

# Business Brief

## Business and Client Advisory



### **ARE YOU PROTECTING YOUR TRADE SECRETS?**

Many companies have valuable information that can be defined as a "trade secret" under California law. Trade secrets increase the value of a company's goodwill, may be licensed and protect valuable company information against competitors. While this is good news, many companies do not have adequate measures in place to protect their trade secrets.

A threshold question for California courts deciding misappropriation of trade secret claims is whether the "information" to be protected meets the definition of a trade secret. The term information is broadly defined by the law and includes "devices, compilations, formulas, methods, processes, programs and techniques." In fact, many forms of information are suitable for trade secret protection as long as the trade secret owner takes "reasonable measures" under the circumstances to protect the information's secrecy.

Companies are advised to work with legal counsel and define the information to be protected before embarking on a trade secret protection program. With assistance of legal counsel, the company should then examine appropriate legal measures to protect their information.

In summary, trade secret protection measures need not be heroic and California law only requires reasonable efforts to keep your trade secret information secret. For more information about options available to you, please contact this office.

### **TAX LAWS – RULES OF THE GAME**

Why is the tax code so complicated? Here's an explanation, plus some information on how the code is interpreted.

Congress writes the tax laws, which become part of the Internal Revenue Code (IRC) or tax code for short. The tax code is amended every year; presently, it's over 4,500 pages long.

Part of the problem is that many tax laws are passed for purposes other than raising money. For example, Congress has attempted to meet the social goal of alleviating the housing problem by giving tax breaks to those who invest in low income housing. Similarly, an economic goal has been addressed through the allowance of rapid tax write-offs to buyers of new business equipment in an effort to stimulate manufacturing. Finally, there are purely political reasons for tax laws. Many special interest groups, such as oil companies, horse breeders, broadcasters, insurance companies and even major league baseball clubs, have gotten tax laws passed that are designed to give them special treatment. These special provisions of the tax code outnumber the laws of general application.

#### ***Interpreting the Tax Code***

Congress has given the IRS the power, in the first instance, to interpret the tax code through a series of IRS regulations. These regulations are expanded versions of some, but not all, tax code provisions with illustrations of how the law is applied in different situations. The regulations are about four times the length of the tax code itself. The IRS also publishes revenue rulings, revenue procedures and letter rulings, which provide guidance in much the same manner as the regulations. Not every provision of the tax code has a corresponding regulation.

There are thousands of situations where it is not clear exactly how the tax law should be applied. In these gray areas, disputes often arise between the IRS and the taxpayer. This is where the tax professionals earn their keep -- by fitting the tax code most advantageously to a client's case. Or put another way, if the tax case is analogized to the fence around Farmer Brown's cabbage patch, the perimeter has gotten so long and twisty that a self-respecting rabbit may have a decent chance of finding enough room to wiggle through or under it.

The IRS is not the final word on interpreting the tax code. The federal court system, composed of the U.S. Tax Court, federal district courts, the U.S. Court of Federal Claims and U.S. bankruptcy courts, all have the power to decide, on a case-by-case basis, how Congress intended the tax laws to be applied. If more than \$50,000 is at stake, a taxpayer can appeal a Tax Court decision to a circuit court of appeal, and in rare cases to the U.S. Supreme Court. If you have any questions regarding your particular tax situation, please contact this for assistance.

## ARE YOUR INDEPENDENT CONTRACTORS REALLY EMPLOYEES? Under Some Laws They Will be Treated as Such

Whether a business classifies its workers as employees or independent contractors is not only an issue with respect to classification for IRS purposes, but with respect to classification under other laws as well.

Many employers improperly classify people who are actually employees as independent contractors for IRS withholding purposes. If misclassification is determined during an audit of either the employer or the worker, or if the worker fails to pay taxes, the employer may be subject to penalties. Additional penalties may also be imposed if the worker who was misclassified as an independent contractor turns out to be a nonexempt employee under state and federal wage and hour laws.

Additionally, many employers are not aware that there are different tests for whether a worker is an independent contractor or an employee, depending on the type of law applied. For example, independent contractors have many of the same rights as employees under state and local anti-discrimination laws. The reverse is also true – sexual harassment, racial or other forms of discrimination initiated by an independent contractor may result in liability to the employer. Additionally, concepts of agency may result in the employer being bound by the words or acts of the independent contractor, such as verbal or written commitments to buy and sell goods or services at a certain rate, or liability for auto accidents.

From the IRS' perspective, there is no "bright line" test for determining whether a worker is an independent contractor or an employee. The IRS looks at three categories of evidence – Behavioral Control, Financial Control and the Type of Relationship itself.

According to IRS Tax Topic 762, Behavioral Control covers facts that show whether the business has a right to direct and control how the work is done, through instructions, training or other means.

Financial Control covers facts that show whether the employer or business has a right to control the business aspect of the worker's job. This includes:

- The extent to which the worker has un-reimbursed business expenses,
- The extent of the worker's investment in the business,
- The extent to which the worker makes services available to the relevant market,
- How the business pays the worker; and
- The extent to which the worker can realize a profit or incur a loss.

Facts covering the Type of Relationship include:

- Written contracts describing the relationship the parties intended to create,
- The extent to which the worker is available to perform services for other, similar businesses,
- Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay, and
- The permanency of the relationship.

