BUSINESS BRIEFS

Legal Developments Affecting Business

SUMMER 2014

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PROTECTING YOUR BUSINESS FROM CORPORATE RAIDING BY KEY EMPLOYEES

By Randall Sutton

Trust in your key employees is critical to business success. In a closely held business, an employee's disloyalty can bring even the most successful business to the brink of bankruptcy.

Over the years, I have handled many "corporate raiding" cases, where a highly trusted key employee or group of employees decided to unexpectedly quit the business and attempt to step into the shoes of the former employer. In many of these cases, the owner had stepped away from daily management and oversight of the business and left most business operations to the key employees. In other cases, key sales or management employees were given great latitude to promote the business, but greed and a desire to "call the shots" led to sabotage and direct competition with the employer while still on the company payroll.

These cases typically have several factors in common:

1) Absentee or hands-off supervision of the employee, which gives the employee freedom to compete without close scrutiny;

2) The employee is highly motivated, successful and a top performer. The employee believes that the company's success rests primarily on the employee's own excellence;

3) The employee is unhappy with management and feels he or she has been treated unfairly, which justifies the employee's betrayal; and

4) The employee is not bound by any express noncompete or nonpiracy agreement, so the employee seeks legal counsel, and is erroneously advised to freely compete.

Under Oregon law, key employees have a fiduciary duty not to directly compete with their employer. Until the employee terminates employment, the employee cannot take any action to advance the employee's interests in competition with the employer. Once the employment relationship terminates, absent a valid noncompete or nonpiracy agreement, competition is fair game. However, even then, courts will sometimes impose restrictions out of fairness on an employee who engaged in acts of sabotage or competition while he or she was employed. Courts will also restrict former employees from using trade secrets that were obtained while working for the former employer.

In cases involving sabotage, theft of trade secrets, or breach of the duty of loyalty, we have been successful in obtaining court orders restraining the former employee from competing and using trade secret information. In especially egregious cases, we have obtained ex parte court orders. These orders allow us to surprise the former employee by conducting an onsite examination of documents and computer data at the former employee's new place of business, without prior notice, and with the assistance of the local sheriff.

Without question, the most effective way to protect your business is through execution of

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valid and enforceable noncompetition or nonpiracy agreements. A "noncompetition agreement" restricts your former employee from competing with your business in any manner within a limited geographic or trade area for an agreed period of time. A "nonpiracy agreement" restricts your former employee from soliciting or transacting business with your customers and from soliciting your employees. These restrictive covenants have a bad reputation. Many claim that restrictions of this nature are not enforceable. The reality is that a court will not go out of its way to make a bad agreement enforceable. Because Oregon imposes strict rules on when these agreements will be enforced, many agreements get signed without strictly following the rules, and the court then refuses to enforce the agreement. For this reason, it is critical that restrictive covenants are drafted and reviewed by qualified legal counsel. When the agreement has been properly drafted and executed, we have successfully enforced restrictive covenants against former employees.

With a valid noncompetition or nonpiracy agreement in place, the task of enforcing competitive restrictions on a former employee is greatly simplified. A noncompetition agreement is not valid unless presented at the job offer stage and signed upon hire. Such an agreement is sometimes enforceable when executed in conjunction with a significant promotion. Laws regulating nonpiracy agreements are more flexible and these agreements can be valid even when signed by a current employee in many cases.

In cases of sabotage and unlawful competition by key employees, the impact on the former employer can be devastating. Fast legal action is required to restrain the employee. When possible, preventative action, with valid and enforceable restrictive covenants in place, is an effective deterrent and powerful tool in avoiding corporate raiding by your key employees. If you would like assistance in analyzing these issues in your business, or have any other employment-related questions, please contact an attorney on our Employment Law Group.

Crowdfunding: An Alternative Financing Tool for Real Estate Development

By Mark Shipman

Crowdfunding as a potential source of financing for real property development in Oregon has been a hot topic lately. A lot has been written about different real estate projects in Oregon, and the greater Northwest and various developers' reliance, in part, on crowdfunding as a funding mechanism. This new activity was stimulated by a 2012 federal law that allows companies to advertise investment opportunities directly to investors under certain guidelines and requirements. This article briefly discusses crowdfunding, the different types of crowdfunding, some limitations, and practical considerations.

