CARR McCLELLAN

PERSPECTIVES

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ED WILLIG'S PERSPECTIVE

DEAR CLIENTS AND FRIENDS:

The changes that have occurred in the firm's nearly 72 year history are remarkable. When Luther Carr and J. Ed McClellan formed Carr McClellan in 1945, they would be among the first in Burlingame to work in a building with a passenger elevator. Today our clients are leading innovation in a wide variety of industries, from technology to food and beverage. And yet as change propels us forward, we are sometimes brought back to the vision that made us great in the first place: We are pleased to announce the reestablishment of the Estate Planning practice at Carr McClellan.

Throughout our history, families have regarded us as one of the premier estate planning practices in California, providing them with the knowledge and technical expertise necessary to create effective, tax-efficient estate plans. We will continue providing counsel on a full suite of services including trust administration, tax planning and estate tax compliance, and representing clients in audits of gift and estate tax returns and tax controversies.

Leading our Estate Planning practice is DAN BROWN, a veteran estate planning attorney with over 30 years of experience. Dan is certified by the State Bar of California, Board of Legal Specialization as a specialist in estate planning, trust and probate law. He is also a Commissioner and the incoming Chair of the Estate Planning Law Advisory Commission, Board of Legal Specialization with the California State Bar.

In addition to Dan, we are pleased to announce two other attorneys joining the firm: DENNY ROJA and SANDRA SPECTOR. Denny has joined the firm's Business and Corporate practice. Denny, a dealmaker at heart, rejoins the firm after leaving the practice of law to serve as managing director for a Silicon Valley-based investment banking firm that provided corporate financial advisory and Mergers & Acquisitions (M&A) services to emerging growth technology firms. He has also served as head of M&A for two Fortune 50 companies. Denny's law practice focuses on corporate M&A transactions including strategic partnering, venture capital financings, corporate finance, intellectual property licensing and advising technology and non-technology startups.

On November 1, Sandra will join the firm's Tax practice. Her practice focuses on corporate taxation, international tax planning, cross border mergers, acquisitions and reorganizations, post-acquisition integrations and transfer pricing. She also represents clients in residency and employment tax matters. We are confident that Denny's and Sandra's expertise will benefit a wide spectrum of clients, and we look forward to introducing you to them.

If you haven't checked out our website lately, we invite you to do so. Our attorneys regularly share their knowledge at www.carrmcclellan.com/insights on a variety of topics including Corporate and Business, Litigation, Real Estate, Tax, Employment and Intellectual Property.

WE HOPE YOU ENJOY THIS ISSUE OF *PERSPECTIVES*. IF WE CAN ANSWER ANY QUESTIONS, DO NOT HESITATE TO GET IN TOUCH WITH ME OR ANY OF OUR ATTORNEYS.

Ed Willig

EMPLOYMENT CLASSIFICATION

INDEPENDENT CONTRACTOR MISCLASSIFICATION

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HEADLINES ABOUT UBER'S $100 MILLION SETTLEMENT OF A CLASS action by 240,000 drivers who claimed they were misclassified as independent contractors rather than employees caught the attention of businesses across California. That attention is warranted. Recent decisions by courts and government agencies are clear that labeling a worker an "independent contractor" is immaterial. Instead, courts and regulators look behind the designation to assess the extent of the company's right to control the worker. While personnel and cost savings by hiring an independent contractor can be substantial, the expenses from misclassification can be far greater. The following is a brief summary of factors a business should consider and implement to reduce its misclassification risk.

California's Labor Code presumes that a worker is an employee. To assess whether a worker is an independent contractor rather than an employee, the California Supreme Court in *Ayala v. Antelope Valley Newspapers, Inc.* (2014) 59 Cal.4th 522 stated, "[t]he principal test of an employment relationship is whether the person to whom service is rendered has the right to control the manner and means of accomplishing the result desired....what matters... is not how much control a hirer exercises but how much control the hirer retains the right to exercise." When assessing the question of control, the IRS considers the following:

BEHAVIORAL: Does the company control or have the right to control what the worker does and how the worker does his or her job?

