TIFFANY & BOSCO P.A.

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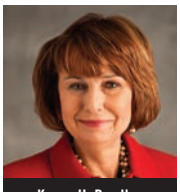
Liability risk under the new Arizona LLC act

JRCASAS/DREAMSTIME

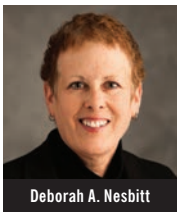
ANNOUNCEMENTS

NEW FACES

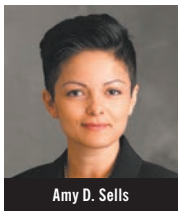
Sells Moves Up, New Shareholders Join Firm in NM


Karen H. Bradley

KAREN H. BRADLEY joined the firm in October 2018 as a Shareholder. Before joining Tiffany & Bosco, Karen was an associate, and later, a managing partner of a New Mexico law firm that represented creditors in residential mortgage foreclosures and related proceedings. Karen concentrates her practice in representing lenders in real estate foreclosures, bankruptcies, evictions, and related actions. She is the author of "Military Spouses Lose Major Battle," and co-author of "Second Mortgage Lien Stripping in Chapters 7 and 13 after *Bank of America, N.A. v. Caulkett*." She has also served as a New Mexico assistant attorney general and has experience in general civil litigation in New Mexico state and federal courts.


Deborah A. Nesbitt

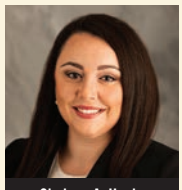
DEBORAH A. NESBITT joined the firm in October 2018 as a Shareholder. Before joining Tiffany & Bosco, Deborah was an associate attorney, and later, a managing partner of a New Mexico law firm that represented creditors in residential mortgage foreclosures and related proceedings. Deborah concentrates her practice in representing lenders in real estate foreclosures, evictions, and related actions. Deborah worked for a title company after law school, learning the ins and outs of title issues.


Amy D. Sells

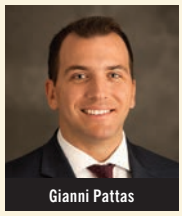
AMY D. SELLS was promoted to Shareholder at Tiffany & Bosco in February 2019. Amy is an appellate practitioner and handles federal and state appeals on a wide range of issues, including commercial law, bankruptcy, and real estate. In addition to her appellate practice, Amy litigates commercial matters and specializes in preparing and arguing major and dispositive motions.

Welcoming New Associates to

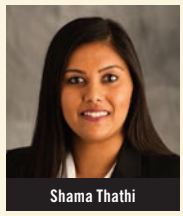
CHELSEA A. HESLA joined the firm in January 2018. Chelsea focuses her practice in the areas of real estate transactions, financing, and commercial leasing. Chelsea has extensive litigation experience and has obtained favorable verdicts in several jury trials. Chelsea received her Juris Doctor from the Sandra Day O'Connor College of Law at Arizona State University. During law school, Chelsea won a national moot court championship and was awarded a scholarship by the American Board of Trial Advocates. Prior to law school, Chelsea worked for an international multi-family property management and development company.


Chelsea A. Hesla

GIANNI PATTAS joined the firm in October 2018. Gianni's practice focuses on civil and commercial litigation. Previously, he practiced insurance defense litigation and defended clients facing lawsuits in the areas of construction defects, dram shop liability, premises liability, and general civil defense litigation. He graduated from Santa Clara University with a Bachelor's degree in Finance and earned his Juris Doctor from University of the Pacific, McGeorge School of Law. During law school, Gianni served as executive chair of the Moot Court Team, which is consistently ranked among the best in the nation. He earned a first place oral argument award at the Saul Leftkowitz Trademark Competition held at the Ninth Circuit Court of Appeals, as well as a first place brief award at the National Entertainment Law Moot Court Competition.


Gianni Pattas

SHAMA THATHI joined the firm in January 2019. Shama focuses her practice on business formations, mergers & acquisitions, and general business planning. Shama's interest in entrepreneurship and business motivated her to pursue a dual-degree in Finance and Accounting at Boston University, graduating *cum laude*. After her undergraduate studies, she worked in her family's business, managing gas stations and convenience stores in Arizona. Shama received her Juris Doctor from the University of Arizona James E. Rogers College of Law in 2015. Before joining the firm, Shama was an attorney for the Governor's Regulatory Review Council, where she gained extensive


Shama Thathi

ANNOUNCEMENTS

Tiffany & Bosco

experience in identifying potential regulatory and compliance issues. Currently, Shama is a member of the Board of Directors for the South Asian Bar Association of Arizona, where she serves as its Treasurer. Shama is also a Board member and Treasurer for the Arizona Asian American Bar Association and a member of the Business Law Section of the State Bar of Arizona and American Bar Association. In her free time, Shama enjoys spending time with her family and travelling.

