

# THE Erblaw News

Volume 2 • Number 3 • September 30, 2001

## Welcome to the New Erblaw news!

*J Christopher Erb*

So, if you haven't had enough of the Erblaw News already, we're planning to increase our assault on your mailbox and your patience. In addition to the new format, you'll notice your newsletter is a little early this time around - that's because it will be every two months from now on!

As always, changes to your mailing address or requests to be included or removed from our list can be addressed to any of us (see the last page) or just go to [www.erblaw.com](http://www.erblaw.com). Comments are welcome too, as always. Enjoy!

## No use crying over spilled wine...

*by Kelly Phillips Erb*

Pennsylvania's strict liquor laws are no secret, but clearly we're not the only state with such issues. Maryland's own liquor laws are being called into question over an incident involving a shipment from the Brick House Vineyards in Oregon to a customer in West Virginia. The winery shipped a half case of 1999 Pinot Noir, valued at about \$240, to the customer via UPS. It is legal to ship wine between Oregon and West Virginia.

So where does Maryland come in?

UPS' regional distribution center for ground systems is located in Maryland. Maryland does not allow the shipment of alcoholic beverages from out-of-state producers to consumers; such shipments are considered a felony. In fact, while the wine shipment in question was initially reported as damaged, UPS told Doug Tunnell, the

winery's owner, that the wine had been destroyed as contraband. As such, UPS spokesman Bob Godlewski has confirmed that UPS would not ship wines in, out or through Maryland.

However, according to Charles Ehart, director of Maryland's Alcohol and Tobacco Tax Division, such shipments are legal so long as the carrier buys a permit. The permits costs \$102, but UPS has not yet applied for the permit. Godlewski encourages wineries to check with UPS before shipping wines out of the state.

## Au Revoir, mes amis

*by J. Christopher Erb*

Unfortunately, that's about the extent of my French. That's unfortunate because this month Chris and Kelly will be travelling to Paris, France, where Chris will be speaking before a meeting of the EAK, a network of European attorneys. The topic will be [Visa Alternatives for Business Travelers](#), and will be held in German.

In addition to Paris, the Erblaw delegation is expected to hold additional meetings in Lyons, Grenoble, and Brussels.

## Your independent contractor - really independent?

*by Lorenzo Bacciardi*

Are your workers employees or independent contractors? As the number of temporary workers in US corporations continues to increase, one of the hot issues is the distinction between employees and independent contractors. The distinction can have tax, benefit, and other implications, so

it is important to know what factors need to be considered.

Generally speaking, an employee is a worker who is dependent on, and controlled by, the employer. Usually, an employee receives instructions as to when, where, and how the work must be performed. Employees are typically employed full time, continuously, and over a long period of time. Employees work at the employer's premises using materials and tools furnished by the employer, and are often paid a salary.

Conversely, independent contractors are in business for themselves and are available to the general public to perform services. Thus, they are free from control and instructions in the performance of services and they work only when called upon to do so. Independent contractors are typically not required to work on the employer's premises and can accomplish the job through assistants, subcontractors, or delegates. Independent contractors have their own tools, equipment, and expendable supplies. Finally, they offer their services to multiple customers at the same time and are paid when the job is completed.

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Courts have identified more than twenty factors used to determine whether a worker is an employee. Some of the most important include:

1. *Instruction and Control.* An employee usually follows the instructions provided by the employer while the independent contractor knows how to physically and procedurally do the job.
2. *Training.* While the employee is usually trained by the employer, the independent contractor receives little or no training.
3. *Integration.* The employee is usually integrated into the business organization of the employer whereas the independent contractor performs the services in his own premises.
4. *Services.* The independent contractor may provide services through assistants or delegates, while the employee is required to perform the job personally.
5. *Continuing Relationship.* The independent contractor works only when called; the employee usually has a continuing relationship with the employer.
6. *Business Expenses.* An independent contractor absorbs business expenses as part of overhead; these expenses are generally paid by the employer in the case of an employee.
7. *Tools and Materials.* The employee is normally furnished tools and materials by the employer; the independent contractor has private tools, materials, and supplies.
8. *Works for Others.* The independent contractor is free to provide services to multiple unrelated persons, the employee works exclusively for his/her employer.
9. *Offers Services to the General Public.* The independent contractor makes his/her services available to the public.

Unfortunately, in many cases, your workers may be somewhere in the middle, exhibiting some of the characteristics of each category. If you are not sure, you should probably review the entire list of criteria or have an outside

audit done. In any case, when in doubt you should probably err on the side of calling the worker an employee, as misclassification can be expensive.