FINANCIAL: Are the business aspects of the worker's job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)

TYPE OF RELATIONSHIP: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

The California Department of Labor amplifies the independent contractor assessment factors at http://www.dir.ca.gov/dlse/faq_independentcontractor.htm.

The consequences from misclassification can be significant. They can include liability for years of unpaid tax withholdings, unpaid Social Security and Medicare contributions, unpaid workers compensation and unemployment insurance premiums, unpaid overtime, minimum wages, and work-related expenses. Reclassification as an employee can also lead to significant waiting time penalties, wage statement penalties, meal and rest break penalties, Private Attorney General Act penalties, and statutory penalties under Labor Code § 226.8(a) of $5,000 to $10,000 for each violation. If the misclassification is willful—voluntary and knowing— then the penalties increase to $10,000 to $25,000 for each violation. And, a class action successfully alleging misclassification can increase those costs by many times more.

With those exposures in mind, the following are pro-active steps businesses should take to minimize employee misclassification risks:

- Review contracts to eliminate provisions that give the company the right to control the methods and means of accomplishing the work.
- Review the contractor's actual activities: who in fact controls the methods and means of performance. Evaluate whether the worker is truly in business for him or herself or whether the worker is economically dependent on the employer.
- Check the duration of the contract—an independent contractor engagement is usually limited.
- Consider adding mandatory arbitration and class action waiver provisions in employment and consulting agreements.

Proper worker classification is a critical risk management process. We are happy to answer your questions about this important issue.

OVERTIME PAY

AN ESTIMATED 4.2 MILLION EXEMPT EMPLOYEES MAY SOON BE ELIGIBLE FOR OVERTIME PAY: DO SOME OF THEM WORK FOR YOU?

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IN ORDER FOR AN EMPLOYEE TO BE EXEMPT FROM OVERTIME premium pay, they must meet two basic tests: perform certain job duties, and make more than a specified salary. Under current federal law, if a full time employee earns less than $23,000 per year, they do not qualify for being categorized as exempt. The $23,000 salary threshold has been the same since 2004. Recently, the White House Office of Management and Budget approved new Department of Labor regulations which will increase the minimum salary of a full time exempt employee to $47,476 per year![1] These new DOL regulations could become effective by December 1, 2016 unless Congress intervenes. The new regulations also provide for the minimum salary for exempt employees to be adjusted every three years to reflect wage growth over time.

As opposed to employers in other states, California employers may not be too concerned about the increase in the federal salary test since California law already requires that most full time employees must make a minimum annual salary of $41,600[2] in order to qualify for being exempt. So there can't be too many California employees whose exempt status will be lost by this salary increase from $41,600 to $47,476, right? Wrong!

DOL data indicates that the proposed increase in an exempt employee's minimum annual wage will result in at least 395,000 California-based employees losing their exempt status, and a total of almost 4.2 million employees nationwide losing their exempt status.[3] In particular, it is projected that smaller businesses and non-profit organizations will be disproportionately impacted. This means that for some employers this federal increase in salary for exempt employees could significantly increase their labor costs. Do some of these employees who will lose their exempt status work for your business?

Recently, there has been significant opposition to the proposed increase in the minimum wage for exempt employees both in the courts and in the U.S. Congress. As of the time of writing this article, a bill passed the U.S. House of Representatives on September 28, 2016 which would delay the implementation of the DOL's proposed increase in the minimum salary of exempt employees from December 1, 2016 to June 1, 2017.[4] However, even if this bill is also passed by the U.S. Senate, and survives the possibility of a veto by the President, it just delays the implementation of this increase in the minimum salary for exempt employees by a mere six months. Therefore, we believe that it is imperative for California employers to be aware that they may have employees currently being paid as exempt who may soon no longer qualify for this status.

Having a plan regarding this proposed increase in minimum salary for exempt employees can significantly reduce your company's costs, and keep your business in compliance with the law. We recommend all U.S. based employers identify those exempt employees who earn less than $47,476 a year, and give us a call to explore how you can plan to minimize a significant increase to the compensation costs of your business. A little planning now can minimize increased costs to your bottom line and potential legal exposure under the new regulations.

