THOMPSON HINE

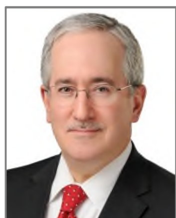
Business Law Update

Spring 2018

Business Perspectives

The More Things Change …

By Frank D. Chaiken, Practice Group Leader, Corporate Transactions & Securities



One of the great things about our legal system, and really a requirement of any well-functioning system, is its ability to adapt to constant change and development in society. Not least of these are changes in technology. Some new technologies create entirely new issues and areas of concern. In many cases, however, technologies provide new ways of doing things that people have been doing, well, since there have been people, only "faster, better, smarter."

Since pre-historic times people have used various means to keep track of things that needed counting. These have included everything from drawing on cave walls, notching sticks, tying knots in string, carving in stone, etching clay tablets and writing on paper of various forms, to using our modern electronic and digital media. All of these technologies served the basic purposes of recording items of value that could be traded, acting as stores of value in themselves, serving as money as a surrogate medium of exchange, or representing various forms of securities as documentation of partnerships, corporations and other joint enterprises. Money itself has taken various forms over the millennia as well, from seashells and enormous undersea rocks (look it up!), to metal coins, paper currency and beyond.

Each new wave of technology in this area has brought with it new challenges in adapting the legal framework governing their use in a variety of contexts, such as enforceability of contracts and transactions, trading of investment interests, and consumer and investor protection.

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Recent News & Related Articles

- Updated Guidance on Financial Performance Representations
- California Departs from FLSA on Flat Sum Bonuses for Calculating Overtime Pay
- SEC Proposes Changes to Liquidity Risk Disclosures
- Fifth Circuit Vacates DOL Fiduciary Rule
- OCIE Announces 2018 Examination Priorities

For more details on any of the topics covered in this *Business Law Update*, please contact the authors via the links at the end of each article or David R. Valz, editor-in-chief. For information on our Corporate Transactions & Securities practice, please contact Frank D. Chaiken, practice group leader.

ATTORNEY ADVERTISING

The newest developments in this are frequently in the news these days: blockchain, cryptocurrencies, crypto-assets, smart contracts and ledgers. These are all new ways of combining multiple technologies, with some technologies now doing several things at once: keeping records, storing value, serving as a medium of exchange, documenting transactions and distributing enterprise value. The legal issues also are familiar: authentication of transactions, clarity of agreements and disclosures. Much has been written in recent years about these topics (see our client update from last summer, "The Growing Commercial Applications of Blockchain Technology," at http://www.thompsonhine.com/publications/the-growing-commercial-applications-of-blockchain-technology).

Lately these new developments are keeping a number of our lawyers busy: advising issuers and investors on the potential and likely legal risks; drawing up the contractual framework for each new variation of product; determining whether a particular "token" or "coin" must be registered as an investment security; identifying the regulatory agencies and regimes having jurisdiction over the offering; and structuring the investment documentation, risk factors and other disclosures (see our client update from last month, "OCIE Announces 2018 Examination Priorities," at http://www.thompsonhine.com/publications/ocie-announces-2018-examination-priorities). Our partner Cassandra Borchers is taking a leading role on these issues in our firm and in the industry (see "The Lawyers Calling the Shots in the Crypto World" by The Information, February 28, 2018).

The technical details, and mathematical ingenuity, reflected in these new technologies are inherently fascinating. Equally important are their uses and implications for commerce and investing. A solid understanding of the technology and its uses is necessary for the implementation of appropriate legal solutions. Our lawyers are continuing to stay on top of the evolving technical and legal landscapes.

Frank Chaiken leads the firm's highly regarded Corporate Transactions & Securities practice, which comprises more than 100 professionals who represent clients of all sizes across virtually every industry. If you have questions or would like to share your thoughts, please contact Frank at 513.352.6550 or Frank.Chaiken@ThompsonHine.com.

Central Ohio Franchise Business Network Meeting

Wednesday, April 25
Columbus

Rocco Fiorentino, CFE, vice chairman of the board for Benetrends Financial and senior managing partner of Primo Hoagies Franchising will present *Change is Good! Who Goes First?*, examining the rapidly changing landscape in the franchising industry and how business models are evolving.

See more information at ThompsonHine.com/Events.

Startups

Launching a Startup? Consider Forming a Corporation Instead of a Limited Liability Company

By Jonathon H. Vinocur and Kaoru C. Suzuki

Every founder of a startup must form a legal business entity and, to do so, the founder must choose the legal form the business entity will take. From among the different types of entities that a founder can choose, the corporation and the limited liability company are the most popular.