Even if a worker meets the IRS' independent contractor test, employers should be aware that under most circumstances, they will be liable for sexual harassment or discrimination by the independent contractor. Therefore, employers may wish to consider insuring this risk, or requiring independent contractors to provide their own insurance. They may also provide certification that they have been trained in the prevention of sexual harassment and discrimination. However, requiring an independent contractor to go through employer-provided training may negatively affect the "behavioral control" portion of the independent contractor test. Therefore, requiring that a person already have this training prior to being hired as an independent contractor may be more prudent. Additionally, an agreement requiring the independent contractor (and his or her employer, if any) to indemnify, defend and hold the employer harmless from any such claims will also provide some protection, if the independent contractor is solvent.

As for being bound by the words and acts of an independent contractor under an agency theory, be sure that anyone who contracts with the independent contractor knows the scope of the independent contractor's authority to speak and act on your behalf. If it appears that you have given the independent contractor *carte blanche* to act and speak for you, you may have inadvertently increased the apparent scope of the independent contractor's authority beyond what you intended.

If you have any question as to whether your workers should be classified as employees or independent contractors or would like to discuss the implementation of independent contractor or employee agreements in your business, please contact this office for assistance.

## PAID FAMILY LEAVE DECISIONS BEGIN JANUARY 1, 2004

In 2003, the Paid Family Care Leave Act (PFCLA) was signed into law. This law establishes the Paid Family Leave insurance program, also known as Family Temporary Disability program. Administered by the State Disability Insurance (SDI) program, the fund provides up to six weeks of partially paid family leave annually to employees who need time off of work to care for a seriously ill child, spouse, parent or domestic partner, or to bond with a new child. Similar to the SDI program, payments come from the SDI program and are funded entirely by employee contributions.

Prior to the passage of this bill, family leave was governed solely by the federal government's "Family and Medical Leave Act (FMLA)" and California's "California Family Rights Act (CFRA)". While these acts are still applicable to certain workers in California, the PFCLA provides benefits to many workers who were not covered under the FMLA and CFRA.

Under the FMLA and CFRA, an employee was not legally entitled to family leave unless the employer has 50 or more employees and the employee has worked for the employer for at least one year and 1,250 hours prior to the request for leave. Under the PFCLA, there is no limitation as to the number of employees for eligibility and only a seven-day waiting period before an employee is entitled to payment for leave. Unlike the FMLA and CFRA, leave is provided to employees if the leave is taken to care for a domestic partner or to bond with the child of an employee's domestic partner.

While the PFCLA eligibility requirements may have detrimental effects on the small employer, the PFCLA, unlike the CFRA and the FMLA, does not require the employer to reinstate an employee who is eligible for leave under the PFCLA, but not CFRA and FMLA, to their job. Additionally, employers may require that an employee use two weeks of vacation before receiving any paid leave. Leave taken under the new law runs concurrently with any leave taken under the FMLA and/or the CFRA.

An employee requesting paid family leave from SDI must provide a medical certificate which contains a diagnosis and diagnostic code or, in the absence of such a code, a detailed statement of the symptoms. This requirement differs from the CFRA where disclosure of the underlying diagnosis of a serious health condition of the family member is not required.

Employers must begin to make deductions of paid family leave contributions from employees who are covered by the SDI program as of January 1, 2004. Employers will note an increase in the SDI deduction to cover the paid family leave contributions. Claims for Paid Family Leave may be commenced on July 1, 2004.

## CREATING A PARTNERSHIP AGREEMENT

### Don't Wait Another Minute To Put Your Partnership Agreement In Writing

If you and your partners don't spell out your rights and responsibilities in a written partnership agreement, you'll be ill-equipped to settle conflicts when they arise, and minor misunderstandings may erupt into full-blown disputes. In addition, without a written agreement saying otherwise, your state's law will control many aspects of your business.

#### ***How a Partnership Agreement Helps Your Business***

A partnership agreement allows you to structure your relationship with your partners in a way that suits your business. You and your partners can establish the terms and conditions for the allocation of shares of profits (or losses) each partner will take, the responsibilities of each partner, what will happen to the business if a partner should withdraw from the business and other important matters.

#### ***The Uniform Partnership Act***

California has its own laws governing partnerships, contained in what's usually called "The Uniform Partnership Act" or "The Revised Uniform Partnership Act" -- or, sometimes, the "UPA" or the "Revised UPA." These statutes establish the basic legal rules that apply to partnerships and will control many aspects of your partnership unless you set out different rules in a written partnership agreement.

Don't be tempted to leave the terms of your partnership up to state laws. Because they were designed as one-size-fits-all fallback rules, they may not be helpful in your particular situation. It's much better to put your agreement into a document that specifically sets out the points on which you and your partners have agreed. For assistance with the preparation of your partnership agreement, please contact this office.

**For further information, please contact us at:**

VOGT & RESNICK  
Law Corporation  
4400 MacArthur Boulevard, Ninth Floor  
P.O. Box 7849  
Newport Beach, CA 92658-7849  
Telephone: (949) 851-9001  
Facsimile: (949) 833-3445  
[www.vogt-resnick.com](http://www.vogt-resnick.com)