

# The Rodi Review

Summer 2005

## LETTER FROM THE EDITOR

Welcome to the Summer 2005 edition of the Rodi Review! In addition to Elizabeth Blakely's legal alert regarding new legislation affecting the use of deferred compensation, we have three articles, including a timely piece by Cris O'Neill about how to appeal a property tax reassessment. Bob Yahiro gives some sage advice on how to select and work with a lawyer in a business transaction, and Bill Christian reviews recent California legislation regarding the protection of consumers' financial information. We hope that you enjoy this issue and that you have a wonderful summer.



Jean Beasley

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Federal law now requires us to provide the following disclosure: The contents of this newsletter were not written to be used and cannot be used by the recipient hereof for the purpose of avoiding any penalties for which the recipient may be liable under federal tax law.

## LEGAL ALERT!

by Elizabeth B. Blakely

In October of 2004, Congress created a great furor in boardrooms across the country with the enactment of Internal

Revenue Code Section 409A. Congress passed this legislation, which restricts severely the use of deferred compensation. This legislation was in response to several widely publicized corporate scandals, including the collapse of Enron, where highly-compensated



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## 'TIS THE SEASON FOR PROPERTY TAX APPEALS

by Cris K. O'Neill

The season for California property owners to contest their property taxes is upon us. Each year, from July 2 through November 30 (September 15 in some counties), taxpayers may file assessment appeals with their county appeals board to challenge the assessed value that the county has assigned to their property.

The primary reason for filing an appeal is to request decline-in-value relief after a drop in a property's fair market value. Granted, such downturns are usually the result of a general decline in real estate market conditions; however, value declines can also be

caused by property-specific problems such as environmental contamination or structural deficiencies.

Another reason that an owner might want to file an appeal is to challenge a reassessment due to an acquisition or the completion of new construction. Taxpayers can file such base-year value challenges up to four years after a change of ownership or a new construction reassessment. A taxpayer may also choose to file an appeal to contest the assessment on items of personal property, such as machinery and equipment. If the taxpayer files the appeal after an audit of such property by the assessor, the taxpayer can simultaneously challenge the real property assessment at the location where the personal property is kept.



## GET THE MOST FROM YOUR DEAL LAWYER

by Robert Yahiro

**T**ens of thousands of lawyers practice in Los Angeles County alone. Finding the right one to represent you in the purchase or sale of your business can be a daunting task. Here are some practical hints for finding and effectively using legal counsel in a business transaction.

### IS YOUR LAWYER LISTENING TO YOU?

The only thing lawyers love more than talking is listening to themselves talk, but a good one will take the time to listen to what you want out of a deal as well as your personal business philosophy. Make sure that you feel you are “connecting” on a personal level with your legal representative and that you are on the same page in terms of understanding your bottom-line negotiating target.

### LISTEN TO YOUR LAWYER

After *you* have talked, listen. After all, you are paying by the hour for the advice. If you and your lawyer have laid out a negotiating strategy, follow it. Never undercut your counsel by making a different deal with the other side. Nothing undermines your lawyer’s authority more than hearing from the opposing attorney, “Your client gave up that point last night, counselor.”

### LOST IN THE “LEGALESE”?

A good lawyer will be able to explain complex legal concepts in plain English. You need to understand the issues standing in the way of getting your deal closed. Equally important, the lawyer must be able to state your position in a way that everyone on the other side understands. Being able to convey the precise point of disagreement in plain and simple language often results in cre-

ative solutions to apparent stumbling blocks.

### THINK TWICE ABOUT HIRING A “MAD DOG”

Think your lawyer needs to be the meanest and nastiest counsel at the bargaining table? Think again. No one likes to be treated in a rude and offensive manner: Not other lawyers and not their clients. More deals will crater, more legal fees will be wasted and more late nights will be spent on



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endless haggling often driven by personal acrimony between attorneys. Remember, “Do unto others...”

### THE RIGHT STUFF

The right legal and deal-making experience can make all the difference. Make sure the lawyer you hire has handled transactions of this nature and has represented your size and type of company. The largest law firm in the city may be suited to take your company public, but that firm is not necessarily the best to help you sell a modest size

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business with complex family issues. The sole practitioner who incorporated your company and prepared your living trust may not be the right one to restructure your business for the next generation of managers.