Each entity has its benefits and pitfalls. For example, limited liability companies (LLCs) may choose flow-through tax treatment, which results in lower overall taxes to shareholders; however, due to their more flexible tax treatment, corporate governance standards and fiduciary duties, LLCs are typically associated with higher administrative and legal costs. This article provides a high-level comparison of the corporation and the LLC.

Institutional Investors Prefer Corporations Formed in Delaware

Generally, the Delaware corporation remains the standard form of entity that is preferred by institutional investors and venture capital funds. This is largely because Delaware offers the most consistent, reliable and predictable set of corporate laws, and a robust body of precedent case law that historically has provided the broadest protection for board members, management and controlling stockholders. This predictability, and the ease with which directors, officers and advisers of corporations are able to form guidelines to ensure that they do not violate any fiduciary duties imposed by the Delaware corporate laws, give investors significant comfort, which results in a lower barrier to entry from an investment perspective. LLCs, by contrast, do not enjoy the same predictability, largely because the case law is not nearly as well-developed and the Delaware Limited Liability Company Act does not provide the same foundation of rules from a statutory perspective, instead deferring to the LLC's operating agreement to govern managers, members and management's duties and obligations. This means investors feel like they need to reinvent the wheel with each new investment.

In addition, investors in a startup can take advantage of the tax benefits of Qualified Small Business Stock (as defined under Section 1202 of the Internal Revenue Code) if the startup is organized as a corporation. Qualified Small Business Stock enjoys tax-free treatment upon sale or other disposition if the stock is held for more than five years. Membership interests or other securities offered by LLCs do not qualify for Qualified Small Business Stock treatment, and are subject to normal capital gains tax (if the security is held more than one year) and ordinary income tax (if the security is held less than one year).

Furthermore, many venture capital and other investment funds are unable to invest in partnerships and LLCs because their major investors are pension and profit sharing trusts and other tax-exempt entities that are subject to certain tax restrictions. Consequently, transfers of corporate stock can be easier than transfers of limited liability company interests because the limitations described in the previous sentence may not apply.

Corporations Are Less Costly to Manage

Corporate Organization Documents vs. LLC Operating Agreements

As mentioned in the previous section, the corporate law in Delaware provides a strong foundation on which to build predictable management and compliance guidelines for directors and officers. The laws and regulations for LLCs, by contrast, defer to the LLC's operating agreement to set forth fiduciary duties and other obligations imposed on its members, managers and officers. This means that each LLC may have different guidelines to follow in terms of compliance with fiduciary duties – leading to the need to analyze and form compliance guidelines on a case-by-case basis, rather than relying on a more established body of statutory laws and regulations. Although this type of flexibility is desirable (or even required) in certain situations, it ultimately can lead to increased administrative costs and legal expenses.

Tax Implications

LLCs have the choice of being taxed as a corporation or as a partnership. If taxed as a partnership, the Internal Revenue Service (IRS) ignores the LLC and the members of the LLC include the profits and losses of the LLC in their respective individual tax returns. Although this avoids the "double taxation" that stockholders of a corporation sometimes encounter (taxed once at the corporate income level, then again as a stockholder when receiving dividends), taxation as a partnership introduces added complexities that ultimately result in administrative costs that may outweigh the benefits – especially for startups. For example, the annual exercise of preparing and delivering Form K-1s to numerous investors can be tedious, time-consuming and costly.

On December 22, 2017, President Trump signed into law "An Act to provide for reconciliation pursuant to Titles II and V of the concurrent resolution on the budget for fiscal year 2018" (2018 Tax Act). Among its provisions are deep cuts in the corporate income tax rate, and comparatively less reductions in individual income tax rates. As a result of the tax rate differential narrowing, the corporation is now even more attractive as a vehicle for startups.

Generally, the administration of filing annual tax returns for an LLC is more complex than corporate tax returns because of its pass-through characteristics. If the LLC is taxed as a partnership, it can be required to take into account special allocations to its members, based on the partnership tax rules under the Treasury Regulations. In addition, if the LLC is taxed as a partnership, taxes must be calculated on a member-by-member basis at each instance throughout a given year where those membership percentages might have changed. This, of course, only adds to its administrative burdens. Lastly, the 2018 Tax Act adds complexities by introducing the concept of tax deductions to a portion of earnings derived by taxpayers from qualified trades or businesses conducted through LLCs.