ACE C. VAN PATTEN joined the firm in October 2018. Ace focuses his practice in the areas of bankruptcy and real estate litigation. Ace was admitted to the Nevada and Idaho bars after graduating from the William S. Boyd School of Law (2009), and has a degree in Economics from the University of Nevada, Reno (2006). In his free time, Ace enjoys spending time with his family, reading, and practicing Brazilian Jiu-Jitsu.


Ace C. Van Patten

FIND AN ATTORNEY
See the directory on the back page of this newsletter or visit us online at tblaw.com.

GOOD WORKS

T&B Staff Community Involvement

For many years, Tiffany & Bosco has been striving to make a difference in our community. This year has been no different. Last December, T&B participated in its annual Holiday Angels Project through the Jaydie Lynn King Foundation, benefiting six families who had at least one child currently in treatment at the Phoenix Children's Hospital Center for Cancer or Blood Disorders. We collected and wrapped over 320 gifts for the families and donated an additional $250 for support. This foundation creates opportunities for organizations and individuals to be involved with and fund programs that provide comfort, hope, and emotional assistance to children who suffer from tumors, cancer, and other blood disorders.

To kick off 2019, we participated in a drive to benefit the Arizona Burn Foundation. Our generous attorneys and staff members raised nearly $500 and donated boxes of coloring and sticker books, bubbles, and stuffed animals. Those donations will be used for therapy and support programs for burn victims.

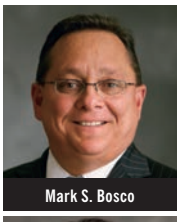
We also had the great pleasure of meeting burn victim Tiara Del Rio, who came to speak to our staff members about the foundation's mission to improve the quality of life of burn survivors and their families while promoting burn prevention education in Arizona.

On March 22, 2019, the Staff Committee held an event at which attorneys and staff made baby blankets for donation to Maggie's Place. Founded in 2000, Maggie's Place provides life-changing programs and services for pregnant and parenting women and their children by offering a warm and welcoming community, a safe place to live and learn, and ongoing services to help them become self-sufficient.

Later in the spring, the firm collected donations to benefit the Salvation Army's Easter Basket Drive. Since its local Arizona founding in 1893, The Salvation Army Phoenix Metro has brought help and healing to the hungry and hurting, giving a hand up—not a hand out—and helping us to serve our neighbors in need without discrimination or judgment.

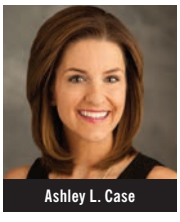
ANNOUNCEMENTS

PROFESSIONAL AND PERSONAL ACHIEVEMENT


Mark S. Bosco


Alisa J. Gray

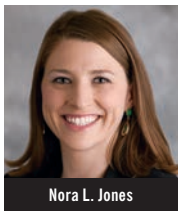
MARK S. BOSCO, ALISA J. GRAY, and **NORA L. JONES** were recognized by the 2019 edition of *AZ Business Leaders* magazine, a major business-to-business publication that acknowledges leaders of the Arizona business community, for their vision, influence, and leadership in their respective practice areas. Mark was recognized for Banking, Alisa for Probate, and Nora for Elder Law.


Ashley L. Case

ASHLEY L. CASE was recognized by Martindale-Hubbell with an AV Peer Review Rating, which means that she was deemed to have very high professional ethics and preeminent legal ability. Ashley was also selected as a finalist in the LL.M. Division of the 18th Annual American Bar Association Law Student Tax Challenge competition. Ashley and her teammate, Ross Uehara-Tilton, competed in New Orleans, Louisiana in January 2019 along with three other teams. Ashley is pursuing her LL.M. from Boston University School of Law and will graduate in May 2019.

DAVID L. CASE published an article titled "Conversion From Non-Grantor to Grantor Trust: Tax Issues" in the February 2019 issue of *Thomson Reuters' Estate Planning Journal*. On February 27, 2019, David presented for the Arizona State Bar on the topic of "Advanced Estate Planning: If an IDGT is a Bridge, is a BDIT a Bridge too Far?" Also, David is chairing a committee for new proposed legislation for the Probate & Trust Section of the State Bar of Arizona.

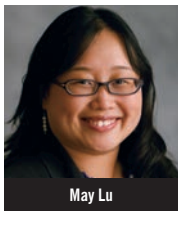
CHELSEA A. HESLA and **AMY D. SELLS** were selected to participate in the 2019 Ladder Down class, a year-long program dedicated to leadership empowerment, business development, and mentoring among women lawyers.


Nora L. Jones

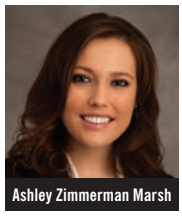
NORA L. JONES has been an active member of the Arizona Chapter of the National Academy of Elder Law Attorneys since 2015. She was selected as a facilitator for the annual AzNaela UnProgram. This year's program was held on March 8, 2019 at The Forum at Desert Harbor, where elder law attorneys engaged in facilitated interactive discussions on practical topics affecting elder law practitioners in Arizona. Nora was also awarded an AV Preeminent Rating, the highest possible rating in both legal ability and ethical standards, by Martindale-Hubbell.


