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Perspectives

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QUESTIONS FROM OUR READERS...

Q. I'm a U.S. citizen and a long-time resident of the UK. For UK tax purposes, historically I have paid UK taxes only on income "remitted" to the UK (which would include UK source income). Of course, I have been fully subject to U.S. taxes throughout that period. I am considering paying the UK "remittance based charge" (30,000 sterling). Can I claim a credit against U.S. tax for this charge?

A. Under a recent IRS ruling (2011-19), the somewhat surprising answer is yes, the 30,000 sterling would be eligible for a credit against U.S. taxes. However, the normal U.S. rules for foreign tax credits will still apply, such as only getting a credit for taxes on non-U.S. source income, using U.S. sourcing rules. Multinational employers with U.S. employees in the UK may want to make these employees aware of the recent ruling.

Upcoming Events...

Social Media, the Internet and the Legal Implications for Managing and Hiring Employees
December 12, 2011
Pillsbury's New York office

Recent Publications...

IRS Implements Voluntary Program for Reclassifying Workers

Labor Department Releases Interim Guidance on Electronic Delivery of Fee Disclosures for Participant-Directed Plans

Health Care Reform Update: Employer-Sponsored Group Health Plans Must Provide New Summary of Benefits and Coverage

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HR Issues in Cross-Border Corporate Transactions

by Susan P. Serota

Cross-border transactions involve a number of issues from a human resources perspective that can have both a social and economic impact on the transaction. It is therefore critical for HR to be involved from the very beginning of a transaction. Some issues arise from both the buyer and seller sides; others are a focus for only the buyer or the seller.

At the time a transaction is first discussed, it will be necessary to determine which employees will be affected—especially in a divestiture. For example, the company will need to determine whether there should be a restriction on internal transfers—a "ring fence"—on all employees , only on certain business units, or only in certain countries. From a seller's perspective, the business being sold may require key executives and/or a trained workforce to transfer with the business in order to obtain full value in the purchase price; from a buyer's perspective, only if these key individuals continue with the business may the buyer be willing to purchase the business at the negotiated price. In addition to determining whether and when such a ring fence should be established, it may also be necessary to consult with legal counsel, work councils and other labor representatives to determine whether it is permissible to restrict employees' transfer rights in each jurisdiction involved or will it be problematic—as it is in much of the European Community for example. Finally, it may be necessary to institute a retention bonus arrangement to keep employees through the closing of the transaction and, in certain cases, for a continuing period.

When negotiating a multi-jurisdictional transaction, it is important to determine when is the earliest possible closing date in each country (based on legal and other transition issues) in order for the seller to prepare for the transfer or termination of the affected employees and for the buyer to have payroll, pension and other benefits in place immediately after the closing. In some transactions it may also be necessary for the buyer to create a local entity employer, which may require governmental approvals resulting in unforeseen delays. Other negotiation issues include: whether transition services will be needed; will employees lose benefits because of the transaction; how will pension plan obligations be transitioned; who will pay severance and other liabilities; will the buyer assume unfunded deferred compensation arrangements; and who will be responsible for liabilities to retirees and former employees of the business?

Often overlooked, especially by U.S. buyers, is the country-by-country implementation of the EU Acquired Rights Directive ("ARD"), which applies in asset transactions and, in general, substitutes the buyer as the employer and continues existing compensation and benefit arrangements. However, the ARD does not require pension liabilities to be automatically transferred. But note that some EU countries do require the assumption of pension liabilities. For example, in Germany a buyer is required by statute to assume pension past-service liabilities attributable to employees who transfer to the buyer. However, there is no parallel required transfer of assets – which then must be bargained for.

