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The Rodi Review
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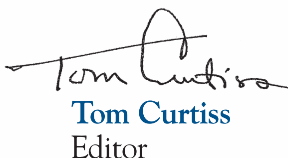
Letter from the Editor

Dear Readers:

After a year's absence, we are again publishing The Rodi Review. We hope that you will enjoy our two articles, both of which we believe are timely. Walter Killmer analyzes the anomalous absence of the federal estate and generation skipping transfer tax and its potential impact on taxpayers dying this year. Dana Howells, who has recently joined our firm, introduces our readers to current issues in Employment Law, her area of specialty. We welcome Dana, after 16 years as in-house counsel, to our professional family!



Tom Curtiss
Editor

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The Perils of Being a California Employer: Recent Developments

By Dana D. Howells

Even in an era of high unemployment and economic stagnation, California continues to experience changes in the employment rules that potentially increase exposure to employers. This article highlights some lurking pitfalls.

Lily Ledbetter Fair Pay Act of 2009 and Very Old Discrimination

Last year President Obama signed the Lily Ledbetter Fair Pay Act of 2009, which basically provides that each present impact of past discrimination (e.g., each paycheck) equals a ***separate*** claim with its own window of time to bring suit. Its effect is designed to extend the statute of limitations within which an employee can bring an action based upon discrimination.

So far courts have split in their application of the law. One court has held that although 16 years had passed since a discriminatory demotion, the pay disparity persisted and was still actionable. That case is now on appeal. An appellate court has held that a failure to promote was time-barred despite arguable present impacts on pay. The net effect of the new law is that companies can now be sued for at least some types of old human resources decisions from the long-ago past that affect pay going forward.

As a common sense safeguard against potential exposure, an employer should ensure that decisions increasing or decreasing compensation, or taking other potentially controversial actions, are supported by contemporaneous documents showing non-discriminatory reasons for the decisions made. It is important to retain such documentation, keeping in mind that employees can continue to litigate old decisions for a period of time following separation.

The Privacy Balancing Act

Increasingly, employers rely on hidden cameras to catch a wrongdoer.

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The Disquieting Consequences of the Estate Tax Sabbatical in 2010

By Walter T. Killmer, Jr.

For more than a decade Congress has debated whether America should retain an estate tax. One anomalous result of this debate is that for an individual dying in 2010 no federal estate tax reporting will be required, and hence no estate tax liability will be due, unless Congress acts to change the law. If this one-year repeal of the estate tax remains in place, the most immediate impact will be on the estates of individuals dying this year, but its consequences may dramatically affect the estate planning documents and lifetime gifting for future years.

An understanding of the current situation and how to respond requires a review first of the estate tax law in effect in 2009, then a review of the law applicable in 2010 to decedents and to gifts made this year and finally consideration of what form any new legislation might take. The balance of this article will attempt to address those issues.

The Federal Estate, Gift and Generation-Skipping Transfer Taxes in 2009

The estate of an individual dying in 2009 was entitled to a federal estate tax exclusion for $3.5 million of assets after deducting debts, estate expenses and bequests to spouse and charity. Assets in excess of that exclusion were taxed at a flat rate of 45%.

For lifetime gifts made in 2009, federal gift tax rates of 41% to 45% applied after exhausting a $1 million lifetime exclusion. This cumulative exclusion was in addition to the annual exclusion for gifts of up to $13,000 per year to each of any number of recipients and the unlimited exclusion for payments of tuition and medical expenses.

Similarly, in 2009 a federal generation-skipping transfer ("GST") tax applied to certain transfers to grandchildren and younger generations. This tax, like the estate tax, included a $3.5 million exclusion, after which transfers were taxed at a flat rate of 45%.

No Estate Tax or GST Tax and a New Carryover Basis in 2010

Beginning on January 1, 2010, the federal estate and GST taxes were repealed for one year. The gift tax has been retained but reduced to a flat 35% rate for gifts made in 2010.

The changes also include a new system for determining capital gain or loss on the sale of assets inherited from an individual dying in 2010. Capital gain or loss is now measured by the difference between the proceeds of sale and the seller's basis (generally, what the seller paid for the asset).

> *"If this one-year repeal of the estate tax remains in place, the most immediate impact will be on the estates of individuals dying this year."*

Previously, the basis of an inherited asset was "stepped up" to its fair market value at the date of death (or "stepped down" if the market value had declined). For assets received from a decedent dying in 2010, a "carryover" of the decedent's basis will replace the step up.