Christopher R. Kaup

CHRISTOPHER R. KAUP was part of a team that won the 2018 Turnaround Management Association award for Turnaround of the Year: Small Company. Chris and his team were involved in the turnaround of Phoenix Manufacturing Partners, LLC, a manufacturing company in Arizona.


May Lu

MAY LU, at the invitation of Strafford, co-presented for the fourth time the CLE webinar entitled "Structuring MOUs, LOIs, Term Sheets and Other Nonbinding Legal Documents" on December 18, 2018. Back by popular demand, she was one of four panelists speaking to members of the Corporate and Business Law Society at the Sandra Day O'Connor College of Law at Arizona State University on February 29, 2019. May also successfully chaired the Arizona Asian American Bar Association's ("AAABA") 23rd Annual Scholarship Awards and Installation Banquet held on March 28, 2019. At the banquet, May was installed as the President of AAABA.


Ashley Zimmerman Marsh

ASHLEY ZIMMERMAN MARSH will serve on the Arizona Women Lawyers Association ("AWLA") Maricopa Chapter Steering Committee for a fourth year. Ashley also chairs AWLA's Judicial Appointments Committee, which assists member-candidates through the nomination and appointment process. Ashley was also selected for the NAIOP Arizona Developing Leaders ("DL") 2019 Steering Committee. The DL program serves commercial real estate professionals age 35 and under. Ashley co-chairs the DL's Master of Real Estate Development subcommittee.


Leonard J. McDonald

LEONARD J. MCDONALD was elected to serve as Secretary for the National Kidney Foundation of Arizona. Leonard previously served two terms as Chairman of the Board of Directors and one term as Vice Chairman of the Board of Directors.


Kevin P. Nelson

KEVIN P. NELSON, for the sixth year, authored *Arizona Real Estate Law* and *Arizona Construction Law-Annotated*, published by Thomson Reuters-West in November 2018.

ANNOUNCEMENTS

Timrobertsaerial/Dreamstime

Tiffany & Bosco Expands Its Presence At 'The People's Open'

Golf fans and non-golf fans alike gathered at the TPC Scottsdale for The Waste Management Phoenix Open during the week of January 28th. Tiffany & Bosco welcomed clients and friends to its newly redesigned, expanded suite alongside the 18th green. With the additional space, all in attendance were able to watch the action on the course as Rickie Fowler claimed his fifth career PGA Tour victory. Despite squandering a lead during the final round, Rickie stormed back to win his first ever "People's Championship."

With each passing year, Tiffany & Bosco becomes more dedicated to giving back and sponsoring the Thunderbirds Charities. To date, the Thunderbirds, who host the Phoenix Open each year, have raised more than $134 million for charitable causes across Arizona. Tiffany & Bosco is proud to continue its contributions to that tradition and is honored to be included among the "Greatest Fans in Golf."

RECOGNITION

Shareholders and Firm Recognized as 'Best Lawyers'

The Best Lawyers in America is a listing of outstanding attorneys who have attained a high degree of peer recognition and professional achievement. The 2019 listing recognized: Michael A. Bosco, Jr., Real Estate Law; Mark S. Bosco, Litigation – Banking & Finance and Mortgage Banking Foreclosure Law; David L. Case, Litigation – Trusts & Estates, Tax Law, and Trusts & Estates; James A. Fassold, Litigation – Trusts & Estates; Alisa J. Gray, Litigation – Trusts & Estates; Richard G. Himelrick, Litigation – Securities; John A. Hink – Real Estate Law; Christopher R. Kaup, Bankruptcy & Creditor Debtor Rights/Insolvency & Reorganization Law and Litigation – Bankruptcy; Leonard J. Mark, Family Law; Robert D. Mitchell, Commercial Litigation and Litigation – Securities; James P. O'Sullivan, Closely Held Companies & Family Businesses Law; Robert A. Royal, Business Organizations (including LLCs and Partnerships); and Michael E. Tiffany, Real Estate Law.

U.S. News – Best Lawyers also recognized Tiffany & Bosco as one of the 2019 "Best Law Firms" for the following practice areas: Family Law, Litigation – Securities, Litigation – Trusts & Estates, Real Estate Law, Trusts & Estates Law, Business Organizations (including LLCs and Partnerships), Closely Held Companies & Family Businesses Law, Commercial Litigation, Family Law, Mortgage Banking Foreclosure Law, Tax Law, Bankruptcy & Creditor Debtor Rights/Insolvency & Reorganization Law, Litigation – Banking & Finance, and Litigation – Bankruptcy.