### KNOW WHEN TO FOLD 'EM

Does your lawyer tell you when you have a weak position or does your legal team push every issue, weak or strong, to the maximum? Your business goal should be to complete the deal by achieving your desired economic terms, minimizing exposure to legal risks and being efficient in the process. Many times endless negotiations over insubstantial or weak points only drive up legal fees, fray nerves and achieve little dollar-wise.

### BEYOND THE LAW BOOKS

Lawyers are supposed to be advisors on the law; however, are you comfortable asking, “If you were in my shoes... should I walk away, should I increase my offer, can I afford to lose the contract?” Beyond practicing law, many lawyers have no real world business experience to be able to say any more than, “You’re the client. I’m just the lawyer. It’s your decision.”

### BE INTELLECTUALLY HONEST

Lawyering is a highly technical profession, based on written rules, regulations and court cases. Sometimes a lawyer, trying to be the client’s best advocate, can be tempted into an intellectually dishonest stance based on a hyper-technical, contorted reading of a contract or the law. Ultimately, a judge or jury will decide (at least theoretically) what is the “reasonable” interpretation of the parties’ actions. Both you and your lawyer may be well advised to reconsider the reasonableness of your thought process. Oftentimes, advancing an untenable albeit technically supportable position will result in more legal fees than it was worth, leaving the client to wonder, “How did I ever end up in this mess?”

## CALIFORNIA IDENTITY THEFT LEGISLATION AND ITS EFFECT ON SMALL BUSINESSES

by William R. Christian

**I**dentify theft has become the fastest-growing crime in the United States, and is a serious problem in California.

Substantial legislative protection is now available. California has enacted a number of laws designed to protect consumer information such as Social Security, driver's license and account numbers.

This legislative protection and the consumer protections provided under federal law increase the risk for businesses dealing with consumer information in the normal course of activity. They also make it important for these businesses to adopt appropriate lines of defense and to take precautions to ensure that they protect such information from disclosure to unauthorized users.

Senate Bill 1386, which became effective July 1, 2003, requires businesses to provide prompt notice to California resident customers of any breach of security involving unencrypted personal data consisting of the individual's first and last name along with any of the following:

- Social Security number;
- Driver's license or California identification number, and
- Account number or credit or debit card number if acquired in connection with any required security code that would show access to the account.

This law applies to any person or business doing business in California and owning or utilizing computerized data that includes such personal information. The business must provide

notice to the consumer if the business reasonably believes that an unauthorized person accessed personal information.

The business may provide such a notice in writing or electronically. If the cost of providing written or electronic notice would exceed \$250,000 or involve more than



*This legislative protection and the consumer protections provided under federal law increase the risk for businesses dealing with consumer information in the normal course of activity...*

500,000 people, the businesses may notify the affected people by email, by posting a notice on a website or by notifying media statewide. Any business failing to comply with the law is

*This law applies to any person or business doing business in California and owning or utilizing computerized data that includes such personal information.*

subject to substantial penalties if a breach occurs.

California has also passed legislation restricting the use of information contained on a person's driver's license. Senate Bill 602, effective January 1, 2004, limits a business' use and retention of driver's license or identification card information to:

1. verification of age or authenticity of the card,
2. compliance with any legal requirement to maintain the information,
3. transmittal of the information to a check service company for approval, and

4. collection or disclosure of personal information required to report, investigate or prevent fraud.

A business may not retain the information for any other purpose and a violation constitutes a misdemeanor punishable by imprisonment of up to one year or a fine of up to \$10,000.

These are only two of a series of protective measures available to California consumers. Further, federal legislation in the Gramm-Leach-Bliley Act of 1999 requires that financial institutions notify customers of what information is protected and how the institution will protect and share that information. Virtually all of our readers are by now familiar with the "Privacy Act" notices sent to them on a regular basis by their financial institutions.

The first line of defense for most companies is encryption. This device provides substantial internal protection to the business. Furthermore, under Senate Bill 1386, even if a breach occurs, encrypted information is considered protected, and no notice to the consumer is required.