For the employer, the advantages of engaging independent contractors can be considerable: flexibility, outsourcing of non-core functions, reduction of the number of employees on payroll, and decreased costs for employee benefits and job related payments. Companies are not responsible for unemployment insurance, Social Security payments, workers' compensation coverage, overtime compensation, and many additional benefit plan costs such as 401(K), health insurance, and stock option plans for independent contractors. They are also free from other administrative burdens such as certain record keeping and reporting obligations prescribed by federal law, recognition of the statutory rights to organize and bargain enjoyed by employees, and application of federal employment discrimination laws.

That said, what happens if the employer misclassifies employees as independent contractors? Usually, the immediate consequence is the assessment of unpaid employment taxes. The IRS has been very aggressive in the enforcement of the employment tax law, so in 1978 Congress laws providing a "safe harbor" from assessment of unpaid employment taxes and penalties. To receive protection from the "safe harbor," three requirements must be met:

1. *reasonable basis*, the employer must have a reasonable basis for not treating the workers as employees. To establish the reasonable basis, the employer can rely on court cases, advice of an attorney or accountant, or results of previous IRS audits;
2. *substantive consistency*, the employer must have treated all other similar situated workers as independent contractor;
3. *reporting consistency*, the employer must have filed form 1099-MISC for each worker. If the employer

## Tidbits

Spouses of L and E visa holders may soon be able to work while in the US under legislation recently passed by the House. Previously, spouses of L and E visa holders who wanted to work were required to apply for their own employment-based nonimmigrant visas.

On August 6, 2001 Florida judge ordered the removal of a feeding tube from Pennsylvania native Terri Schindler-Schiavo. Schindler-Schiavo had been in a coma since February 1990. Her husband of 16 years has been fighting to remove the tube, while her parents maintain that Schindler-Schiavo would prefer to be kept alive; Schindler-Schiavo has no Living Will or Medical Power of Attorney. The case has drawn national interest from both right-to-life and right-to-die groups.

Recent changes to the K visas make it easier for spouses of US citizens to remain in the US while their immigrant visa petitions are pending. Prior to the (relatively) new provisions, the K visa was limited to fiances only, leaving spouses searching for visa alternatives until visas became available.

For those who thought it was over, apparently the offspring of Bush v. Gore live on in California, Florida and Georgia, and may survive in Illinois as well. The cases, brought by civil rights groups, withstood motions to dismiss in those states, although have been significantly narrowed in some instances. Most deal with the allegedly discriminatory effects of certain voting regulations and methods.

If all goes as planned, callers to our office will hear the cheerful voice of Liz Heffner, our part-time secretary, when they call our offices on Tuesdays and Thursdays. Welcome, Liz! With the addition of Liz and our new part-time accountant (thanks Mom!) the office is becoming a busy place to be.

files the form for some workers, and not for others, the safe harbor would not be available for the workers for whom the form was not filed.

How would you classify your workers? Do you meet the requirements under the “safe harbor” rules? Remember the three main factors: who controls the activities, who provides the tools and workplace, and who is the worker’s primary source of business. If the answer to most of these questions is you, the worker is probably an employee.

### Dual citizenship for Germans

by *J. Christopher Erb*

Recent changes to German law have made it possible for Germans living in the United States to become citizens of the United States without losing German citizenship. Previously, under German law, taking an oath of loyalty to another nation’s government would cause German citizens to forfeit citizenship. Unfortunately, the United States requires just such an oath, leading to a quandary for many German citizens living in the United States. Indeed, many of these long-term residents were forced to choose between German citizenship and very disadvantageous tax treatment in the United States.

Recognizing this, German law was relaxed somewhat to make dual citizenship possible for many Germans living abroad. The new legislation, effective January 1, 2001, makes the retention of German citizenship easier, provided certain criteria are met. German citizens must submit an application for approval to retain German citizenship prior to applying for US (or other foreign) citizenship.

There are limitations, however. Applicants must demonstrate that there are valid reasons for the decision to apply for foreign citizenship. In many cases, this is not difficult, and examples can include estate tax plan-

ning, retention of right to live in the United States, and better career opportunities in fields where American citizenship is a requirement. The other requirement is that the applicants must have continuing ties to Germany. Such ties can include family and friends, bank accounts or other property in Germany, eligibility for German social security or pensions, and continued immersion in German culture.