Corporations Can Offer More Favorable (and Certainly More Easily Understood) Equity Incentives for Employees

Another key difference between corporations and LLCs is that corporations can grant incentive stock options (ISOs) to their employees. Employees who receive ISOs do not recognize income upon either the grant or exercise of these options and payment of tax is deferred until the underlying shares are actually sold. In addition, stock acquired through the exercise of an ISO and held for the longer of (i) two years after the date of grant of the ISO and (ii) one year after its exercise, gets capital gains treatment upon sale (i.e., the sale is taxed at a lower tax rate than ordinary income rates).

The difference between the exercise price and the underlying share's fair market value for Non-Qualified Stock Options (NQSOs), by contrast, is taxed as ordinary income, and the subsequent sale of the stock acquired through exercise of the NQSO is only treated as ordinary income if the stock is sold within one year after the date of exercise and as capital gains if sold after one year after the date of exercise.

LLCs typically grant profits interests as equity incentive-based compensation . These are difficult to understand for founders and employees alike, and results in the recipients becoming K-1, instead of W-2, recipients and are generally difficult to administer. LLCs can grant options (but not ISOs) to their employees; however, an option grant by an LLC also includes added administrative burdens, such as recording a capital shift upon exercise of the option to avoid giving the employee a capital interest in the LLC, as well as compliance with other Treasury Regulations.

The analysis of how individual ISOs, NQSOs, profits interests and other equity incentive awards must be considered on a case-by-case basis and one should consult with their accountant, tax and legal advisers to determine specific tax treatment of any equity incentive award.

Conclusion

This article serves to provide a very high-level summary of the relative advantages of forming a startup as a corporation rather than an LLC – especially for startups in the tech, life sciences, energy or other high-growth sector seeking institutional financing. Furthermore, all of the advantages of corporations outlined above may not apply to every startup company and founders should consult with their accountant, financial advisers and legal advisers in making a determination, based on their specific circumstances.

For additional information, please contact Kaoru Suzuki or Jonathon Vinocur.

Government Regulatory

Applicable Companies Must Respond to U.S. Benchmark Survey of Foreign Direct Investment by May 31

By Scott E. Diamond* and Frank D. Chaiken

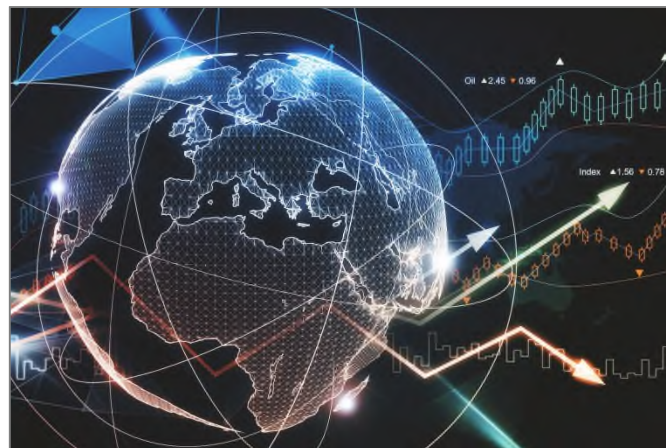
The Bureau of Economic Analysis (BEA) is an agency within the Department of Commerce tasked with gathering and producing economic statistics that report on U.S. economic growth, development and investment. Included in the data that BEA gathers is certain information on U.S. businesses in which a foreign person has made a direct investment in a U.S. company. "Direct investment" means the direct or indirect ownership or control by one person of 10 percent or more of the voting securities of an incorporated business enterprise or an equivalent interest in an unincorporated business enterprise.

The BE-12 Benchmark Survey is conducted every five years and is BEA's most comprehensive survey, in terms of both the number of companies covered and the amount of information gathered, on financial and operating data of U.S. affiliates (i.e., enterprises or subsidiaries) of foreign multinational companies. The survey is used to produce statistics on the scale and effects of foreign-owned business activities in the United States. Congress, the White House, federal agencies, and state and local officials use the data and statistics to analyze how foreign direct investment affects U.S. jobs, wages, productivity and taxes. BEA has recently released the necessary survey forms to conduct the Benchmark Survey for fiscal year 2017; completed responses are due to BEA no later than May 31, 2018.

Who Must File and What Must Be Reported?

The BE-12 Benchmark Survey is required for each U.S. affiliate (including real estate held for non-personal use) in which a foreign person, company or entity owned or controlled, directly or indirectly, 10 percent or more of the voting securities of an incorporated U.S. business, or an equivalent interest if an unincorporated U.S. business, at the end of a company's fiscal year ending in 2017.