James P. O'sullivan

JAMES P. O'SULLIVAN was invited to join the Arizona State Bar's Senior Lawyer Task Force and is an active participant of its Mentoring Subcommittee. Jim also presented on buy-sell agreements to the Phoenix Tax Workshop in January 2019.

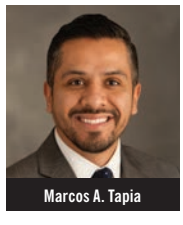
JAMES P. O'SULLIVAN and **MAY LU** co-chaired and presented with Shawn K. Aiken, Tom Maguire, Michael R. Metzler, and Charles Wilhoite on "Buy-Sell Agreements: 'Prenups' for Business Owners" to the Arizona State Bar on October 18, 2018. In addition, they were panelists on the Bar Leadership Institute Mentoring Panel on November 16, 2018.

GAYA SHANMUGANATHA was elected to serve as a Maricopa County representative for the Young Lawyer Division of the State Bar of Arizona. The division endeavors to assist new lawyers and provide opportunities for serving the public, and to improve the administration of justice and the legal profession.

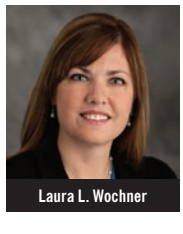
Gaya Shanmuganatha

SHAMA THATHI recently joined the Board of Directors of the Indo-American Foundation of Arizona, which promotes and supports Indo-American social and cultural activities in the Phoenix area.

MARCOS A. TAPIA was recently elected to serve as the 2019 Vice-President for Los Abogados, Arizona's Hispanic Bar Association. A formal announcement of the new executive board will be made at this year's Los Abogados 42nd Anniversary Gala being held at the Wild Horse Pass Casino and Resort. All proceeds of the annual gala go to fund Los Abogados' Pre-Law, LSAT prep, and law student scholarship programs.



Marcos A. Tapia



Laura L. Wochner

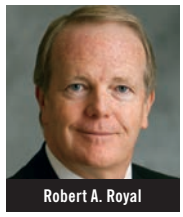
LAURA L. WOCHNER was appointed Chair of the 2019 Maricopa County Bar Association Real Estate Section.

ARE YOU COVERED?

Liability risk under the new Arizona LLC act

BY ROBERT A. ROYAL
ILLUSTRATIONS BY JR CASAS

Arizona's new LLC Act will take effect in 2020 for all LLCs. Here is a summary of the key provisions covering liability exposure and litigation procedures to address disputes:


Robert A. Royal

LIABILITY PROVISIONS IN THE NEW ACT

(1) A Member is liable to pay his or her contribution. (2) When an LLC distributes profits, a wrongful distribution makes the person receiving those profits liable to the LLC. (3) Managers remain liable for any debts they owe to a Member or the

BUSINESS MATTERS

Company even if they are removed. (4) Any Member or Manager who interferes with another Member's right to inspection of company records can be taken to court and made to pay attorneys' fees and costs for the inspection denial. (5) A person who provides false information or causes another to sign a false record submitted to the Arizona Corporation Commission may be responsible to those who rely on the false information. This extends to financial records. (6) But the corporate shield and protection from the debts of the LLC remain the same—Managers and Members are not liable for such debts.

NEW FIDUCIARY DUTY LIABILITY

The current LLC Act does not provide for fiduciary duties. Also, there has been no firm Arizona case law establishing such duties among Members, Managers, and the LLC. The new Act reverses that position by providing that a Member of a Member-Managed LLC owes to the Company and the other Members a duty of loyalty and a duty of care. Members may avoid breaching their duty of care if they did not engage in (1) grossly negligent or reckless conduct or (2) willful or intentional misconduct. The Member can discharge the duty of loyalty, care, and any other duties created by the Operating Agreement by acting in good faith and with fair dealing, or if an undisclosed transaction at issue was fair to the Company. The Manager of a Manager-Managed LLC also owes the Company and its Members the duty of loyalty and the duty of care in the same manner. However, these duties may be expanded, limited, or eliminated in the Operating Agreement as long as the elements of good faith, fair dealing, willful or intentional misconduct remain. One default method of describing fiduciary duties is to equate them to the duties of a director, officer, or shareholder in a corporation.