In an asset transaction, both buyers and sellers should focus on notice and consent requirements relating to the transfer of employees. The United States is the only country with "employment at will" providing U.S. employers great flexibility in determining their workforce. In many countries, either by statute or by contract, employers may be unable to reduce the workforce unilaterally without negotiating with a works council, a trade organization, the governmental labor administrator or agency, or the employee. In countries such as Taiwan and many South American countries, there are statutory and contractual severance payments required to be paid to transferring employees. In China and Japan, the employee's consent to transfer is required. Thus, tri-party agreements should be considered between the buyer, the seller and the employee to provide for employee agreement to the transfer, what compensation and benefits will be provided by the buyer, and whether severance, if any, will be paid or waived.

HR Issues in Cross-Border Corporate Transactions (continued)

HR issues in cross-border transactions will arise in each country where there are employees of the target business. Because of differing social, cultural and legal climates, headquarters HR will need to consult early with local HR regarding whether the terms and conditions of employment will be the same, substantially similar in the aggregate, or will change after closing. One of HR's key responsibilities is communicating with employees and their representatives before, during and after the transaction regarding the effect of the transaction on their employment, compensation and benefits. Being involved early in the planning of a cross-border transaction will ultimately save costs and make a more effective transition.

Susan P. Serota is a partner in the New York office. She can be reached at 212.858.1125 or susan.serota@pillsburylaw.com.

Social Security in an International Context

by James P. Klein

The U.S. program for social security has been much in the news lately, with characterizations that are both favorable and unfavorable. No matter how it is described, it remains an important program in the U.S., and it also has a significant role for persons working in an international context. Following is a discussion describing how U.S. social security operates for multinational employers and employees, and how it currently coordinates with other countries' social security systems.

The Jurisdictional Basis of U.S. Social Security

Under the domestic law of the U.S. (that is, the law applicable under U.S. statutes and regulations, without regard to treaty overrides) employers are obligated to pay FICA and Medicare taxes ("Social Security tax") for all employees working in the geographic U.S. Of course, employees are obligated to pay a matching Social Security tax (in a break from the historical 50/50 approach to this tax, employees in 2011 had to pay only 4.2%, as opposed to employers' 6.2%). Social Security tax will apply for services in the U.S., even if the employer is not a U.S. entity, and even if the employee is not a U.S. person. So under the domestic law of the U.S., a Brazilian national working in the U.S. for a branch of a Hong Kong company will be in U.S. social security, and the employer and employee tax will apply. In determining who is the "employer", the U.S./IRS tests of employment apply.

For services performed outside the U.S., the domestic law of the U.S. also requires that U.S. social security will apply for a "U.S. person" (U.S. citizen or green-card holder) employed by an "American Employer" (U.S. corporations, also certain partnerships and trusts). So a U.S. citizen working for a foreign branch of a U.S. company will be covered by U.S. social security. An American employer can also elect a special status for a foreign subsidiary (called a "3121(l) election"), but this is not popular since such an election will apply to all U.S. persons employed by the foreign subsidiary, will require the employer to pay both employer and employee taxes, and is irrevocable. Thus, if the U.S. person is employed outside the U.S. by a foreign subsidiary, U.S. social security will not apply (absent that special election). There is no "voluntary" coverage by U.S. social security; either it applies or it doesn't apply.

In addition to the domestic law of the U.S., there are important treaty provisions.

Social Security Totalization Agreements

In 1977 Congress authorized the U.S. to enter into treaty arrangements with other countries in connection with social security coverage *and* benefits. In regard to benefits, the statue (section 233) permits the U.S. president to enter into agreements "totalizing" benefits under U.S. social security. This basically means that two countries can agree on a system whereby the benefits are paid on a proportionate basis from each system, as if all service were in one of the systems, but then with each system paying a proportional benefit. This is a good thing for beneficiaries, in that it will usually increase the social security benefits payable from the U.S. system and the foreign system. Since 1977, the U.S. has entered into totalization agreements with 24 countries. This "totalization" approach does not apply for countries that have not entered into a totalization agreement with the U.S.