The information required to be provided includes identification of foreign parents, industry classification, major products and/or services provided by the U.S. affiliate, certain financial and operating data, including sales or gross operating revenues, other information related to assets and liabilities, and information related to exports and imports.



What Form Should Be Used?

The Benchmark Survey has four forms. The version of the form that must be filed by a company is determined by the following criteria:

Form BE–12A. This form is filed for a U.S. affiliate that is majority-owned (i.e., more than 50 percent) by a foreign parent(s) and that has total assets, sales or gross operating revenues, or net income of more than $300 million (positive or negative).

Form BE–12B. This form is filed for a U.S. affiliate that:

- is majority-owned by a foreign parent(s) and has total assets, sales or gross operating revenues, or net income of more than $60 million (positive or negative) but for which none of these exceed $300 million (positive or negative).
- is minority-owned (i.e., at least 10 percent but less than 50 percent) by a foreign parent(s) and has total assets, sales or gross operating revenues, or net income of more than $60 million (positive or negative).

Form BE–12C. This form is filed for a U.S. affiliate that is majority- or minority-owned by a foreign parent when total

assets, sales or gross operating revenues, or net income is $60 million or less (positive or negative). Further, only select data items on this form are filed for a U.S. affiliate that has total assets, sales or gross operating revenues, or net income of less than $20 million.

Form BE–12 Claim for Not Filing. This form is filed for a U.S. affiliate that does not meet the requirements for the other BE-12 survey forms. BEA has indicated the following as examples of entities that do not meet the filing requirements of the BE–12 survey: (1) a U.S. affiliate in which the foreign voting ownership interest (or the equivalent) is less than 10 percent; (2) a U.S. affiliate that is fully consolidated or merged with the survey response of another U.S. affiliate; or (3) a U.S. business enterprise that was liquidated or dissolved in 2017. In addition, under certain circumstances, private funds may be exempt from filing.

Go to BEA's BE-12 Benchmark Survey web page for additional details on reporting requirements and information on which of the BE-12 forms to file. BEA has cautioned the business community that completion of these surveys may be time consuming and to allow for sufficient time to conduct an analysis and prepare all necessary forms prior to the filing deadline.

Responding Is Mandatory

Responding to the BEA's Benchmark Survey is mandatory under the International Investment and Trade in Services Survey Act (Public Law No. 94–472). An initial failure to report typically results in a warning letter from BEA demanding compliance. Ultimately, however, failure to report may subject a company to a civil penalty of not less than $4,527, and not more than $45,268, and to injunctive relief commanding the company to comply, or both. In certain situations, including willful non-compliance, criminal penalties may also be applied, including the potential for imprisonment of up to one year.

The International Investment and Trade in Services Survey Act protects the confidentiality of the data that companies report and specifies that the survey data may only be used for general statistical and analytical purposes and cannot, without the permission of the submitter, be presented in any manner that would allow a company to be individually identified. BEA is prohibited from granting another agency access to the data for tax, investigative or regulatory purposes. In addition, data reported on the survey is not subject to Freedom of Information Act (FOIA) requests.

Thompson Hine is prepared to assist clients in completing these Benchmark Surveys. Please contact your relationship attorney, Frank Chaiken or Scott Diamond for additional information.

**Scott is a senior legislative and regulatory policy advisor in the International Trade practice group; he is not licensed to practice law.*

Opportunities & A Couple of Minefields – Impacts of Tax Reform on Real Estate Development

Thursday, May 3
Cleveland

The Tax Cuts and Jobs Act (TCJA) lowered business tax rates and provided the most significant overhaul of the U.S. tax code in more than 30 years. This seminar, presented by PwC, Project Management Consultants and Thompson Hine, will focus on the provisions in the TCJA that significantly impact the real estate industry.

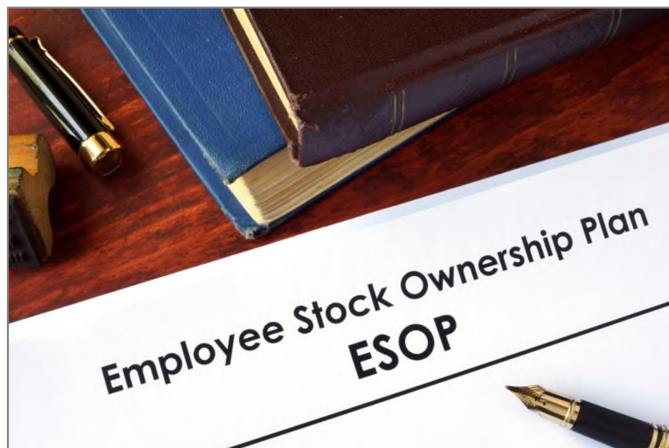
See more information at ThompsonHine.com/Events.