LITIGATION PROCEDURES TO ADDRESS DISPUTES

The new LLC Act provides procedural remedies that supplement the Operating Agreement to protect the Company and its management from bad conduct by Members or Managers. The most controversial new procedure enables the LLC or a Member to ask that another Member be expelled by judicial order. The grounds for such expulsion include (1) engaging in wrongful conduct that affects the Company, (2) willfully and persistently breaching the Operating Agreement, or (3) engaging in conduct that renders it not reasonably practicable to carry on the activities and affairs of the Company with that person as a Member. The new Act also permits a Member to ask the court to dissolve the entire LLC when it is not reasonably practicable to carry on the Company's business in conformance with the Articles or Operating Agreement. Other grounds for utilizing that procedure include when (1) the Company is conducting unlawful activities, (2) the Members or Managers are

More Provisions of Arizona's New LLC Act

BY MAY LU & JAMES P. O'SULLIVAN

Whether you are a member or a manager of an existing limited liability company ("LLC") or plan to form an LLC in the future, the new Arizona Limited Liability Company Act (the "New Act"), which becomes effective on August 31, 2019, will affect your LLC if you: (1) have no operating agreement; (2) have an operating agreement that does not address an issue covered by a default rule in the New Act; or (3) have an operating agreement that has a provision not permitted under the New Act. Some of the key provisions in the New Act that you should consider when reviewing your existing operating agreement or negotiating a new operating agreement include the following:

1 **Timelines:** The New Act will apply to all new LLCs formed after September 1, 2019 and to any existing LLC that elects in its operating agreement to be subject to the New Act. However, the New Act will apply to all existing and new LLCs after September 1, 2020, which means that the default rules of the New Act will apply unless the pre-existing operating agreement contains provisions that override the default rules.

2 **Restrictions on Provisions in Operating Agreement:** While an operating agreement may contain any provision that is not contrary to law, the New Act sets forth a limited list of statutory rules that cannot be modified and those that can be modified with certain restrictions (the "Restrictions"). For example, an operating agreement cannot (i) eliminate the contractual obligation of good faith and fair dealing or the duty to refrain from willful or intentional misconduct or (ii) limit or eliminate a person's liability for violation of such contractual obligation or such duty.

continued next page >

deadlocked, (3) the controlling persons have acted in a manner that is illegal, fraudulent, or have caused or threaten to cause a material adverse effect on the Company, (4) a Member commits waste by misapplying or diverting substantial assets of the Company for unrelated purposes, or (5) a breach of the duty of loyalty occurs.

Members retain the right to bring a direct claim against another Member, Manager, or the LLC. If the LLC is not acting to bring a claim for its benefit, the Member may step into the shoes of the Company to bring such claims to recover money for the Company. If any of these claims are made against a Member or Manager, reimbursement for expenses, including attorneys' fees through indemnification, is possible under the new Act. In fact, an LLC shall reimburse Managers if they have complied with the sections concerning appropriate distributions, fiduciary duty, and management, including advancing expenses. But reimbursements must be repaid if a person is determined not to be entitled to indemnification.

The new LLC Act uses risk as a policing function to deter wrongful activities. Even if Operating Agreements lack these procedures, companies can now rely on the new LLC Act to enforce reasonable rules of governance.

GET COVERED

Do you have questions about the new LLC Act? Please contact the attorneys at Tiffany & Bosco if you need assistance regarding, or have any questions about, the implications of the Act.

3 **Indemnification:** The prior LLC Act did not provide any default rules regarding the indemnification rights of members and managers. In contrast, the New Act details when the LLC is required to reimburse a member or a manager for payments made by such member or manager, when the LLC is required to indemnify a member or manager for third-party claims, and when the LLC is permitted to advance reasonable defense costs. Subject to the Restrictions, these default indemnification rules can be changed in an operating agreement.

4 **Information Rights:** The New Act adds a requirement that the LLC must provide to the members or managers, as applicable, all information and records that are material to a decision prior to the vote being held. The New Act also specifies the scope of the right to information to which a person is entitled based on the position of the requesting person—whether such person is a member or manager, a dissociated member (i.e., a former member), a legal representative (i.e., the personal representative of an estate), or a transferee.

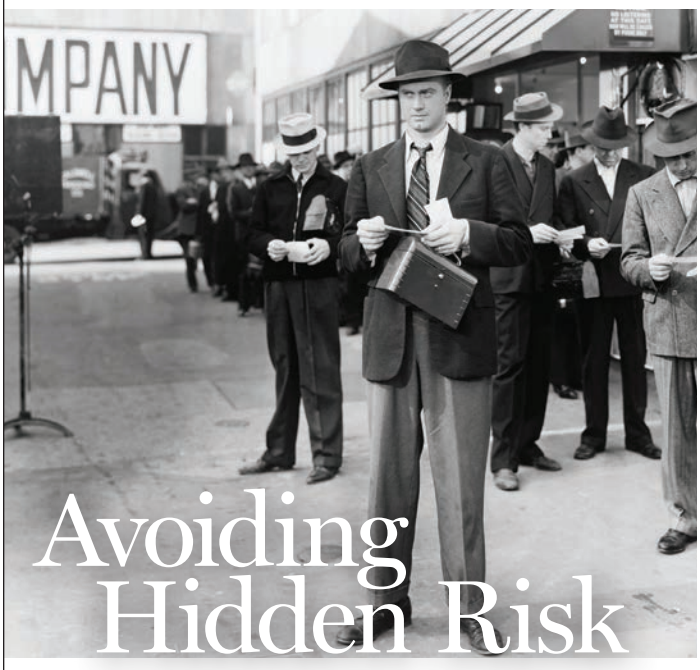
Similar to the statutes governing corporations, the New Act describes the process for obtaining information from the LLC, which includes requiring that the requesting party make a demand describing with reasonable particularity the information sought and the purpose for such demand, and that the LLC respond within 10 days of receipt of the demand. The New Act makes clear that an operating agreement can impose reasonable restrictions and conditions on access to and use of the information, as well as alter the process to obtain the information.