What is Crowdfunding?

Crowdfunding, or crowd financing involves the collection of money from supporters (the "crowd") to fund an initiative. The initiatives can be charitable (e.g. a nonprofit where you donate for a relief cause, or to support creative music or film ventures), or commercial (e.g. financing the start of a new company or sale of a new product). The supporters contribute to an organization (the "platform"), which connects the initiative director and the crowd together. Kickstarter, a popular website that raises funds for creative projects, is one current example of crowdfunding.

Types of Crowdfunding

There are four general types of crowdfunding models. In charitable based models, supporters contribute money, but do not receive a financial benefit in return. They may get a commemorative item or a thank you for contributing in return for their donation. With compensation based models, supporters contribute money, but do receive a monetary benefit in the form of an item of some value. The item can be a product, or a pre-release of an item that the money was contributed to produce (independent music/movie). Credit based models are where a supporter contributes money and negotiates for a certain rate of return on the contribution. With credit based models, the supporter is like a lender/creditor and the recipient is like a borrower. The last type is a commercial based model, where the supporter receives shares of or interest in the company in exchange for the financial contribution. It is with this last type of crowdfunding where real estate developers and investors will find another source for financing and investing.

Commercial Based Crowdfunding

Currently, the Securities and Exchange Commission (SEC) allows for the investment in real estate projects under Regulation D, through the sale of securities to accredited investors. An accredited investor is generally someone that has more than $1 million or more in liquid assets, or $200,000 in annual income.

Under the JOBS Act, the Securities and Exchange Commission (SEC) is working on adopting rules that would regulate the investment for small real estate projects under changes to Regulation A. This would allow companies to raise capital by offering securities to unaccredited investors using the internet. Under the proposed rules, individuals with annual income less than $100,000 could invest a maximum of 5% of their annual income. Those with higher incomes could invest up to 10%. Companies using the crowdfunding model permitted by Regulation A could only raise $1 million a year.

Practical Considerations Surrounding Crowdfunding

Before you run out and file for a new portal, or think about investing in a project, there are a couple of things you should consider, including the following:

- Only licensed brokers or attorneys that routinely handle securities will be able to advise you in such matters.

- The proposed SEC rules (Reg A) will provide a safe harbor for investors/developers to look for opportunity to either invest or secure money for real estate projects on a small scale. Portals or projects that don't fall within the Reg A rules can still qualify for crowdfunding, however these will need to be approved by the SEC as a security under a separate process.

- Crowdfunding investments are not liquid. In some cases, you may need to hold the ownership interest for a year or more from the date of investment.

- Setting up a new platform or portal for a project will take time (many months) to get approval through the SEC.

- There are additional reporting requirements for crowd-financing that are not present with other real estate investments. Similar to annual stock reports, the portal company will need to file annual reports with the SEC, investors, brokers, and potential investors.

- There could also be subscription/ investment fees that will be attached to the contribution.

Conclusion

Crowdfunding under the JOBS Act may not be the answer for everyone looking to invest, or seeking additional financing for real estate projects. However, it will provide more opportunities for investors to participate in real estate investments. Once the SEC passes the new regulations, there will be an increase in internet-based platforms offering real estate investment opportunities. If you have any questions about how this issue may affect your business, please call an attorney in our Real Estate and Land Use Group.

Reducing Estate Taxes for Family Farms

By Kelley Washburn

As the majority of a family farm's wealth is generally tied up in land and equipment or needed for working capital, paying an estate tax within nine months of the death of the farm owner can be a burden. The last thing most farm families want after spending a lifetime building the farm operation is to have it liquidated so the next generation can pay the estate tax. Fortunately, there are several planning strategies and tax advantages available to reduce the estate tax burden when passing down the family farm.