The application is straightforward, although the documentation required is fairly significant. There is a fee of between DM 375 and 500, due once the application has been decided. For more information contact this office or the German consulate in New York.

### It’s Suddenly Easier Being Green

by *Kelly Phillips Erb*

It is difficult to completely absorb the implications of the Economic Growth & Tax Relief Reconciliation Act of 2001 (“EGTRRA”). As a result, estate planners are scrambling to advise clients about techniques that effectively achieve estate and tax planning goals while providing additional benefits to clients, their families and (we hope) the greater good.

One estate and tax planning technique that is gaining momentum is the granting of conservation easements during lifetime, or at (and in some cases, after) death through the use of wills and trusts. Prior to the new tax act, the restrictions on the transfers made such grants highly impractical and, in some instances, nearly impossible. However, the new law under EGTRRA, dramatically reduces former geographical limitations for estate tax exclusions and clarifies valuation issues, so that this once overlooked technique is suddenly an attractive option.

There are a number of criteria under the IRS Code and applicable Regulations that govern the donation

of qualified conservation contributions. Briefly, a qualified conservation contribution must be exclusively for conservation purposes. The conservation purpose must be protected in perpetuity. For a donation to be protected in perpetuity, there must be a legally enforceable restriction on any interest retained by the donor that prevents any use of the retained interest found to be inconsistent with the conservation purpose of the donation. In other words, no deduction is allowed if the contribution would accomplish one conservation purpose but would permit destruction of other conservation interests such as, for example, preserving green space while destroying a historical building.

Under IRC section 170, a qualified conservation contribution is a contribution of a property interest to a qualified organization exclusively for conservation purposes. “Qualified conservation contribution” has been defined to include restrictions granted in perpetuity on the use of the property, such as an easement. In the past, qualified conservation contributions have included donations of green space, historical buildings and even building facades (IRS PLR 199933029).

The estate and gift tax counterpart to section 170 is section 2055, one of two code sections of the estate tax concerned with donations of interests in real property to charitable organizations.

Section 2055 allows an estate or gift tax deduction for an irrevocable transfer of an interest in real property, such as an easement, to a qualified organization exclusively for conservation purposes. Conservation purposes are defined as:

1. the preservation of land areas for outdoor recreation by or for the education of the general public, including water areas for public boating or fishing and nature or hiking trails open to the public;
2. the protection of a relatively natural habitat of fish, wildlife, plants or similar ecosystem, including habi-

tats for rare, endangered, or threatened species;

3. the preservation of open spaces, including farmland and forest land for the scenic enjoyment of the general public so long as the preservation is pursuant to a government plan or for the significant benefit of the public; or
4. the preservation of a historically important land, such as battlefields, archaeological sites and land within a registered historic district, or a certified historical structure, including properties listed in the National Register.

For these purposes, a qualified organization generally refers to the federal government, any US state or possession including D.C., and any local or municipal governments within the US, so long as the contribution is made for exclusively public purposes. A qualified organization may also refer to certain 501(c)(3) (tax exempt) charities which normally receive substantial support from those same governmental units or the general public.

Under this section, a donor can choose whether to donate property during life or at death. The value of the deduction will be reported on a federal gift tax return (federal form 709) or federal estate tax return (federal form 706).

In contrast, section 2031 is applicable only at death. It provides for a potential exclusion from a decedent's estate of up to \$500,000 for the value of the property contributed. If the executor makes the election, the estate may exclude the lesser of a percentage of the value of the easement reduced by any section 2055 deduction, or the exclusion limitation. For estates of decedents dying in 1998, the exclusion limitation is \$100,000. That amount has increased by \$100,000 each year to \$400,000 currently; next year, it will reach the maximum exclusion value of \$500,000.

EGTRRA offers an additional benefit for purposes of this exclusion: the geographic restrictions on easements have been eliminated. Formerly,

in order to qualify for the exclusion, the land subject to the easement must be in or within 25 miles of an area which is a metropolitan area as defined by the Office of Management and Budget; a national park or wilderness area designated as part of the National Wilderness Preservation System; or in or within 10 miles of an Urban National Forest as designated by the Forest Service. In order to qualify for the deduction, the property must merely be located in the US or any US possession, and be owned by the decedent or a member of the decedent's family at all times during the 3-year period preceding the date of the decedent's death.