However, the legislation also provides that "coverage" (which system collects the taxes) will be sorted out such that there will be "a period of coverage under the [U.S. system] or under [the foreign system] *but not under both* [emphasis added]." If you look at the Social Security Administration website ("SSA Website"), it will explain that totalization agreements "eliminate dual Social Security taxation, the situation that occurs when a worker from one country works in another country

and *is required* to pay social security taxes to both countries on the same earnings [emphasis added].” This is an important concept: for the treaties to apply to employer and employee taxes, it should start with duplicative coverage. If no duplicative coverage, then there should be no treaty application to taxes (but see the discussion on France below). So when a U.S. person is sent on assignment outside the U.S. to a treaty partner country, the first step is to determine if there is duplicative coverage. If not (for example, where the person works for an employer who is not an American employer), then the treaty shouldn’t apply to taxable coverage (but as a practical matter that isn’t always the case; see below). As the SSA Website states “the agreements, moreover, do not change the basic coverage provisions of the participating countries’ Social Security laws—such as those that define covered earnings or work. *They simply exempt workers from coverage under the system of one country or the other when their work would otherwise be covered under both systems* [emphasis added].”

It should be pointed out that as an administrative practice, many U.S. companies file for totalization treatment without looking closely at whether the U.S. system actually covers the individual working outside the U.S.; they will treat the individual as “seconded” (a term without meaning in the U.S.) and somehow employed by the U.S. company for social security purposes, and employed by the non-U.S. affiliate for corporate tax, corporate law (permanent establishment) and immigration purposes. Like many areas of international taxation, this area historically has had loose compliance but we probably can look forward to more strict compliance in the future.

Income Taxation of Social Security Benefits

Over the years, U.S. social security benefits subject to U.S. income tax has grown from zero to 50% to 85% (for higher-income recipients). The general rule under U.S. domestic tax law (again, ignoring treaties) is that non-U.S. social security benefits are fully taxable (less any basis the taxpayer may have). However, there are issues as to what is social security from other countries, and in addition there are income tax treaty overrides for many countries.

The general income tax treaty position is that only the country providing the social security can tax it. While the U.S. has income tax treaties with many countries, a number of important trading partners do not have income tax treaties with the U.S. (e.g., Brazil, Hong Kong).

Comparison of Social Security Tax Rates and Benefits, and Selected Totalization and Income Tax Treaty Provisions

The following is a very brief discussion of the social security benefits and treaty provisions for a few important trading partners, each of which has an interesting, distinctive aspect.

Australia: Historically, Australia had a strong private, funded defined benefit system, called “superannuation.” At one time in the past the benefits were largely (95%) tax exempt to the employee. In 1992 the system became compulsory for all employers, with a choice to be either defined benefit or defined contribution. In a few years, the bulk of Australian superannuation will become funded, defined contribution plans. As part of retirement policy, Australia also has “social security” but it is a fully means tested system, something like “welfare” to U.S. eyes. In a surprise move, the U.S. agreed in 2002 to a social security totalization treaty with Australia in regard to the private, funded superannuation system (but not the means tested social security system). Does that mean that the U.S. income tax treaty applies to superannuation as if it were social security? Apparently not. The IRS seems to think the totalization characterization is irrelevant for income tax purposes. That means the vested, funded retirement benefits are taxable in advance of payment, with no income tax treaty relief. The Australian mandatory employer contribution rate is 9%, although there can be voluntary supplemental contributions. In terms of benefits, like any defined contribution plan that will depend upon the amount of contributions and the earnings rate.

Social Security in an International Context (continued)

China: In 2011 China promulgated its first comprehensive social insurance law. Social security coverage is mandatory for employees of companies operating in the PRC. Both employers and employees are required to make contributions (regardless of citizenship), with contribution rates determined at the provincial or municipal level. There is no totalization agreement between the U.S. and China, but under the U.S.-China income tax treaty, social security benefits are only taxable by the country providing them.

