requires employers of 20 or more employees (including temps and workers outside the city) to provide commuter benefits to covered employees. NOTE: The minimum wage rate in San Francisco effective January 1, 2009 is \$9.79 per hour.

- Bailout for Bike Riders (HR 1424, Div. B, Sec. 211) is part of a \$700 Billion bailout and gives employers tax incentives for providing commuting benefits to employees who bike to work.

- Health Coverage for Seriously Ill College Students (SB 1168) provides up to 12 months of continuing health coverage for college students taking a medical leave of absence from school.

- FMLA Revised Regulations (29 CFR Pt. 825), provides new rules for administration of the federal Family and Medical Leave Act (FMLA).

- Filing Workers' Compensation Claims (AB 2181), eliminates duplicate filing requirements for reporting work-related injuries.

- Background Checks for Video Providers and EMTs (AB 2232, AB 2917), mandates background checks for anyone acting on behalf of a video provider and/or emergency medical technicians (EMTs).

If any of the above relate to your business or company, please contact Carr McClellan's Employment Department for more information or advice regarding how these changes may affect your business in 2009.



# NAVIGATING TROUBLED WATERS: BUSINESS NEGOTIATIONS AND LITIGATION IN A DOWN ECONOMY

By *Jeremy A. Burns, Esq.*

Lately, Carr McClellan has seen more clients seeking assistance with their clients and customers who are not making their payments. These cases often involve a simple breach of contract. Others involve complex landlord-tenant disputes. We have been able to help our creditor clients negotiate arrangements that strengthen their legal and financial positions, while also giving struggling business partners "breathing room." In other situations, immediately commencing litigation has resulted in a favorable outcome.

Other clients find themselves in the reverse situation. They are having difficulty paying their vendors and face actual or potential litigation. The lawyers at Carr McClellan have been successful in helping these clients negotiate affordable arrangements.

It pays to contact Carr McClellan as soon as you become involved in a business dispute. Carr McClellan's litigation group is particularly adept at finding the best way to negotiate the resolution of these disputes. Clients sometimes wait too long before seeking assistance, making it harder to help them. Even worse, those who cut deals with their business partners without assistance can inadvertently cede negotiating leverage.

When a client does call to ask for help with a business dispute, the first step is to help the client take stock of the situation. Sometimes, immediate litigation is called for by our clients who are creditors. Unfortunately, it can take being sued to encourage a recalcitrant client or customer to come to the bargaining table. Hopefully our clients have contacted us early, and we have been able to help them strengthen their position in anticipation of litigation. Whether they have done so or not, our team will efficiently and effectively represent their interests.

In some circumstances, we can negotiate payment plans. From a creditor's perspective, the key issue is determining what happens if the other party does not comply with the payment plan. The best arrangements for creditors immediately strengthen their legal and financial position, and can often be structured to simplify, or even circumvent, litigation. At best, the creditor client gets paid in full. At worst, a disputed debt has been changed into an undisputed collection matter, reducing uncertainty and expense. From the debtor's perspective, the best arrangements provide sufficient time to make affordable payments. Interestingly, most of the payment plans we have recently negotiated have been timely paid.

Now, more than ever, savvy businesses rely on the wisdom of trusted advisors to wisely advocate, successfully negotiate, or, depending on the circumstances, vigorously litigate. As litigators at Carr McClellan, we understand that our clients judge our results by the bottom line. If you find yourself in a financial conflict with a client, customer, vendor, landlord or tenant, please allow the litigation attorneys at Carr McClellan to assist you as soon as possible.

*Jeremy A. Burns is a member of the Litigation group.*

### LETTER OF INTENT, *from page 3*

and until a final Purchase Agreement has been negotiated, executed and delivered by each of Seller and Buyer. Both parties reserve the right to refine or change the foregoing business terms and add additional terms as this transaction is further negotiated and documented. This letter of intent shall not be construed in any way as creating any agreement which can be specifically enforced. If either party elects in its sole and absolute discretion to discontinue further discussions at any time or for any reason, neither party shall have any rights or obligations pursuant to this letter of intent or otherwise."

Consider using a Non-Binding Letter of Intent as a means for streamlining your next business transaction. The transactional attorneys at Carr McClellan are experienced in the art of crafting Non-Binding Letters of Intent and take care to save clients the wasted time, energy and legal fees involved in negotiating long legal documents before a basic business deal is agreed upon.

*S. Kendall Patton is a member of the Real Estate group.*

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