5 **Voting Rights:** Unlike the prior LLC Act, which provided for per capita voting of the members (i.e., each member has one vote regardless of that member's ownership percentage), the New Act provides that most decisions will be made by a "majority in interest" of the members in a member-managed LLC, unless otherwise provided by the New Act (e.g., unanimous approval required to change the operating agreement or admit a member with voting rights) or an operating agreement. According to the New Act, a "majority in interest" means one or more members holding in the aggregate a majority of the interests in the LLC's profits held at that time by all members.

Regardless of when the New Act becomes effective for your LLC, you should review your existing operating agreements to determine whether you need to make any amendments to address the New Act. Or, if you are thinking of forming a new LLC, you should consider whether you want to override any of the New Act's default rules in your operating agreement.

The transactional attorneys at Tiffany & Bosco are available to assist with amending existing operating agreements or drafting new ones.

EMPLOYMENT LAW



Everett Collection/Dreamstime

Avoiding Hidden Risk

Exceptions to corporate insulation from personal liability for wages, torts

BY PAMELA L. KINGSLEY

Since the Industrial Revolution in the 1820s, American entrepreneurs and investors have insulated themselves from personal liability for acts and debts through the incorporation or formation of their businesses.

However, those protections are not absolute. This article discusses two exceptions to insulation from personal liability that business owners should be aware of when their companies have employees: employees' wages and torts committed within the scope of employment.


Pamela L. Kingsley

First, an individual business owner or investor may be liable for wages earned by employees under certain circumstances. Unless they are exempt from overtime, employees earn time-and-a-half for all work time over 40 hours in a workweek and at least $11 an hour until the next increase on January 1, 2020. A.R.S. § 23-363.

Employers owe wages to employees for work performed. Almost all owners know that their businesses must pay their employees on a timely basis. Many also believe that if a company truly (i.e., legitimately) cannot afford to pay employees, the owner can close the doors, have the business declare bankruptcy, and walk away. It is true for other company obligations where there are no signed personal guarantees, so it must be true for wages as well, *right?*

Wrong.

The hitch lies in the broad definition of "employer." The Fair Labor Standards Act ("FLSA") defines "employer" as "any person acting directly or indirectly in the interest of an employer in relation to an employee." 29 U.S.C. § 203(d).

Stated differently, "the definition of 'employer' under the FLSA is not limited by the common law concept of 'employer,' but is to be given an expansive interpretation in order to effectuate the FLSA's broad remedial purposes." *Boucher v. Shaw*, 572 F.3d 1087, 1090 (9th Cir. 2009). For example, "[w]here an individual exercises 'control over the nature and structure of the employment relationship,' or 'economic control' over the relationship, that individual is an employer within the meaning of the Act, and is subject to liability." *Lambert v. Ackerley*, 180 F.3d 997, 1012 (9th Cir. 1999) (en banc).

The key to determining whether an individual falls within the FLSA's definition of employer—and thus may be personally liable for unpaid wages—is whether the individual exercises economic or operational control over the employment relationship.

Courts have found individuals to be employers and, thus, personally responsible when the person has (1) held a significant ownership interest with operational control of day-to-day functions, (2) been an officer with ultimate control over day-to-day operations, (3) been the officer principally in charge of directing employment practices, (4) possessed the power to hire and fire employees, (5) possessed the power to set salaries and wages, (6) been responsible for maintaining employment records, or (7) been the 50 percent owner and president who ran the business, issued checks, maintained records, determined employment practices, and was involved in scheduling hours, payroll, and hiring employees.

If a company is insolvent or has declared bankruptcy, the supervisor with control may represent the sole recourse for employees entitled to wages and other compensation. *Boucher v. Shaw*, 572 F.3d at 1093 (holding the "bankruptcy [of the company] has no effect on the claims against the individual managers at issue here"). "'The overwhelming weight of authority is that a corporate officer with operational control of a corporation's covered enterprise is an employer along with the corporation, jointly and severally liable under the FLSA for unpaid wages.'" *Id.* at 1094 (quoting *Donovan v. Agnew*, 712 F.2d 1509, 1511 (1st Cir. 1983)).