France: The French social security system is complex, comprehensive and expensive. Contribution rates are extremely complex, but for salaried employees, the employee contribution rate is around 25% and the employer's 45%. Benefits are about 50% of pay. The U.S.-France totalization agreement is one of the few that (notwithstanding the U.S. statute) actually grants coverage under the treaty where it would not exist under U.S. domestic law. This is the result of the unusual provision that deems an employee's service to be treated "as if he were employed in its territory" when a person is sent on assignment from that territory to the other country. So, for example, if a French citizen is hired by a French employer in the U.S., the employee is in U.S. social security under the U.S. domestic system (there is no treaty override to this situation). But if that French company then directs that French national to go from the U.S. to France, the treaty permits the employer to treat the service "as if" rendered in the U.S. (for up to five years) and subject to U.S. social security tax. This will eliminate French social security tax. Under the U.S.-France income tax treaty, generally the country paying the social security benefit taxes the benefits.

United Kingdom: The UK has a system somewhat like the U.S., although more complicated. The UK system is called "National Insurance." Employee contributions are given a modified cap, and are about 12% of compensation. Employer contributions are 12.8% and are essentially not capped. Benefits are modest (on an EU basis) and along the lines of the U.S. programs's, with a very complicated formula. There is a totalization treaty, which is technically only applicable for individuals in both the U.S. and UK systems. For example, a U.S. citizen transferred to the UK to work for a branch of the U.S. company will be in U.S. social security. If the assignment is expected to be for less than five years, the U.S. company will get a "certificate of coverage" in the U.S. system, which will permit the UK operation to keep the U.S. citizen out of UK national insurance (social security). By contrast, the transfer from the U.S. to employment with a UK subsidiary in the UK will not continue U.S. social security, so the UK can apply its social security tax. As noted above, this is often ignored for "seconded" employees. The UK is the source of this "seconded" concept, and leads to considerable confusion when compared with the U.S. employment concept. In any event, when a certificate of coverage is issued by one country, the individual need not pay Social Security/national insurance taxes to the other.

James P. Klein is counsel in the New York office. He can be reached at 212.858.1447 or james.klein@pillsburylaw.com.

Employee Data Privacy—An Overview of Employer Responsibilities

by Scott E. Landau and Bradley A. Benedict

Employers collect a substantial amount of personal information about their employees. Companies need to be aware of their obligations under the profusion of data protection laws and regulations that govern the collection, use and transfer of personal information. This is an especially daunting task for companies that have operations subject to the laws of multiple jurisdictions, as requirements vary widely from country to country and even from state to state. This Advisory summarizes some basic concepts to consider under current data privacy laws that relate to human resources matters.

Companies use employees' personal information for a variety of purposes—from evaluating applicants during the hiring process to administering payroll and employee benefit plans to managing separation and other post-employment benefits. And as more employers adopt enterprise-level information management systems and outsource certain human resources administration functions, increasing amounts of personal data is being transferred and shared within and between organizations. Maintaining compliance with applicable data privacy laws is a responsibility employers cannot afford to overlook.

Protected Information

As a rule, only personally identifiable information ("Personal Data") is afforded special protection by data privacy laws. This usually includes one or more types of data that identifies or is linked to an identifiable living individual (e.g., name or Social Security Number). In some cases, it includes a combination of such information that could potentially identify an individual (e.g., birth date, gender and postal code taken together). Many (but not all) data privacy laws exempt Personal Data that has been encrypted. Certain types of "Sensitive Data" are often given enhanced protection under comprehensive data protection regimes. Sensitive Data may include, for example, race, ethnicity or national origin, political opinions or associations, union membership, sexual orientation, marital status, health-related information and criminal history. It should be noted that data privacy laws are not restricted to protecting active employee information, so companies' obligations extend to any non-employee groups whose Personal Data they may acquire, such as clients and customers, but also job applicants, consultants, independent contractors and terminated or retired employees.