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[1] *https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-11754.pdf*

[2] Although $41,600 is the minimum salary requirement for most exempt workers, California law has different minimum wage and salary requirements for physicians, computer professionals and outside salespersons.

[3] *http://blog.dol.gov/2016/05/18/who-benefits-from-the-new-overtime-rule/*

[3] *http://www.law360.com/articles/845764/house-oks-bill-to-put-brakes-on-dol-s-overtime-rule*

FOOD SAFETY

NORTHERN CALIFORNIA FOOD INDUSTRY ENTREPRENEURS ATTRACT GLOBAL INTEREST

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I AM SURE ALL OF YOU KNOW, THE UNITED STATES HAS BEEN experiencing a trade imbalance for years, with our economy having shifted toward a "service" economy and away from a "manufacturing" economy. But we have pockets of economic activity where that trend has been reversed. Are you surprised that one of them is cheese making? Yes, as reported by the Wall Street Journal, the United States is experiencing a cheese glut, sending prices downward. America's per capita consumption of 36 pounds per year is just not enough. Eat more cheese, please.

So, given this surplus you would think that U.S. cheese makers would be the last targets for acquisition by foreign acquirers. But that has not been the case for Swiss dairy company, Emmi, which bought one of our local favorite artisan cheese makers-Cow Girl Creamery earlier this year. This acquisition followed Emmi's purchase of Redwood Hill Farm and Creamery of Sebastopol and Cypress Grove Chevre of Arcata a few years back.

What's going on here? As is most often the case, many things. Developments at each of the local, national and international levels are likely at work. The acquisition of Cow Girl Creamery is indicative of the attractiveness of high quality, innovative food companies that have become part of the fabric of Northern California. This attractiveness is a "pull" feature and is based on demonstrated strong consumer loyalty, sustainable agricultural and manufacturing practices and scalability. Also at work is a "push" feature, i.e., the increasing need of food and beverage industry companies to access capital, markets and, not unimportantly, the resources to comply with new laws and regulations aimed to guaranty the safety of our food supply and the health of the consuming public.

Although the Food Safety Manufacturing Act ("FSMA") was signed into law back in 2011, its far-reaching mandates are only now being felt by food companies as regulations become final and effective. Registration of food facilities, increased inspection authority, additional record keeping, as well as mandates for implementing food safety processes and procedures at each stage of the supply chain, are all increasing compliance costs for food and beverage industry companies, both small and large. In late August, the FDA released its long awaited detailed guidance to the food industry to help it comply with FSMA. As you might think, increased regulations generally impact smaller companies disproportionately. Obtaining knowledge, training workers and overseeing compliance all take significant resources that often need economies of scale to be financially feasible.

Not only is the FSMA adding to the challenges faced by small artisanal food companies, but recently other laws and regulations and expansive interpretation of existing laws are as well. For example, California's Prop 65, passed in 1986 to protect consumers against harmful chemicals believed to cause cancer or reproductive harm, is being used in some cases to block the use of ingredients, such as black licorice, turmeric and ginger that can contain small levels of banned chemicals acquired from the environment generally. Also recently, after 10 years in the making, the House passed (in a bi-partisan vote of 403-12!), and the President signed, an update to the 1976 Toxic Substance Control Act that granted the EPA the additional authority to require companies to study chemicals contained in products and to review more chemicals found in products. This portends closer scrutiny of product ingredients and compositions.

Accordingly, despite the local and regional successes experienced by many artisanal food companies, and their desire to stay "local," the challenges that they face will be increasing. Some of those challenges may only be met by achieving scale by joining forces with a larger company that will give them access to the knowledge, resources and capital to comply with the demands of the public and government regulations for food safety, sustainability and healthy products. So just like America's glut of cheese did not prevent Emmi of Switzerland from acquiring gems like Cow Girl Creamery, we can expect many other similar specialty food companies to be subject to the "push" and "pull" forces of the increased focus on food safety in our legal environment.