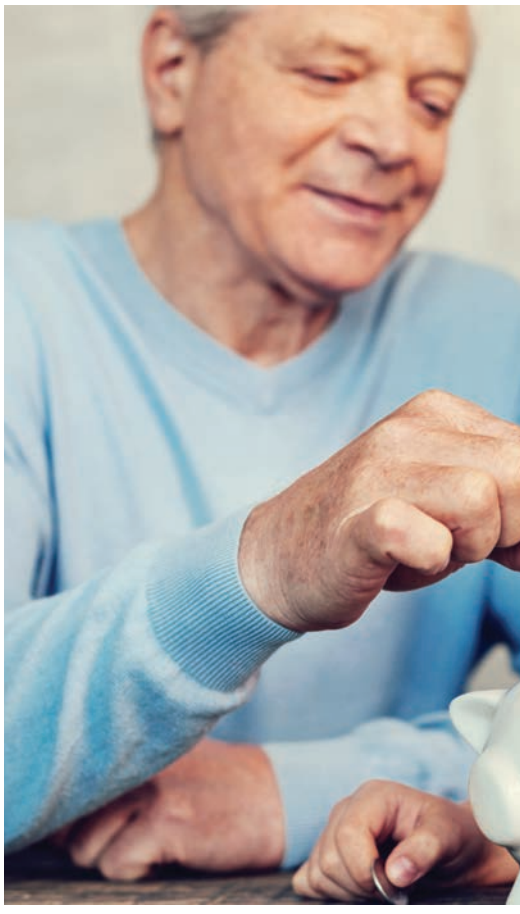
Second, an individual business owner may be personally liable for more than just unpaid wages. Someone with day-to-day control, including the right to fire, can be jointly and severally liable with the company for torts committed in the scope of the individual's employment.

Turning from wages to torts, a supervisor can be found personally liable for harming someone by wrongfully terminating the person's employment. *See Higgins v. Assmann Elecs., Inc.*, 217 Ariz. 289, 293-94 (App. 2007); A.R.S. § 23-1501(3)(c)(ii). A supervisor may be responsible for both compensatory and punitive damages.

The lesson for investors and owners with economic or operational control over their companies' employees, and even for those who are neither owners nor investors but who do exert operational control, is that they may be liable for their companies' obligations even when they never made any such agreement. By being aware of potentially hidden legal consequences, those individuals can avoid putting themselves at risk.

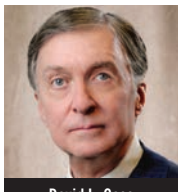
ESTATE PLANNING

Select Tax Issues Regarding Grantor Trust Planning



BY DAVID L. CASE

The use of "grantor trusts" in estate planning has steadily climbed during the last three decades, as numerous tax planning benefits can be achieved therefrom. The term "grantor trust" is commonly used to refer to a trust for which the settlor or Trustor (i.e., the person establishing the trust) is treated as the owner of trust assets for income tax purposes under one or more of the provisions of I.R.C. §§ 671 to 679, commonly known as the "grantor trust" rules.



David L. Case

Of course, a typical revocable living trust is a grantor trust, due to the Trustor being the lifetime beneficiary and the Trustor's ability to amend or revoke the trust. However, the planning covered in this article deals with irrevocable trusts, and there are numerous ways to "intentionally fail" the grantor trust rules so that an irrevocable trust is treated as a grantor trust.

Though it may seem inconsistent to someone who is not a tax attorney or CPA, most often this planning is designed so that although the Trustor is the owner of trust assets for income tax purposes, the transfer of the assets is complete for property law purposes, and for gift, estate, and generation-skipping transfer tax purposes.

Where the Trustor or settlor of an irrevocable trust is likely to have a taxable estate for estate tax purposes and is amenable to grantor trust planning, significant tax savings can be achieved because the Trustor will be liable for all income tax on the trust's income. This can result in further "transfer" of economic benefit to the trust beneficiaries without wealth transfer tax consequences—which over time can result in significant estate and gift tax savings.

The IRS has held that because the Trustor is liable for the tax, payment thereof cannot be a taxable gift, thereby giving rise to this great planning opportunity.

In addition, sales and exchanges between a grantor trust and the Trustor establishing it are not recognized for income tax purposes, which can provide many tax planning opportunities.

Frequently, gift or sale transfers to grantor trusts also involve fractional interest discounts for minority interests in family business entities (perhaps from 20% to over 40%) established by appraisal, which in turn allow significant leveraging of the tax benefits of the planning.

The IRS also has ruled that use of the popular I.R.C. § 675(4)(C) substitution of assets power in the trust provisions to intentionally make an irrevocable trust a "grantor trust" for income tax purposes will not, in and of itself, cause estate tax inclusion—as some tax planners previously feared. This also can provide tax planning and general estate planning flexibility and opportunity.

One example is the ability to exchange high income tax basis assets of the Trustor for low income tax basis assets in the trust before death, in order to allow an I.R.C. § 1014 "step up" in the low basis for those assets at death.