Data Privacy Laws Around the World

United States. A few U.S. federal statutes protect specific types of Personal Data. The most important of these for employers are the Health Insurance Portability and Accountability Act ("HIPAA"),[1] covering certain health-related information; the Genetic Information Nondiscrimination Act ("GINA"), which applies specifically to genetic information; and the Fair and Accurate Credit Transactions Act ("FACTA"), designed to protect consumer credit information. In addition, most U.S. states have laws concerning data security and security breach notification.[2] Many of these laws are identity-theft protection measures that generally impose an obligation to protect Social Security Numbers and similar Personal Data against unauthorized use or disclosure and require secure destruction of such data. One state has gone a step further: since March 1, 2010, Massachusetts requires most companies to adopt a written security policy that meets certain standards to protect a broad range of Personal Data collected from customers and employees who reside in the state. A compliant plan requires not only security measures, such as encryption of Personal Data stored on portable devices, but also training and oversight of vendors who have access to the data.

Employee Data Privacy—An Overview of Employer Responsibilities (continued)

Although U.S. law is trending toward stricter protection of Personal Data, the laws in other countries are often much more extensive that even the strictest U.S. standards. Many U.S. companies that do business globally will need to go beyond the requirements of U.S. law to facilitate the lawful flow of Personal Data into the U.S. from countries with more restrictive rules, as further discussed below.

European Economic Area. The European Union's data protection Directive 95/46/EC (the "EU Directive") recognizes Personal Data privacy as a fundamental right and establishes a comprehensive scheme to protect such information, as implemented by the enacting legislation of the nations comprising the European Economic Area ("EEA"). These extensive rules cover the collection, processing (including storage) and transfer of Personal Data in any form. Among other things, requirements include the adoption of reasonable security measures, an obligation to notify (and in some cases obtain consent from) individuals about the collection, protection, use and disclosure of their Personal Data, and may include notice filings with local data protection authorities. Because the EU Directive merely sets forth minimum standards, there is considerable variability in the specific restrictions imposed and degree of flexibility allowed under the laws of individual EEA countries.

The EU Directive also generally prohibits transferring Personal Data, without consent of the individual, to countries whose laws do not ensure an "adequate" level of protection, unless the receiving entity agrees to model contractual provisions providing for such protection. U.S. laws are not deemed sufficient in this regard, but the EU and U.S. Department of Commerce created a self-certification safe harbor program whereby U.S. companies can pledge to adhere to seven principles to become eligible to receive Personal Data from EEA nations.[3] These safe harbor principles relate to (1) notification requirements as to Personal Data collected, how it will be used and who will have access, (2) opt-out opportunities for the use of Personal Data and opt-in requirements (i.e., obtaining prior consent) to use Sensitive Data, (3) restrictions on transfers to third parties (e.g., benefit plan administrators) to ensure the third party maintains security measures consistent with the safe harbor principles, (4) taking reasonable security precautions against loss, misuse and unauthorized access, (5) limiting use to necessary or consented-to purposes, (6) allowing individuals to access and correct their Personal Data and (7) implementing an enforcement mechanism meeting certain standards (e.g., submitting to the dispute resolution body of the applicable EEA nation).

Non-EEA Countries. Legislation concerning data protection varies greatly in other countries. Some have comprehensive data protection laws in the manner of the EU Directive, including Argentina, Australia, Canada, China and Japan. Mexico and India also recently enacted broad data privacy legislation. Some countries have laws of limited applicability, focusing on specific types of information or processes, while others have little or no legislation in this area.

Other Considerations

- Employers should consider all legal requirements (whether local, state or provincial or nationwide) that may impact their data privacy policies and procedures. These may include, for example, employee record retention rules, "whistleblower" statutes and restrictions on monitoring or surveillance of employee activities and communications.
- Certain processing or handling of Personal Data, and changes to a company's privacy policies, may require disclosure to and/or consultation with unions or works councils representing affected employees, particularly in the EEA.