TRADE SECRETS

WHAT BUSINESSES NEED TO KNOW ABOUT THE DEFEND TRADE SECRET ACT

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ON MAY 11, 2016, PRESIDENT OBAMA SIGNED NEW FEDERAL TRADE secret legislation into law. The Defend Trade Secret Act of 2016 ("DTSA") provides companies with new powerful tools to protect their most valuable information. To take full advantage of these new tools, companies must develop and implement a response plan before any theft occurs. This article identifies how companies may position themselves to take advantage of this important new legislation.

THE DTSA PROVIDES A NATIONWIDE CIVIL RIGHT OF ACTION FOR MISAPPROPRIATED TRADE SECRETS.

Unlike patents, copyrights, and trademarks, trade secrets were only protectable under state law. As a practical matter, the outcome of a trade secret case often turned on which state's laws applied to the dispute, leading to conflicting results and confusion, particularly for companies operating in multiple states.

The DTSA attempts to solve this problem by providing a uniform body of law across the nation. But, the statute may fall short in several key respects. First, the DTSA does not preempt the existing body of state trade secret laws. As a practical matter, the existing state law and the DTSA operate in parallel. Second, the DTSA does not alter existing state laws related to employee mobility between competitor companies; state laws differ greatly on the freedom of employees to move between companies. The DTSA's inability

AS A PRACTICAL MATTER, THE OUTCOME OF A TRADE SECRET CASE COULD OFTEN TURN ON WHICH STATE LAWS WERE APPLIED TO THE DISPUTE, **LEADING TO POTENTIAL CONFUSION**, ESPECIALLY FOR COMPANIES OPERATING IN MULTIPLE STATES.

to resolve these two major sources of variation present potentially significant impediments to uniformity. As a result, the DTSA's noble efforts at creating a uniform, national body of trade secret law may actually create more confusion and complexity for businesses.

THE DTSA PERMITS A COMPANY TO SUE IN FEDERAL DISTRICT COURT.

With the enactment of the DTSA, a trade secret plaintiff now has the option to file suit in federal court. To take advantage of this forum, the theft must have taken place on or after May 11, 2016 and the stolen trade secret must be related to a product or service used in, or intended for use in, interstate or foreign commerce—a relatively low threshold in today's increasingly global and digital economy.

In other words, the DTSA provides an aggrieved company with an initial strategic decision of whether to proceed in state court or federal court depending on what forum it believes will provide it the greatest protection. That early strategic decision can be complicated and important, depending on the location of the parties, the nature of the alleged harm, and the applicable state law.

SEIZURE OF TRADE SECRET INFORMATION

The most noteworthy provision of the DTSA is the ex parte seizure remedy. Unlike its state law counterparts, the DTSA empowers a federal district court to grant a petition to seize trade secret information to prevent its dissemination. To obtain a seizure order, the aggrieved party must demonstrate:

- other types of court orders would be an inadequate remedy;
- immediate and irreparable harm would occur;
- the potential harm to the petitioner outweighs the harm to the accused and substantially outweighs the harm to any third party;
- the petitioner is likely to succeed in showing that the information to be seized is a trade secret obtained by improper means by the accused; and
- the accused has actual possession of the trade secret and any property to be seized.

All the requirements for granting a DTSA seizure petition should be discussed with an attorney. To take full advantage of this procedure, companies should revisit their trade secret protection programs to ensure there is a mechanism for early detection of irregular access and use of its trade secrets.

EXCEPTIONS AND IMMUNITIES

The DTSA sets forth certain exceptions and immunities that permit the disclosure of trade secret information by third parties in certain circumstances. For example, there is no DTSA claim stemming from otherwise lawful activity conducted by local, state or U.S. governmental entities. In addition, the DTSA grants whistleblower to individual employees who disclose a trade secret to a federal, state or local governmental official, or attorney for the purpose of reporting a suspected violation or in a court filing under seal.