Private Companies

Five Ways to Prepare to Sell to an ESOP

By David Whaley and Kelsey Mehaffie

Employee stock ownership plans (ESOPs) have become popular among shareholders of closely held or family-owned businesses looking for an ownership succession plan or seeking an alternative to traditional mergers and acquisitions transactions. An ESOP is a qualified retirement plan in which employer profit sharing contributions are utilized to purchase shares of the stock of the employer (Company). In addition to providing the morale boost of transferring ownership of the Company to the Company's employees, the popularity of ESOPs stems from the significant tax benefits that can be achieved by the selling shareholders and the Company. If a Company's shareholders are interested in selling their stock to an ESOP, there are a few steps that the Company can take from a legal perspective in order to prepare for the sale of the Company's stock to the ESOP, including the due diligence process that is a prerequisite to the sale.



1. **Convert the Company to a Corporation.** ESOPs must be invested primarily in "qualifying employer securities," defined as common stock issued by the Company. As such, if the Company is a non-corporate entity, such as a limited liability company, then the Company will need to convert into a corporation—either an S corporation or a C corporation. Most state corporate codes provide mechanisms for converting from a limited liability company to a corporation by the filing of articles of conversion. The Company should engage legal counsel to prepare the appropriate conversion documents.

2. **Consider the Company's Subsidiaries and Affiliates.** If the Company has one or more subsidiaries, then the Company will need to consider whether such subsidiaries' employees will also participate in the ESOP. If the shareholders of the Company have instead created a web of affiliated entities with commonality of ownership (i.e., the same shareholder or small group of shareholders owns each entity directly), then the Company might consider putting a holding company structure in place via a contribution agreement. The terms of the contribution agreement provide that the shareholders will contribute their stock in the affiliated entities to the Company in exchange for stock in the Company (i.e., the parent company). The end result is that the Company owns all of the stock of the affiliated entities (making those entities wholly owned subsidiaries of the Company), and the shareholders own stock of the Company. This step is key to unlocking value in and transferring indirect ownership of the affiliated entities in the ESOP sale.

3. **Amend the Company's Articles.** The Company's articles of incorporation should include the number of shares that the Company is authorized to issue to its shareholders. Corporations may not issue shares in excess of the amount of authorized shares set forth in the articles. Because the Company will likely be shifting from having a small number of individual shareholders (perhaps only the Company's founders) to a large number of beneficial shareholders (each employee of the Company who is eligible under and participates in the ESOP), the Company will almost certainly need to amend its articles of incorporation in order to increase the amount of authorized shares. The Company should consult with its legal counsel and financial advisers in order to determine through a feasibility study exactly how many shares will be needed in order to maintain the ESOP.

4. **Get the Company's Legal Documentation in Order.** The trustee and its advisers will conduct thorough financial and legal due diligence in the course of preparing to value the Company and purchase the Company's stock. The financial due diligence requests will center on the Company's financial statements. The legal due diligence requests will run the gamut and include the Company's corporate governance, contracts, employment practices, litigation, financing arrangements, etc. The Company will receive an initial due diligence request, followed by supplemental requests based on the information provided. The process for responding to due diligence requests is easier (and cheaper) if the Company has gathered and prepared all of its legal documentation ahead of time. For example, all of the Company's corporate formation documents, material contracts with customers and suppliers, employment agreements, and lending documentation should be located and organized ahead of time. In addition, each of these agreements should be reviewed by the Company's legal counsel to confirm whether there are any change in control provisions that would be triggered by the sale of the Company to the ESOP.

5. **Ensure Compliance with the Company's Bylaws.** If the Company does not have bylaws in place, the Company should engage legal counsel to prepare bylaws for the Company. The bylaws set forth certain requirements, such as the number of directors the Company must have and the specific officers that must be appointed. If the Company has bylaws in place, but has not been documenting annual elections of its directors and officers, then it should engage legal counsel to draft written consents of the shareholders and the directors to elect the directors and officers, respectively, and to ratify past actions.

Most ESOP trustees request that the Company establish a compensation committee and a nominating committee of the Company's board of directors in connection with the sale of the Company's stock to the ESOP. These committees are often comprised of independent members of the board. The compensation committee typically determines any modifications to the compensation of the selling shareholders and their family members. The nominating committee typically recommends to the shareholder(s) (i.e., the ESOP trustee) the candidates for election to the board. These committees must be authorized in the Company's bylaws and established by resolution of the Company's board of directors. The Company's legal counsel can draft these documents prior to the trustee's diligence requests, thus eliminating one item from the Company's to-do list on a post-transaction basis.