Penalties and Compliance. Many data privacy laws explicitly provide affected parties with personal rights of action for statutory violations. Civil fines are also common, and some laws permit criminal prosecution for egregious cases. For example, fines for a HIPAA privacy violation range from $100 to over $50,000 per violation (up to an annual cap as high as $1.5 million) depending on the level of culpability, but offenses committed knowingly can result in criminal prosecution.[4]

Employee Data Privacy—An Overview of Employer Responsibilities (continued)

Further, employers whose employees' identities are stolen due to knowing violations of FACTA may be held responsible for minimum statutory damages of up to $1,000 per employee plus punitive damages and attorney's fees and can be subject to civil fines of up to $2,500 per employee in enforcement actions brought by the Federal Trade Commission and additional amounts from state authorities. The EU Directive grants data subjects a private right of action for data privacy law violations, and local data protection authorities have enforcement powers that include the imposition of fines, which can be severe. Agencies in France, Spain and Germany have levied fines of €1 million or more. In Spain, where enforcement has been particularly aggressive, a recent law change lowered the minimum and maximum penalties for various violations and provides for non-monetary resolution of minor infractions. Criminal penalties also exist in some EEA countries for certain offenses. Outside of the statutory penalties and claims, companies need to be concerned about civil suits for damages and the adverse effects of Personal Data security breaches on public and employee relations.

Minimizing Risk

Data protection laws tend to be complex and, in part because they are relatively new, there is not a great deal of interpretive guidance on compliance matters. Companies seeking to minimize their exposure from legal violations and security breaches involving employee Personal Data should consider adopting data privacy and protection best practices that aim to limit the amount of Personal Data they collect, process, transfer and store; secure Personal Data collected (in all formats in which it is kept); limit access to Personal Data to the extent practicable and provide training to staff who handle Personal Data; ensure third parties receiving Personal Data are subject to and apply appropriate security measures; prepare for security breaches involving Personal Data; maintain accuracy of the Personal Data collected and processed; and monitor compliance with all applicable data protection laws and regulations as well as any safe harbor and contractual requirements adopted by the company.

Endnotes

1. Although employers that do not provide health services are not generally covered by the HIPAA rules, they may nevertheless be subject to the act's restrictions in their capacity as administrators of a health plan.

2. Forty-nine U.S. states and territories have enacted data breach notification laws in some form.

3. Safe harbor certification is also available under Swiss data privacy law, which is similar to the EU Directive.

4. The U.S. Department of Health and Human Services has investigated and resolved thousands of HIPAA data security incidents and complaints, but the agency imposed its first-ever civil monetary penalty for a HIPAA privacy rule violation in February 2011, in the amount of $4.3 million (the majority of which was attributable to the entity's failure to cooperate with the agency's investigation).

Scott E. Landau is a partner in the New York office. He can be reached at 212.858.1598 or scott.landau@pillsburylaw.com.

Bradley A. Benedict is an associate in the New York office. He can be reached at 212.858.1523 or bradley.benedict@pillsburylaw.com.

For more information, please contact:

New York
Susan P. Serota
+1.212.858.1125
susan.serota@pillsburylaw.com

Peter J. Hunt
+1.212.858.1139
peter.hunt@pillsburylaw.com

Scott E. Landau
+1.212.858.1598
scott.landau@pillsburylaw.com

Washington, DC
Howard L. Clemons
+1.703.770.7997
howard.clemons@pillsburylaw.com

San Diego North County
Jan H. Webster
+1.858.509.4012
jan.webster@pillsburylaw.com

San Francisco
Christine L. Richardson
+1.415.983.1826
crichardson@pillsburylaw.com

Silicon Valley
Cindy V. Schlaefer
+1.650.233.4023
cindy.schlaefer@pillsburylaw.com

Editors
Scott E. Landau
John H. Battaglia

Editorial Staff
Bradley A. Benedict
Kathleen D. Bardunias

For mailing list inquiries, please email
executivecomp@pillsburylaw.com

Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | 877.323.4171 | www.pillsburylaw.com

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