For assets that have appreciated in value, a $1.3 million basis adjustment is available to increase the basis of those assets. An additional $3 million basis adjustment is available for certain assets passing to a surviving spouse. In the case of any difference between basis and fair market value of more than $1.3 million (or $4.3 million with a surviving spouse), the Executor or Trustee must decide how to allocate the basis adjustment among the assets, often creating an impossible conflict of interests.

What Will Happen in 2011

Unless Congress enacts additional legislation, the series of tax cuts enacted in 2001, including estate tax repeal, will "sunset" at the end of 2010. On January 1, 2011, the estate, gift and GST tax law will revert to the law in effect prior to the 2001 tax act.

For a decedent dying in 2011, the estate tax exclusion will drop to $1 million, with graduated estate tax rates topping out at 55%. The gift tax will revert to the same rates and exclusion as the estate tax, and carryover basis will be replaced again with stepped-up basis. The GST exemption will be about $1.3 million, with a 55% flat rate.

What May Still Happen in 2010

No one can predict whether Congress will even be able to enact any estate tax legislation this year, and if so, what form such legislation might take. With growing concern about the federal budget deficit, a permanent extension of estate tax repeal seems unlikely; however, at least five legislative scenarios seem plausible:

1. Extend the law in effect at the end of 2009, making its provisions retroactive to the beginning of 2010.
2. Reenact the law in effect at the end of 2009, but apply its provisions only to decedents dying after the date of enactment.
3. Reenact the estate tax, but with some of the changes that have been proposed in recent bills. The proposals include a larger or smaller estate tax exclusion, higher or lower estate tax rates and restrictions on valuation discounts for fractional interests in real estate and investment entities.

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This legislation might be retroactive to the beginning of 2010, or effective only after the date of enactment.

4. Reenact the estate tax, with or without changes to the 2009 law, but allow each 2010 estate to choose no estate tax with carryover basis, or an estate tax with stepped-up basis. This approach would blunt any constitutional challenge to retroactive legislation, but could potentially complicate further any estate tax reporting.
5. Nothing happens. A very distinct possibility is that Congress will find neither the time nor the political will to enact a "new" tax for this year. On January 1, 2011, however, the estate, GST and gift tax regime will revert to the more onerous system in place in 2001.

Effect on Estate Planning

The current uncertainty primarily affects those who die this year and their executors, trustees and beneficiaries, but potential opportunities, and problems, exist for others as well. For example, a donor who is considering a large taxable gift may wish to make that gift while the gift tax rate is 35%. The risk is that any legislation would reinstate the higher gift tax rates retroactively.

The one-year repeal may also warrant review of estate planning documents. Many wills and living trusts define amounts or shares by reference to the federal estate tax, and those provisions may need to be revised to prevent unintended consequences.

Consider, for example, a trust that gives to the settlor's children "the largest amount that can pass free of federal estate tax"; the balance then passes to the surviving spouse. If the settlor had died in 2009, a maximum of the first $3.5 million would have passed to the children, and the balance would have passed to the surviving spouse. Under current law everything could pass to the children, and the spouse would then receive **nothing**.

Alternatively, if the formula applied to the trust for the surviving spouse or to an outright gift to him or her, none of the settlor's estate would pass to his or her children by a first marriage, savaging the settlor's intent. An amendment to the trust now could cap for this year only the children's or spouse's share at $3.5 million or another appropriate amount.

> *"For assets received from a decedent dying in 2010, a 'carryover' of the decedent's basis will replace the step up."*

As a practical matter, the funding of most trusts, even applying the current formula, would be capped by the amount of the deceased settlor's community property. The surviving spouse's one-half interest in the community property would be unaffected.

In a second marriage, however, if the deceased spouse's estate is primarily his or her separate property and the deceased spouse wishes to provide for children from a prior marriage in addition to the new spouse, the possibility of overfunding one gift to the frustration of the other is a clear danger. Absent some kind of corrective (if temporary) amendment before death, the estate fiduciary of a 2010 decedent may be compelled to seek the guidance of the Probate Court. By its nature, because the spouse and first-marriage children would have hopelessly conflicting interests, expensive litigation is almost inevitable.

By the time you read this article, everything, or nothing, may have changed. The legislative outlook remains unclear and bears watching; however, anyone at risk of dying in 2010 or with a family member at risk, should consider whether to revisit his, her or their present estate plan.

The Perils of Being a California Employer

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In relying on such devices, the employer should have very good reasons and do so in a thoughtful, limited way. A recent California Supreme Court case is instructive.