With any questions, please contact David Whaley or Kelsey Mehaffie.

Year Two: What's New?

Wednesday, May 16
Cincinnati

Lawyers from our Labor & Employment and Employee Benefits & Executive Compensation practice groups will examine the rapidly evolving legal landscape under the Trump administration and the developments that affect employment laws and benefit plans.

See more information at ThompsonHine.com/Events.

Mergers & Acquisitions

Data Privacy Concerns Should Be a Focus in M&A Transactions

By Rob D. Powell and Craig A. Foster

In 2017, $2.93 trillion in mergers and acquisitions closed in North America and Europe. With the sheer volume of merger and acquisition (M&A) transactions taking place, it is increasingly critical that parties evaluate the risks and liabilities associated with insufficient privacy and data security practices. Failure of a target to meet legal or internal obligations can present significant risk to the buyer. Vulnerabilities and non-compliant practices in a company's security program can, ultimately, jeopardize a deal and affect the valuation of the target company. This is particularly true when large amounts of consumer, health or financial data are involved.

For these reasons, buyers should beware: issues discovered after closing can expose companies to liabilities like class action litigation, government investigations or expensive remediation costs. In the United States, regulators are increasing enforcement efforts related to privacy violations and issuing significant penalties. In Europe, and globally, administrative agencies are doing the same. Given this enormous potential for liability, parties must be intentional in their approach to the handling of personal data in all phases of M&A transactions.

Some early considerations during due diligence of an M&A target should include:

- What personal data does the target have?
- How is personal data collected and managed, and how sensitive is it?
- Where is the target's data, and who regulates it? How is the data regulated?
- How does the target and how will the buyer use the data?
- Does the personal data involve foreign citizens or children?
- Is the source of the data known, and is it segregated and secure?

Additionally, targets should be evaluated for compliance with the promises and representations they have made to consumers and on their website, such as privacy policies and opt-ins, regulatory privacy notices, customer agreements and website terms of service. Marketing practices, such as email marketing, telephone/text marketing, use of online behavioral advertising, use of cookies and similar software, and compliance with do-not-track requests also must be reviewed. If the target processes data overseas or across borders, there may be additional compliance requirements.

A buyer's due diligence also should include a review of the target's internal policies, including policies on data collection, storage, disclosure and disposal of personal information; any security programs (i.e., physical, technical and administrative safeguards) and testing procedures; procedures regarding processing of consents; and procedures for compliance with cross-border data transfer requirements. Internal policies may also include any established records retention policies, such as how data is classified and segregated, any encryption technologies utilized, and policies in place to prevent data loss.

Major high-profile data breaches can bring on class-action lawsuits and liabilities that can impact a company years after being acquired. The buyer should question the target's data incident response plan, and identify any previous data breaches and vulnerabilities. Upon discovery of any prior breach or breaches, the buyer should clearly define the scope of each such breach, and evaluate all actions taken in response to every breach under applicable laws and regulations. Improper breach responses, fines imposed, administrative actions taken, and customer-related consequences can all threaten a deal or expose a buyer to liability.

In M&A transactions, properly tailored representations (reps) and warranties relating to privacy and data security matters are essential to managing the parties' risks. Reps and warranties are statements of fact and assurances made by the target. They are designed to allocate the risk between the parties, determine obligations to close or walk away

before closing, and serve as a basis for damages claims or indemnification after closing. The scope and type of reps and warranties depend on the target's specific business and to what extent the target relies on the processing of personal information (e.g., health care, financial services, retailer), whether the transaction requires the transfer of personal information, the bargaining position of the parties, and the specific facts learned during due diligence. Reps and warranties should be carefully crafted based on the nature of the deal and the lessons learned from the due diligence conducted.

While mergers and acquisitions can breathe new life into companies and industries, all parties to an M&A transaction must continue to be mindful that the evaluation of a target's privacy practices is a crucial first step, and that carefully tailored reps and warranties are essential to allocating each party's risk. Failure to do both can lead to significant legal, financial and reputational consequences for all parties involved.

With any questions, please contact Craig Foster or Rob Powell.

Managing Tomorrow's Cyber Threats Today

Thursday, April 26
Cleveland

Please join us for a conversation with multiple experts in the field. Keynote speaker **Brig. Gen. Gregory J. Touhill**, President of Cyxtera Federal Group and the former (and first-ever) Chief Information Security Officer for the United States, will explain the challenges and solutions related to addressing contemporary cybersecurity threats across a broad range of industries.