The second line of defense is an intrusion detection system, a software program that continuously monitors the network and computers for breach. The third line of defense are firewalls to assure that the company's computers are appropriately protected.

The recently enacted legislation emphasizes the political need to be proactive about protecting consumer information. If you have questions or concerns about the impact of the new legislation, please feel free to contact us to discuss these matters.

## 'TIS THE SEASON FOR PROPERTY TAX APPEALS

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Other reasons to file assessment appeals include (a) challenging the assessor's determination that a property transfer constitutes a true change of ownership, which can trigger a complete reassessment of the property at a much higher value, (b) failure to grant property tax exclusions or (c) a decision to impose penalty assessments.

Assessment appeals must be filed on pre-printed applications. These are available for free from county assessment appeals boards. Filing an appeal application is akin to filing a complaint in court. Consequently, the owner must prepare the application carefully to ensure that the claims are accurately and fully stated. Here are some important items to consider—and pitfalls to avoid—when filing an assessment appeal application:

- Use the latest application form available. County assessment appeals

boards modify their appeal forms nearly every year.

- Make sure that the party or entity filing the form is the one affected, usually the property owner or a tenant who is responsible for paying the taxes under a lease.
- If the form permits, mark the boxes for all of the grounds that support the appeal. If the specific reason for bringing the appeal does not appear next to one of the boxes on the form, attach an additional page that sets forth the reason in detail.
- In the space for the taxpayer's opinion of value, put an amount that comports with what is known about the property's value (even though, in many cases, the value the assessor assigned to the property will not be known until a property tax bill arrives in October).
- If a partnership, corporation or other entity legally owns the property, make sure an authorized person signs the application. If the application is filed by mail, ensure that it is postmarked

by the U.S. Postal Service (not the company postage meter) no later than November 30 (or September 15).

There will always be instances where information was omitted or an error was made. An amended application can be filed if the omission or error is detected prior to November 30 (or September 15).

If the omission or error is found after that date, it may still be correctable. The clerk of the appeals board will probably find the deficiency and—if it is relatively minor—allow the problem to be corrected. If the error is significant, the taxpayer may file a request to amend the application.

Of course, filing a formal appeal should not be an owner's first step in challenging a property tax assessment. It is better to start the process by contacting the assessor's office and attempting to resolve the matter informally. If a genuine disagreement requires adjudication, however, completing a valid appeal application may be the only way to resolve the matter fully. Happy filing!

## LEGAL ALERT!

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executives were able to walk away with over \$50,000,000 while rank and file employees were left with nothing.

Deferred compensation is an **unfunded and unsecured**, but legally binding, right of a service provider to receive payment in the future for services performed currently. Prior to Section 409A, the provider paid no tax on deferred compensation until actual payment. Under 409A, however, if a deferred compensation arrangement does not meet certain requirements, the service provider will be taxed at the time of service instead of at the later payment date. In addition, Section 409A imposes a 20% penalty tax on top of the service provider's normal tax. In order to defer

the payment of tax to the year the service provider actually receives compensation, payment can be made only upon the occurrence of one of the following events: Separation from service, death, disability, a specified time, change of control or unforeseeable emergency.

Unfortunately, in its attempt to curb corporate abuse, Congress has enacted a statute that is overly broad in its application. Section 409A applies to *any* arrangement where a service provider, even a single individual, has agreed to accept compensation at a future time. Section 409A not only covers publicly-traded corporations but also privately-held companies, where deferred compensation arrangements such as phantom equity are a very common device for incentivizing key employees without shareholders giving up actual ownership.

The IRS has provided some initial guidance in the form of Notice 2005-1, but has not yet issued regulations, although proposed regulations with guidance on plan provisions are pending. Deferred compensation arrangements must be amended before December 31, 2005 in order to comply with Section 409A. Amendments to deferred compensation arrangements other than those required to conform to Section 409A could trigger an income recognition event.

If you or your business are a party to a deferred compensation arrangement, you should contact legal counsel to discuss whether your deferred compensation arrangement currently complies with Section 409A or whether you need to amend that arrangement.