

Legal **ALERT**

**Rules for Conducting Employee
Background Checks**

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**A Charitable Remainder Trust
Offers A Wealth of Tax Benefits**



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Rules for Conducting Employee Background Checks

During the hiring process, no doubt you try to verify the information on applicants' résumés to help weed out those who may be dishonest or unqualified. You probably ask references and previous employers about a candidate's competence, productivity and integrity. And you may call professional associations to confirm certifications and state agencies to confirm licenses.

These are basic screening steps for any new hire. Some employers do more extensive credit checks that might involve, for example, searching for criminal convictions, verifying Social Security numbers, ordering credit reports, inspecting motor-vehicle records and workers' compensation files, verifying military service, and interviewing neighbors.

Liability for Negligent Hiring

But before you begin a background check, best you study the rules and then proceed cautiously. Federal and state statutes limit the kinds of information you may seek without an applicant's permission. The same statutes also restrict the ways you can use that information as a basis for rejecting a candidate. Violating these statutes can be just as damaging to your reputation and your bottom line as not conducting background checks at all. So you have to walk a narrow path between checking inadequately and checking too aggressively.

If you contract with an outside agency to conduct background checks, you still must know the law and ensure the agency complies — because in some cases you can be held liable for its negligence.

Federal Statutes

State statutes also may apply, but here are the three most important federal acts you must comply with when you conduct background checks:

1. Fair Credit Reporting Act of 1971,

2. Privacy Act of 1974, and

3. Americans With Disabilities Act of 1990.

You don't have to know everything about these acts. But you should be familiar with these important provisions relating to employee background checks:

Written authorization. You must obtain applicants' written authorization before you request their educational records (including transcripts, recommendations and financial-aid status), credit reports, medical records, or character investigations.

Medical records. Healthcare organizations can release medical records only if they relate to the employee's ability to perform specific job duties. But ask us to check HIPAA requirements.

School records. Some schools and colleges will release educational records only to a student or former student — not to an employer.

Military records. U.S. military branches may disclose a member's name, rank, salary, duty assignments, awards and duty status to an employer without the member's consent. But you usually need an applicant's consent to seek any other information — including disciplinary actions or character references.

Criminal records. State laws vary in allowing disclosure of information about criminal convictions. Most states require you to either notify an applicant or get his or her permission to conduct the search. Records of arrests that didn't result in conviction are generally not available to employers, unless an arrest relates to 1) job performance, or 2) related convictions or both. For employees who earn less than \$75,000 annually, the government may not disclose criminal convictions or arrests older than seven years, and a private investigation agency that uncovers that information may not disclose it to an employer.



Other Requirements

Print each authorization form on a sheet separate from the employment application, and ask us for correct wording. In most cases, if applicants request, you must give them copies of any credit reports and character reports that you obtain from third parties. You must carefully word requests to a consumer-reporting agency or credit bureau for information about an employee or candidate.

You may not investigate job applicants randomly or based solely on whether they “seem suspicious.” Doing so may appear discriminatory. The best policy is to consistently check all applicants for some positions — based on salary levels, job duties or other nonarbitrary criteria.


Rejections

Let’s look at what the statutes say about rejecting a candidate based on background information you uncover. If you take “adverse employment action” — that is, reject a candidate or fire an employee — based on a credit report or background check by a consumer-reporting agency, you must:

- ➔ Notify the subject in writing of the reasons for your action,
- ➔ Give the subject copies of the background information you obtained and the outside agency’s name and address that conducted the background check,
- ➔ Inform the subject that the outside agency played no role in making the decision and can’t provide specific reasons for the action, and
- ➔ Not base an adverse employment action solely on a candidate’s criminal record, bankruptcy, disability or workers’ compensation history unless it relates to the candidate’s ability to adequately perform specific job duties.

We can advise you on these requirements.

Protect Yourself

Screening and investigating new employees isn’t as simple as it used to be. But learning and abiding by the rules will help protect your business from allegations of negligent hiring, as well as from unqualified and disruptive employees. We’ll be glad to provide more guidance on complying with the law. 

Are You Liable for Your Contractors' and Distributors' Hiring Mistakes?

Sometimes, and for some kinds of positions — such as those involving entering customers’ homes, security work, childcare, or processing confidential information — you should go beyond basic screening steps and conduct deeper background checks even in the case of independent contractors.

In fact, sometimes you are legally bound to dig deeper into a new employee’s background. If you don’t, you could be held liable for negligence if your new hire commits a crime, causes damage or hurts somebody while on the job.

Here’s a case in point:

The Kirby Company makes vacuum cleaners and markets them through independent distributors. Kirby requires them to sell the product *only* door to door. The distributors in turn hire their own salespeople and call them “independent contractors.”