Presenters:

- **David Hickton**, Founding Director, University of Pittsburgh Institute for Cyber Law, Policy, and Security
- **Steven G. Stransky**, Senior Counsel, Thompson Hine

We will also have two panel discussions featuring experts in information privacy and cybersecurity:

Panel I: Data Privacy in a Changing World

- **Andrew Fausett**, Deputy Legal Adviser, National Security Council, The White House
- **Erin Lewis**, Director of Compliance and Ethics, The Goodyear Tire & Rubber Company
- **David Lieber**, Senior Privacy Policy Counsel, Google
- **Tom Zych**, Partner, Thompson Hine LLP (moderator)

Panel II: Cybersecurity – Evolving Threats and Risk Management

- **Scott Bailey**, Co-Founder & President, N1 Discovery
- **Neal Pollard**, Partner & Director, Forensic Technology Practice, PricewaterhouseCoopers
- **Kelly Ulrich**, Deputy Chief Information Security Officer, KeyBank
- **Darcy Brosky**, Attorney, Thompson Hine LLP (moderator)

8:00 – 8:30 a.m. *Registration, networking & continental breakfast*
8:30 a.m. – Noon *Program*

See more information at ThompsonHine.com/Events. Please register online by April 23.

Continuing Legal Education: 3.0 credits have been requested for Ohio, Michigan and Pennsylvania.

Business Succession Planning

Effect of Estate, Gift and Generation-Skipping Transfer Tax Law Changes on Business Succession Planning

By James Spallino, Jr. and Jennifer A. Myers

President Trump recently signed into law the Tax Cuts and Jobs Act. While the impact of the Tax Cuts and Jobs Act on the individual income tax and corporate tax arenas has been widely publicized, the Act also made significant changes to the estate, gift and generation-skipping transfer tax laws. These changes, which are effective for taxable years beginning in 2018, present significant wealth transfer opportunities for clients, particularly those owning assets whose values are expected to appreciate, such as closely held business interests. Under the new law:

- The exemption base for federal gift and estate tax purposes of $5 million (i.e., the amount that an individual can transfer during life and/or at death without paying gift or estate tax) has doubled and continues to be indexed for inflation occurring since 2011. In recently released Revenue Procedure 2018-18, the Internal Revenue Service officially announced that the unified exemption amount for an individual for lifetime gifts and decedents' estates in 2018 will be $11.18 million. The annual gift tax exclusion for 2018 also increased to $15,000 per donee; however, such increase was due to inflation, and not as a result of the new law.

- The exemption base for generation-skipping transfer tax purposes of $5 million (i.e., the amount that an individual can transfer to persons who are more than one generation below him or her, such as grandchildren, without paying generation-skipping transfer tax) has also doubled and is indexed for inflation occurring since 2011. Accordingly, the exemption amount in 2018 for generation-skipping transfers is also $11.18 million.

- A surviving spouse may continue to utilize the unused unified exemption amount of a predeceased spouse for gift tax purposes, and a surviving spouse's personal representative may continue to utilize the unused unified exemption amount of a predeceased spouse for estate tax purposes, provided a proper portability election was made at the death of the predeceased spouse. Thus with proper planning, a married couple can transfer in 2018 up to $22.36 million of wealth to subsequent generations free of the federal estate, gift and generation-skipping transfer tax.

- The maximum rate for the estate, gift and generation-skipping transfer taxes continues to be 40 percent.

Unless Congress acts to extend the increased exemptions, they will expire at the end of 2025. On January 1, 2026, the exemption amounts are scheduled to revert to pre-2018 levels. There is some uncertainty in the new law as to whether tax that is avoided for gifts that take advantage of the increased exemptions may become due if exemptions revert back to pre-2018 levels, although the new law directs the IRS to clarify this issue in Regulations. Despite this mild uncertainty, it would appear that there is a limited window of opportunity for clients to make significant lifetime gifts and/or undertake significant planning to benefit younger generations. Clients who had previously exhausted their lifetime exemption from the federal gift and estate tax should give serious consideration to additional gifting in the near term. Further, given the current low interest rate environment, consideration might also be given to the gift or sale of closely held business interests to certain types of trusts.