The benefits under either section can be significant. As an example, consider a property owner with 10 acres of land, who only utilizes a fraction of the space. The property owner or his family may be unwilling to part with the unused portion of the property because of what might ultimately happen to the property; it could be resold to a developer who could create a field of townhouses in a previously attractive and environmentally important area. However, now that property owner can donate the unused fraction of the property during his lifetime or via will. Depending on the timing, the result is an estate or gift tax deduction and/or exclusion for the value of the donation. In addition, the green space will border the remaining property for perpetuity; this might enhance the remaining property, which could be transferred to family members. A small business or farmer could donate surrounding green space as a "buffer zone" to residential areas, this preserving the character of the area, keeping peace in the neighborhood, and earning a great tax advantage to boot. In this way, this technique can be a great tax planning tool for homeowners, farmers and small business owners.

The uncertainties in the tax code present special planning challenges for the future. However, changes under EGTRRA should continue to make planning for the future an important

consideration for taxpayers. Opportunities for donations of conservation easements can offer tax benefits, enhance property values and provide for the common good. And that's something that we can be certain of.

## Noncompetes in a slower economy

by J. Christopher Erb

In the height of the Internet euphoria, where ideas, even the most cockamamie ideas, could make a fortune, employers began to discover a little tool known as the noncompete. Long known in certain technical and sales oriented industries, noncompetes were often used to keep salesmen from jumping ship to the competition, then calling on the same clients as they had before.

In general, noncompete clauses may be enforced against employees in Pennsylvania (and most other states). That said, due to the public policy against restricting the right of individuals to make a living, an employer seeking to enforce a noncompete must show that the requirements for the noncompete have been met. In order to be enforced, a noncompete must be:

1. ancillary to employment;
2. supported by adequate consideration;
3. reasonably necessary to protect the employer; and
4. reasonable in scope and duration

The "ancillary to employment" requirement means that the agreement must have been made at the time employment was entered into, generally speaking.

A noncompete is generally supported by consideration if it was made prior to the begin of employment as part of an employment agreement or if it was made after employment began in exchange for additional compensation or a promotion. The continuance of an employment relationship is not sufficient consideration for a noncompete

absent some additional compensation or other favorable change of status.

The last two requirements depend on the particular employee and employer, and must be reviewed on a case by case basis. For example, it may be reasonable for a company to restrict the right of a sales person to sell for its immediate competitors, in light of the contacts the sales person has made with clients who already require those services. Similarly, it may be reasonable to protect those rights within the salesperson's previous sales territory with the company for a period of one year, but not across the entire country. In contrast, in Internet-based industries, courts have shown a willingness to enforce a nationwide or even worldwide noncompete.

As noted above, the noncompete has become almost standard, even in industries that never had (or needed) them before. With more noncompetes comes pressure to break them. Already, employees who are fired for incompetence may not be subject to noncompetes, on the theory that if they are so bad at their job that you had to fire them it won't hurt you for them to work for someone else. With increasing unemployment, it will be interesting to see how many of these noncompetes are enforced, and how creative courts and lawyers will be in getting around them.

### Talk about making sure your affairs are in order!

by Kelly Phillips Erb

At the center of Hong Kong's most sensational probate court battle is a question regarding a will purportedly written by the husband of Asia's richest woman, Nina Wang. Nina says the will was penned and signed by her husband, Teddy, in March 1990, a month before he was kidnapped and never seen again. Teddy was declared legally dead in September 1999.

The will named Nina as sole executor and beneficiary of his entire estate, including Hong Kong's largest private property developer. The estate brings Nina's fortune to \$3.7 billion, as estimated by Forbes magazine.

The validity of the will is being challenged by Teddy's father, Wang Din-shin. He wants the court to recognize a March 1968 will in which Teddy made him the sole executor and beneficiary. Wang Din-shin told a Hong Kong court that Teddy cut Nina out of his 1968 will after private detectives found out she was having an affair with a warehouse manager earlier that year.

The probate court hopes to wrap things up by October. Stay tuned!

### Setting up shop in the US

by Lorenzo Bacciardi

Are you a European corporation ("EU corporation") seeking to enter the US market? Do you want to establish a US subsidiary to manufacture and market in the US? What are your choices? One option is to directly establish a subsidiary in one of the fifty states. If this is your choice, consider the following:

1. *Choice of entity.* A C-corporation ("corporation") may be advisable because it provides deferral and control as to when taxes become due, as well as more firmly established liability protection.