EMPLOYEE NOTICE REQUIREMENT

The DTSA requires employers to provide notice of the employees' whistleblower protection in any agreement that governs the use of trade secret or confidential information. This notice can be provided explicitly in such an agreement or implicitly by reference to a policy document describing the whistleblower immunity. An employer's failure to comply with this notice requirement will result in a waiver of exemplary damages and attorneys' fees in any later action against an employee who did not receive the notice. The notice requirement applies to all—and only those—agreements entered into after May 11, 2016. Companies should contact an attorney to review their relevant employee agreements and handbooks to ensure compliance with the DTSA.

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TRANSFER TAX

PROPOSED REGULATIONS ISSUED UNDER I.R.C. SECTION 2704

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THE WINDOW FOR A USEFUL TRANSFER TAX PLANNING TOOL MAY be closing shortly. Clients contemplating transfers of interests in closely held businesses to family members should take action and consult with us immediately.

Congress and the Internal Revenue Service have been concerned that some people are not paying their fair share of transfer taxes. This perceived concern is especially true in the area of entity discounts. We have known for some time that the Internal Revenue Service frowns upon the use of discounts in transfers of entities within families. These discounts have the effect of lower transfer tax costs, when compared to the proportionate value of the underlying assets owned by the entity. However, the legal theory behind discounts is sound. Short of congressional action or legislative Regulations by the Internal Revenue Service, these discounts are available for transfer tax planning. Unfortunately, Congress authorized the Service to issue legislative regulations pertaining to discounts. For the last year and a half these Regulations were merely a rumor.

On August 2, 2016, the Treasury issued the long anticipated Proposed Regulations under I.R.C. Section 2704. 81 Fed. Reg. 51413-51425 (Aug. 4, 2016). In the current form, the Proposed Regulations would severely limit, and possibly eliminate, the use of certain valuation discounts on entity transfers between family members. This applies to closely held businesses, limited partnerships, corporations and limited liability companies.

If the Proposed Regulations are finalized without changes, the Proposed Regulations would:

- Clarify that Section 2704 applies to corporations, partnerships, limited partnerships and limited liability companies, as well as other business entities.
- Treat as an additional taxable transfer the lapse of voting and liquidation rights for transfers made within three years of death of interests in a family-controlled entity, thereby eliminating or substantially limiting the lack of control and minority discounts for these transfers.
- Disregard for valuation purposes the ability of most nonfamily member owners to block the removal of covered restrictions unless the nonfamily member has held the interest for more than three years, owns a substantial interest in the entity, and has the right, upon six months' notice, to be redeemed or bought out for cash or property.
- Disregard for transfer tax valuation purposes restrictions on liquidation that are not mandated by federal or state law in determining the fair market value of the transferred interest. This has the effect of disregarding limitations on liquidation contained in the governing document of the entity.
- Eliminate discounts for transfer tax valuation purposes based on the transferee's status as a mere assignee and not a full owner and participant in the entity.

The effective date for these proposed rules is somewhat confusing. The effective date for the Proposed Regulations for (i) lapses of rights, and (ii) applicable restrictions is the date the Proposed Regulations are published as Final in the Federal Register. The effective date for the Proposed Regulation dealing with transfers subject to disregarded restrictions is 30 days after the Proposed Regulation is published as Final in the Federal Register.

The Proposed Regulations are currently open for comment. Written and electronic comments on the Proposed Regulations must be received by the Internal Revenue Service by November 2, 2016. A public hearing is scheduled for December 1, 2016.

Regardless of modifications that may be made to these Proposed Regulations when issued in final form, the use of discounts on transfers of entity interests is going to be curtailed. This will have the effect of increasing the transfer tax values, and therefore increasing transfer taxes.

Things to consider:

- Make transfers of family-owned entities before the proposed regulations become final.
- Review Buy/Sell agreements that govern family-owned entities.
- Review business agreements for any covenant that affects the owner's ability to cash out, such as shareholder agreement, loan documents, and stock purchase agreements.

Saving transfer taxes must be considered with optimal income tax and property tax outcomes. All three tax systems intersect. For example, reduction of transfer taxes must be weighed against the benefit of the capital basis adjustment upon the death of the transferor.

If you would like to discuss these issues further, please contact us.

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