RECENT DEVELOPMENT OF METHODS OF CONVERSION

When converting an existing non-grantor, complex trust to a grantor trust for income tax purposes, additional tax and related issues must be analyzed.

Fortunately, in addition to the continuing development and evolution of the tax law in this area, including that relating to conversion of an irrevocable non-grantor trust to a grantor trust, there also has been a significant amount of development in the methods to update and modify existing irrevocable trusts.

Arizona now has clear statutory authority providing options not only for modifying irrevocable trusts, but also to have judicial review and approval of such changes. This, of course, provides certainty and finality for beneficiaries and trustees, as well as their advisors, which further facilitates this planning.

For several reasons, this author prefers using statutory methods for specific

Viacheslav Iacobchuk/Dreamstime

modification under Arizona law, though "decanting" techniques also can be used in Arizona where appropriate.

Petitioning the appropriate court for approval of a modification to an irrevocable trust is common where there is an important tax issue involved, such as converting an existing irrevocable non-grantor trust to a grantor trust for income tax purposes. Not only does court approval provide proof that the change is authorized by law, gives the optics of permanence, and can guard against liability for the Trustee, under Revenue Ruling 73-142, it also may bind the IRS for some purposes even if the IRS is not a party and even if the highest state court is not involved, as indicated to be necessary by other authority.

Where tax planning is involved in modification of an existing, funded irrevocable non-grantor trust, due to estate tax concerns, it is often advisable for the Trustor to not be a party to, or even directly consent to, the court petition for approval.

Arizona intentionally varied from the original Uniform Trust Code in this regard in structuring its legislation so that the Trustor cannot be a party to the petition or action under these provisions. As with most states, Arizona law requires that the "modification is not inconsistent with a material purpose of the trust."

With respect to converting a non-grantor trust to a grantor trust, this certainly enhances the tax planning goal of possibly reducing estate tax (and perhaps income tax), which is frequently the main reason for establishing irrevocable trusts.

OVERVIEW OF TAX ISSUES REGARDING CONVERSION

The primary tax issues raised by some tax planners when converting an existing non-grantor trust to a grantor trust are whether the conversion can cause (1) current recognition of gain by the Trustor for income tax purposes on trust assets due to a "deemed sale or exchange" of the assets, (2) inclusion of trust assets in the estate of the Trustor for estate tax purposes at death, (3) a current taxable gift to be deemed to have occurred, or (4) a loss of the generation-skipping transfer ("GST") exemption for the trust.

If an irrevocable trust contains the substitution of assets power at the time of creation, it is clear that it is a grantor trust under the grantor trust rules, and that these listed adverse tax effects will not occur.

Though additional authority in full rulings or higher court cases would provide even more certainty, based on existing authority, it appears the conversion of a non-grantor trust to a grantor trust, such as by adding the substitution of assets power, also should not create any of these adverse tax consequences. This is especially true if the Trustor is not involved in the conversion.

Regarding the income tax issue, there is authority that conversion does not create a deemed sale or taxable exchange that could create taxable gain, so long as the changes to the trust are not too drastic, such as where dispositive provisions are completely re-written or modified significantly.

As for a gift tax issue, it can be argued the Trustor could not have made a gift if not involved in the modification or court approval process, and if the beneficiaries are taking the action to modify or decant the trust, the economic benefit is flowing to them, not another donee. In addition, if the IRS position is that actual payment of the tax is not a gift, then it would not seem logical that modifying the document to make the trust a grantor trust to require payment of the tax could be a gift.

It also seems remote that the conversion of a non-grantor trust to a grantor trust would cause estate tax inclusion for the Trustor if he or she is not involved in the conversion. For example, it would be very difficult to reconcile that the addition of an I.R.C. § 675(4)(C) power, where the Trustor is not involved in the trust modification or decanting process and is not a party to the petition for approval of the conversion, would cause estate tax inclusion, when the law is clear under Revenue Ruling 2008-22 that the retention of this power by the Trustor at the time the trust is established does not cause estate tax inclusion.

Regarding the issue of whether conversion may cause a loss of GST tax exemption for the trust, in recent years, the IRS has consistently taken the position that the trust modification safe harbor rules for grandfathered trusts also apply to other GST exempt trusts. Numerous Private Letter Rulings have so held, which seems to provide a path for planning in most cases to avoid loss of the GST exemption.

SUMMARY

Utilizing grantor trusts for tax and estate planning is very common, and as more supportive authority appears and knowledge of the benefits increases, barring a change in the tax law, it will likely continue developing and expanding.

LEARN MORE

This article is a summary of an extensive article by David L. Case, "Conversion Of A Non-Grantor Trust To A Grantor Trust: Tax Issues," from the February 2019 edition of *Estate Planning*, a Thomson Reuters (WG&L) publication, available on the Tiffany & Bosco website tblaw.com.

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