Someone at a home for abused children was accessing child porn late at night on a computer in an office shared by two women who worked only the day shift. The employer placed a hidden "nanny cam," activated during limited hours to try to identify and stop the offender. The two women discovered the camera and sued the employer even though they had no proof they were ever actually filmed.

> *"The business need for surveillance measures should be strong and the intrusion carefully minimized to every extent possible."*

The California Supreme Court held that the two women had a reasonable expectation of privacy in their shared office, but the employer's business justification and its limited use of such intrusive measures outweighed the women's right of privacy. The plaintiffs wrongly thought that "hidden camera in my office" was all they needed to allege. Not so. Each privacy case will turn on its unique facts

The business need for surveillance measures should be strong and the intrusion carefully minimized to every extent possible. This particular employer was a Church-affiliated home for abused children, and the employer was protecting those children from pornography. Open and obvious security cameras, not concealed cameras, should be the usual option for employers to detect misconduct whenever possible.

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A Potpourri of Wage and Reimbursement Issues

- **Meals and Breaks.** Under California Labor Code Section 226.7, employers must pay an additional hour of pay at the "regular rate" for every workday where a rest break or meal period is missed, but it is not clear what the result is if, on the same day, a worker misses both a rest break and a meal period. A federal court applying California law has held that if both a meal period violation and a rest break violation occur on the same day, the employer owes two hours of extra pay. If, however, two meal periods are missed on the same day (e.g., a 12 hour day) or if multiple breaks are missed in one day, only one hour of extra pay is owed. Because meal periods and rest breaks are found in different Labor Code sections, if the employee misses one of each in the same day, the court has held that the employer owes **twice**.
- **Mileage Charge.** Employers who pay less than $0.50 per mile – which is the IRS mileage rate – have the burden to prove that they reimbursed for the actual cost of driving a mile. Defending such a calculation may require more effort than it is worth with no reasonable expectation of success.
- **Commute Not Paid.** Simply driving a company car does not turn the commute from home into paid time. The Ninth Circuit has held that when an employee's job is to call on clients during the work day, his "on the clock time" properly started when he arrived at the first client's place of business. The court found that planning, prioritizing and Mapquesting trips for the day were de minimis and also not compensable.

Private, Unsupervised Settlement of Wage Claims is Upheld.

For years, it has been doubtful in California whether an employer can get a valid release of wage and overtime claims. In a class action against Pick up Stix, Inc., the plaintiffs' lawyers argued that restaurant managers did not have sufficient discretion and freedom to be exempt from overtime pay. While the class was being certified, the employer derailed the plaintiffs' efforts by offering 200 managers a payment in exchange for a complete settlement.

> *"When confronted with a wage and hour class action suit, employers should consider offering a fair settlement straight away in exchange for a release."*

In response, the employees' attorneys claimed that such settlement agreements were void under the California Labor Code. The court held that once a specific claim is identified and a good faith dispute exists as to any amount owed, the employer can negotiate a binding compromise agreement. The lesson of this case is that when confronted with a wage and hour class action suit, employers should consider offering a fair settlement straight away in exchange for a release.

Disability, Accommodations, Medical Leaves and Caregivers

The Americans With Disabilities Act ("ADA") and similar state laws have created gray areas that can ensnare the hapless employer. Disability law can be counter-intuitive, and it is an area where seeking good legal advice early can really help.

- **2-Day Physical?** An employer was held liable under the ADA for a medical provider's overbroad return to work/fitness for duty physical. A long time employee took a medical leave for knee surgery. The return to work exam lasted **two full days**.

  The court held that the intrusive physical violated disability discrimination laws and held the employer liable, even though the medical provider designed the examination.
- **Communications Within Management.** A cancer survivor who worked as a checker needed constant water consumption and therefore needed more frequent restroom breaks. Her supermarket employer had agreed to accommodate her. A new manager who was uninformed of her condition and the accommodation failed to grant her a break despite several requests, and she was humiliated when she urinated on herself. Past decisions suggested that the burden was on the employee to tell the new manager about her disability and to request the accommodation. The court put the duty on the employer to make sure the accommodation was honored.
- **Accommodations for Service Dogs.** A court in Montana held an employer liable under ADA and Montana law for failing to install non-slip mats to accommodate an employee's service dog who could not walk on tile without slipping. The dog was injured and lost the ability to aid her disabled owner, who then quit. The court observed that the non-slip mat accommodation was needed for the owner to be able to have equal access to and privileges of employment. The court did not focus on "performing essential job functions" (which most accommodations requests involve), but rather equal accessibility.

Productive employees and good employer-employee relations are key components of a sound, profitable enterprise, including good compliance practices to prevent employee lawsuits.