Oregon Natural Resource Credit (ORS 118.140)

Estates in which the farm operation accounts for at least 50% of the owner's total estate qualify for an Oregon Estate Tax credit of up to $7.5 million. The amount of the credit is based on the ratio of the farm to the total estate. For example, if the farm is 70% of the total estate, then the credit will be for 70% of the Oregon Estate Tax. To qualify for the credit, the total estate of the farm owner must not exceed $15 million, and the farm must pass to family member(s) who operate the farm for 5 out of 8 years following the owner's death.

Valuation Discounts

Farmland is often owned 100% by parents, either individually or in an LLC. As such, when the parents pass away, 100% of the LLC's value will then be included in parents' estate for estate tax purposes. One way to reduce the percent included in parents' estate is to gift an interest in the LLC to the farm heir(s) so that both parents have minority interests. Upon the parents' deaths, the values of their separate minority interests receive a discount for estate tax purposes, thereby reducing the value that is included in their estate and subject to estate tax. The trick here is to ensure that one parent's interest does not pass outright to the surviving parent (or to a general power of appointment marital trust), thereby turning what initially were two separate minority interests into one majority interest owned by the surviving parent. Transferring the deceased parent's interest to a Bypass or QTIP-type trust for the life of the surviving parent will enable the parents' interests to be valued separately, thereby preserving the minority discounts.

Life Insurance

In the common instance where the farm operation is land rich and cash poor, life insurance can provide the liquidity needed to pay estate tax. Life insurance can also provide an inheritance for non-farm heirs, rather than leaving the entire estate to the farm heir, or worse, splitting the farm between a farm and non-farm heir. Additionally, if the life insurance is owned in a special trust called an Irrevocable Life Insurance Trust ("ILIT") and certain procedures are followed, the insurance will not be included in the insured's estate, and therefore not subject to estate tax.

Special Farm Use Valuation (IRC2032A)

Farms passed down to family members who continue to farm for at least 10 years following the owner's death may elect to have the land valued at its agricultural use value, rather than its fair market value, for Federal Estate Tax purposes. The agricultural use value (which is set by a formula) is often lower than the fair market value, resulting in a lower estate tax. Like the Oregon Natural Resource Credit, to qualify for the Special Farm Use Valuation, the value of the farm operation (real and other business property) must exceed 50% of the owner's total estate. The real property itself must exceed 25% of the owner's total estate.

As a side note, it is important to consider how these mechanisms interact with each other. For example, lifetime gifts of LLC interests for the purpose of receiving valuation discounts could reduce the parents' farm ownership below 50% of the parents' total estate, thereby disqualifying them from the Oregon Natural Resource Credit and Special Farm Use Valuation. Additionally, while a strategy that lowers the estate value results in lower estate taxes, the lower value will also lower the income tax basis at death and eventually cause more capital gains tax if the farm is sold by the heirs.

Tax Deferral and Installment Payments of Estate Tax (IRC 6166)

In certain situations where estate tax is due, the IRS will allow the portion of Federal Estate Tax attributable to a farm operation to be deferred and paid in installments. To qualify, the value of the farm operation must exceed 35% of the decedent's estate. The executor of the estate may then elect to pay all or part of the estate tax in up to ten equal annual installments, with the first installment being due within 5 years of the original due date of the estate tax. However, the IRS will charge interest on the deferred portion of estate tax (at a reduced rate), and the IRS will likely require a bond or property lien until the tax is paid.

Although there are several mechanisms available to farmers to help reduce the estate tax burden, advance planning is generally needed to take full advantage of these benefits. Please call our Estate Planning Group if you have questions regarding the strategies farmers can use to reduce estate taxes.

DREAM OF TURNING YOUR PASSION INTO A BUSINESS? WATCH OUT FOR THE HOBBY LOSS RULES.

By David Myers

Like many of us, you have dreamed of turning your hobby or passion into a regular business. Something you could do every day and hopefully, with a little planning and luck, be paid for. You will not have to worry about any unusual tax headaches, other than paying your taxes, if your new business is profitable. However, if your new business consistently generates losses, then the IRS may step in and claim that the business is really just a hobby, and perhaps a very expensive one at that. What the IRS is really saying by claiming that the activity is a hobby rather than a business, is that it is not engaged in for profit.