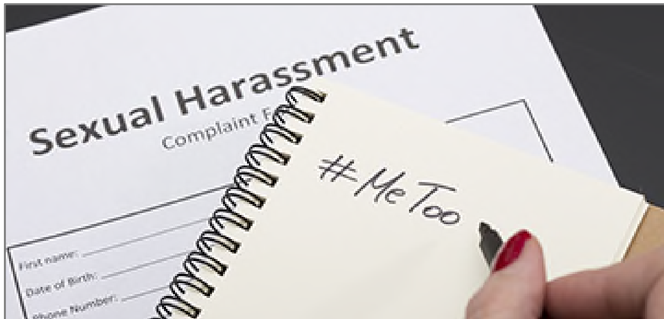
In light of the significant changes in the tax law, all succession plans should be reviewed. Although the sunset of the expanded exemption amounts is currently several years away, we suggest that additional planning be evaluated in the near term as we may never be certain when applicable tax laws may again be modified.

With questions, please contact Jim Spallino, Jennifer Myers or any member of our Personal & Succession Planning group.

Employment Law

#MeToo Movement Highlights Importance of Employer Response to Sexual Harassment

By Nancy M. Barnes and Lindsay Nichols



Anyone who has been paying attention to the news in recent months is aware that sexual harassment is *the* hot button issue of the day, especially in the entertainment and media industries. The use of #MeToo in social media has become a way for women (and men) to share personal experiences. However, sexual harassment is not confined to Hollywood and Washington. Employers in all industries would be well advised to pay attention.

In response to the focus on sexual harassment, we recommend employers take the following actions:

1. Update Anti-Harassment Policy. While most employers have an anti-harassment policy in place, it should be reviewed and updated regularly. Even if there are no major changes to the law since the policy's last review, other important societal changes (for instance, the prevalence of social media use) may need to be addressed. Make sure that all employees have received the policy and acknowledged its receipt in writing.

2. Conduct Anti-Harassment Training. Employers should educate their employees on the anti-harassment policy as well. In some jurisdictions, the training is mandatory. We suggest employers review their policies annually and conduct anti-harassment training now, due to the current environment, and then every two years.

3. Review Reporting Structure & Be Prepared to Investigate. An employer's "reporting structure" refers to the internal mechanism that enables employees to report harassment. For example, some companies have anonymous hotlines, some use Human Resources, and others direct employees to report up the chain of command; there are even smartphone apps that can be used to report harassment. The goal here is to make it easy for employees to complain. An employer will want to consider the pros and cons of specific methods, however. For example, allowing employees to report anonymously may encourage reporting, but not provide an employer with enough detail or information to use to investigate a report. And, when a report does come in, the employer's designated individuals should be fully trained and prepared to respond promptly.

4. Watch for Legal Developments. In the wake of the sexual harassment headlines splashed across the news recently, it's more important than ever for employers to pay attention to new and proposed legal developments. Here are just a few examples:

- **State Legislation.** New York, California, New Jersey, Pennsylvania, South Carolina and Washington are considering passing laws that limit the use of non-disclosure and mandatory arbitration clauses in employment contracts and settlement agreements. Proponents of such laws argue that the use of these types of clauses keep bad behavior out of the public eye, and don't effectuate wide-spread change. Opponents of the laws suggest that forcing parties to litigate sexual harassment allegations may force both employers and employees to make very private subject matter public.

- **Training Requirements**. In California, the existing requirement that employers with 50+ employees must provide two hours of sexual harassment training for supervisors every two years has been expanded as of January 2018 to require components about harassment based on gender identity and expression and sexual orientation; content covering specific examples; and the use of knowledgeable trainers. Other states, such as Connecticut and Maine, have similar training requirements.

- **New Standards.** In both Florida and New York, female legislators have proposed new laws that would make a single unwelcome advance or single severe incident sufficient to sue for damages.

- **State Fair Pay Acts.** While most states have an equal or fair pay act in place, California's Fair Pay Act was recently expanded to include compensation differences between members of one race or ethnicity and those of another, as well as to prohibit pay differentials based on prior salary alone.

- **State Initiatives.** In New York, Governor Andrew Cuomo has indicated support for mandatory annual reporting of sexual harassment proceedings for companies doing business in New York; legislation that would prevent taxpayer money from being used to fund sexual harassment suits against public officials; banning confidentiality agreements in the public sphere unless at the victim's request; and the creation of a uniform code of sexual harassment policies for state and local government.

- **Federal Tax Law.** Under the new federal tax law, payments (including attorneys' fees) related to sexual harassment or sexual abuse matters are not deductible if such settlements or payments are subject to a nondisclosure agreement. As written, the breadth of this provision is broad enough to pick up unpaid back pay and severance payments by an employer.

Please contact Nancy Barnes, Lindsay Nichols or any member of our Labor & Employment practice to further discuss how an employer can best respond to the hot button issue of sexual harassment.

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