2. *Where to incorporate.* The incorporation of the US subsidiary in Delaware has long been considered advantageous because of the favorable corporate legislation, the specialized corporate court system, the well established body of corporate judicial precedents, and the predictability of the resolution of possible disputes. In many cases, however, other state's laws have been changed to make them competitive with Delaware, or even better, particularly if you will be basing your operations in those states.
3. *Capitalization of the US subsidiary.* A mix of debt and equity may be advisable since it results in a better economic and tax result; the interest deduction can be used to offset the US subsidiary's income.

At the end of the first year, the newly formed US subsidiary, after having paid US corporate tax, will pay dividends and interest to the EU corporation. The international tax treaty for the avoidance of double taxation between the EU member State and the US applies reduced withholding taxes on the payment of dividends and interest. While the withholding on dividends is usually never lower than 5%, the withholding on interest may sometimes be zero.

Once dividends and interest are received by the EU corporation, the computation of tax liability in the EU member state may result in a second taxation. This additional taxation is usually eliminated with the foreign tax

**Do you know what the 18th Amendment to the Constitution is? Can you define res judicata? What does AMT stand for? (if you don't know this your haven't been reading carefully!) How many justices sit on the Supreme Court?**

Is there a law-related question you've always wanted to know the answer to? Send your questions via fax (215.508.4428), E-mail (erblaw@erblaw.com) or post (The Erb Law Firm, PC, 5235 Ridge Avenue, First Floor, Philadelphia, PA 19128) to our office. Please include your name and contact information.

We will select one question to appear in the next edition of the newsletter.

credit system or with an exemption system provided by the EU member State. The tax credit system grants a credit for taxes paid abroad creditable to the EU corporation's tax liability. The exemption instead, by definition, exempts the foreign income received by the EU corporation from a second taxation.

A tax issue may arise when the international tax treaty applies high withholdings on dividends and interest without providing a credit or exemption system. These issues can often be resolved by creating a holding company between the EU corporation and the US subsidiary. The holding company is a company which holds stocks of related corporations belonging to the same owner. The holding company may also provide services to the corporations.

You can establish a fully owned holding company in another country which in turn forms the US subsidiary, as opposed to the EU corporation establishing the US subsidiary. The use of a holding company provides tax advantages so long as the holding company has a *legitimate business purpose*, such as research and development, ownership of technology, licensing of technology, market analysis, cash management, or development of business relations with foreign customers on behalf of the US subsidiary.

The corporate taxation of the US subsidiary does not change, so the substantial advantages may follow from

the tax treatment of dividends and interest paid to the holding company. Clearly, it is to your advantage to establish the holding company in a country that provides favorable tax treatment.

Much as US corporations often look to Delaware for favorable tax treatment, in the EU, corporations are increasingly looking to the Netherlands. In fact, the Netherlands-US international tax treaty for the avoidance of double taxation provides for a withholding tax of 5% on dividends and no withholding tax on interest. The dividends and interest are then received, as foreign income, by the holding company. Under the Netherlands law, dividends derived from qualifying shareholders are exempt from Dutch corporate income tax ("participation exemption"), while the Dutch corporate income tax is applied on interest. The income of the holding company is then repatriated, as dividends, to the EU corporation where the EU parent-subsi- diary directive applies.

The parent-subsi- diary directive provides a special tax treatment for distribution of profit made by a qualifying EU subsidiary to its qualifying EU parent ("outbound dividends") or received by a qualifying EU parent from its qualifying EU subsidiary ("inbound dividends"). When outbound dividends are paid, zero withholding tax is applied. When inbound dividends are received, an exemption,

usually of 95% of the dividends received is granted.

The choice of placing a holding company in the Netherlands allows you to obtain substantial tax savings and can result in complete elimination of double taxation. Conversely, sometimes, the direct investment could bear a double taxation for the amount of the withholding on dividends and interest not creditable to, or not exempted from, the EU member State. Besides, this gives you a great excuse to check out tulip season!

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## Changes, comments, questions

Do you want your newsletter faster, better, stronger? Try switching to our e-mail list, which means you'll get our fancy pdf file for easy printing, on-line viewing, and archival. Ok, maybe it's only faster at the moment, but we hope to add links and other fancy features soon.

Yes, I'd like to switch to the e-mail list (pdf file), here's my e-mail address: \_\_\_\_\_

Please add me to the e-mail list (pdf file), here's my e-mail address: \_\_\_\_\_

I prefer snail mail, sign me up (or change my info) for the normal mailing list at following address: \_\_\_\_\_

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