What are the practical consequences of such a claim by the IRS? In short, the answer is deductibility; net hobby losses generally cannot be deducted from your income, whereas net business losses generally can. Under the so-called hobby loss rules, you will still be able to claim those deductions that are available whether or not the enterprise is engaged in for profit (such as state and local property taxes). However, your deductions for business-type expenses (such as rent or advertising) will be limited to the amount by which your gross income from the hobby exceeds those expenses that are deductible, whether or not the activity is a for profit enterprise. Deductible hobby expenses are also subject to a floor of 2% of your Adjusted Gross Income (a specific number on your tax return), meaning that the expenses cannot be deducted unless they exceed 2% of your Adjusted Gross Income. By contrast, if the enterprise is not affected by the hobby loss rules, all otherwise allowable expenses would be deductible, even if they exceeded income from the enterprise. This can make a big difference in your tax liability.

There are two ways to avoid being subject to the hobby loss rules. The first way is to show that the business turned a profit in at least three of the last five consecutive years. This rule changes to two of the last seven years for breeding, training, showing, or racing horses, which is a hobby that the IRS has frequently audited and challenged deductions. The second way is to run the venture in such a way as to show that you intend to turn the business into a profit-maker, rather than to operate it just as a hobby. IRS regulations state that the hobby loss rules will not apply if the facts and circumstances show that you have a profit-making objective.

How can you prove that you have a profit-making objective? In general, this can be done by running the new venture in a businesslike manner. More specifically, the IRS and the courts will look to the following factors:

- How you run the activity (for example, having a business plan, formal financial statements, etc.);
- Your expertise in the area (and your advisers' expertise);
- The time and effort you expend in the enterprise;

- Whether there's an expectation that the assets used in the activity will rise in value;

- Your success in carrying on other similar or dissimilar activities;
- Your history of income or loss in the activity;

- The amount of occasional profits (if any) that are earned;

- Your financial status (for example, are you independently wealthy and able to fund the enterprise indefinitely or are your resources limited?); and

- Whether the activity involves elements of personal pleasure or recreation.

None of these factors alone will sink your case and subject you to the hobby loss rules. Rather, courts have taken a holistic approach and weigh the factors in favor of finding the activity a hobby against those weighing in favor of finding the activity a business. Your enterprise should have carefully crafted and formal organizational documents and regular minutes of meetings to document that there is a clear profit-making objective. The classic hobby loss situation involves a successful businessperson or professional who starts a side business such as dog-breeding or farming. However, the long arm of the IRS can reach out in more surprising situations, such as a businessperson who starts what appears to be a bona-fide business but enjoys what he or she does and has the unfortunate luck of not being able to turn a profit.

So, if you think your business has, or will generate consistent losses, and there is any element of personal pleasure or recreation, either for you personally or from an objective perspective, then you should consider the impact of the hobby loss rules. If you think a venture of yours may be affected by the hobby loss rules, contact our Business & Taxation Group to find out what you can do right now to minimize your tax risk and the headache of a long and drawn-out IRS audit.

IRS Announces New 60-Day IRA Rollover Rules

The IRS will soon be changing the rules that regulate how often you can take tax-free rollovers out of your IRA. Tax-free rollovers are distributions from an IRA that are payable to the account owner, but which are re-deposited into the IRA (or another IRA) within 60 days. Under current rules, you are allowed to take one tax-free rollover from each of your IRAs once every 12 months.

Example: Johnny has seven IRAs, each of which holds $50,000. On April 1, 2014, Johnny withdraws $45,000 from IRA #1 and buys himself a new car. On May 20, 2014, Johnny withdraws $45,000 from IRA #2, and on the same day he deposits the $45,000 back into IRA #1. On July 10, 2014, Johnny withdraws $45,000 from IRA #3, and on the same day he deposits the $45,000 back into IRA #2. Johnny continues this throughout the year, withdrawing and depositing every 50 days or so, one IRA at a time. Because Johnny never takes more than one rollover distribution from each IRA during 2014 and he re-deposits all withdrawals within 60 days, none of Johnny’s distributions are considered taxable distributions, including the one that paid for Johnny’s new car.

Effective January 1, 2015, any distribution from an IRA that would otherwise qualify as a tax-free rollover will only be considered a tax-free rollover if the IRA owner has not taken a tax-free rollover from any of his or her other IRAs over the prior 12 months. In the example above, the second distribution that Johnny takes from an IRA in 2015 will be considered a taxable distribution, regardless of whether Johnny is able to re-deposit the amount into the same (or another) IRA within 60 days. A similar rule will also be in effect for Roth IRAs. Significantly, this new rule only affects tax-free rollovers from IRAs, i.e., distributions made payable to the IRA owner. The new rule does not affect how often an IRA owner can initiate a tax-free transfer among IRAs, i.e., money transferred directly from one IRA to another.

Sorry Johnny…

Firm Seminars and Announcements

Congratulations to ***Randall Sutton***, who has been selected for inclusion in The Chambers Guides for Employment Law. Chambers & Partners has been ranking the best law firms and lawyers since 1990, and now covers 185 jurisdictions throughout the world. Both lawyers and law firms are ranked based on the research of 150 full-time editors and researchers who survey clients and peers.

Jeff Moore has been invited to speak at the annual Oregon Society of CPAs' Estate & Trust Conference held in Portland on June 20. Jeff will be speaking on various tax and planning issues for IRAs and retirement benefits. The day-long conference will provide an overview of recent developments and issues in estate planning, trust planning, and estate and trust reporting.

David Briggs is currently presenting a series of Employment Law seminars for the Marion Polk Medical Society's membership throughout the year. Please contact MPMS for more information and registration.

The firm held a raffle at its recent Sporting Clays Shoot, and, with the generosity of our guests, raised $3,410 for the ***Marion-Polk Food Share***. The funds go toward MPFS's hunger-relief efforts to provide emergency food assistance and increase self-sufficiency for families living with limited resources.

The firm is proud to support many not-for-profit organizations in the mid-Willamette Valley and their activities during the year. We hope to see you at these upcoming events:

- **Salem Young Pros Legacy Golf Scramble** – On June 27, the 4th Annual Golf Scramble will take place at Creekside Golf Club. This tournament pairs respected Salem-area community leader with Young Pros for golfing, BBQ, prizes, and an award banquet. Register at: www.salemchamber.com.

- **St. Paul Rodeo** – Mark your calendars now and join the fun at the 79th Annual St. Paul Rodeo July 1 – 5, 2014. This Rodeo has it all—professional bull riders, a Wild West art show, carnival, BBQ cook-off, parade, and five evenings of fireworks! The competition includes the roughest, toughest contests between cowboys and cowgirls and animals, and is designated as one of an elite group of eight rodeos attracting the top competitors in the world. Check it out at www.stpaulrodeo.com.

- Oregon Dental Association and Marion & Polk Dental Association will host this year's **Mission of Mercy** on July 11 & 12 at Chemeketa Community College. Saalfeld Griggs' Dental Industry Group will volunteer at this year's event. Dental screenings and services are provided on a first-come, first-served basis, at no charge to those who attend. Volunteers can register online at www.oregondental.org by selecting "OR Mission of Mercy" and "Volunteer Registration".

- Visit the downtown riverfront in July for the **RiverRock Wednesday Concert Series**! Three concerts will feature these guest artists: July 9 – Super Diamond, July 16 – Janiva Magness and Curtis Salgado, and July 23 – Kristian Bush of Sugarland. Tickets: www.riverrocksalem.com

The Litigation & Employment Law practice group is pleased to welcome ***Therese Adams*** to the firm. Therese is a Texas transplant who fell in love with Oregon when she attended Willamette University College of Law. A top student, she has worked in human resources for a number of larger employers and comes to us with experience handling workers' compensation defense matters.