After trying to sell a Kirby vacuum cleaner to a housewife, a salesman raped her in her Texas home in 1993. If the distributor had conducted a background check on the salesman when it hired him, it probably would have learned that he had previously received “deferred adjudication” in court for sexual misconduct.

The manufacturer didn’t directly hire the salesman. But should it nevertheless be held responsible for his misconduct? The rape victim thought so, and filed civil charges against Kirby for its distributor’s negligence. The victim argued that Kirby should have required the distributor to conduct background checks before hiring salespeople, because Kirby required in-home demonstrations as its distribution method and that method created significant risks to potential customers.

A civil court jury agreed with the victim and awarded her \$160,000 in actual damages. The Texas Supreme Court upheld the verdict and the damage award.

The lesson: If you hire independent contractors or distributors, 1) require them to conduct background checks on employees who get into potentially risky situations — such as entering customers’ homes; 2) obtain appropriate insurance coverage; and 3) seek an indemnity from distributors and require them to have insurance coverage.

The Civilized Way to Collect Debt

Collecting past-due balances is one of the most agonizing tasks in business. In many large companies, the accounts-receivable department or credit manager handles collections. If your company is small, you might handle collections yourself. But whether your company is big or small or in between, you'll want to collect debts diplomatically and tactfully to preserve your good reputation.

Guidelines

The Fair Debt Collection Practices Act (FDCPA), administered by the FTC, regulates third-party collection activities throughout the country — including collection agencies and law firms that provide collection services. Although the FDCPA doesn't apply to in-house collections, the act provides a set of prudent guidelines. Here are the most important FDCPA-established rules:

- ↪ Contact debtors by mail (but not by postcard), telegram, e-mail or fax at any time, but by phone only between 8:00 a.m. and 9:00 p.m.



- ↪ Contact debtors at a reasonable place — such as at home — unless they authorize you to call at work.
- ↪ Disclose your true identity. Don't misrepresent yourself as an agent of the government or a credit bureau. Never use a false name. In fact, don't lie in any respect.
- ↪ Don't threaten debtors with jail if they don't pay. Don't imply that they have committed a crime. But if a debtor's check bounces, you may contact authorities because that may be a criminal offense under state law.
- ↪ Don't reveal information about a debt to anyone else — except a debtor's attorney. If a debtor has moved, you may contact third parties to "trace" the debtor's new address and phone number, but don't discuss the debt itself with outsiders.
- ↪ Avoid profanity, threats of violence or other verbal abuse.
- ↪ Don't threaten to take further legal action — such as filing a lawsuit — unless you intend to and it is legal to do so.
- ↪ If a debtor owes you for more than one transaction, and sends you a payment for a particular transaction, apply the payment to that transaction.

Other rules apply, and we can advise you on them.

Judgment and Enforcement

If your collection efforts are unsuccessful, you'll need to consider filing a lawsuit in state court. If a debtor lives in or operates a business in another state, you may have to file in that state. State law typically allows you to file suit either where the defendant resides or where the transactions arose.

In a legal action, sometimes the easiest part is convincing a judge that a debtor owes you money. Often more difficult is actually collecting a debt when a court rules in your favor. If a debtor still fails to pay after being ordered by a court, we can ask the court for further relief, including:

Information subpoenas and discovery orders that require debtors to disclose their identities, location and

Dealing With an Insolvent Debtor

Trying to collect a debt from a thriving business can be difficult enough. But financially distressed or insolvent debtors present a completely different ball game. In a slow economy, you may encounter more of these situations than usual.

If you believe that a debtor is in financial difficulty — and you think the business is likely to recover — you'll probably want to preserve the business relationship. In that case, you may wish to negotiate more liberal credit terms, including giving you a security interest in the debtor's assets. You'll have to decide, based on the risks involved, whether to continue shipping goods or providing services to the debtor during this period.

If a distressed company files for bankruptcy, you'll have to get in line with other unsecured creditors to try to collect what you're owed. Exercising lien rights — if you have them — can convert your status from unsecured creditor to secured creditor. You may want to continue doing business with a company in Chapter 11 reorganization under new credit terms — such as cash on delivery — depending on prospects for a long-term relationship with the company. But keep in mind that most Chapter 11 bankruptcies fail. Please consult us for advice on dealing with debtors in bankruptcy proceedings.

status of bank accounts, personal property, employers, income and other assets.

Attachment that compels law enforcement officers to seize and sell a debtor's property or other assets to satisfy a debt.

Replevin that compels law enforcement officers to recover and return to you goods you sold to a debtor that the debtor hasn't paid you for.

Distraint that allows a landlord to seize property — such as furniture or appliances — of tenants who haven't paid rent.

Levy that compels a police officer to take possession of and hold a debtor's property until a debt is paid.



In a legal action, sometimes the easiest part is convincing a judge that a debtor owes you money.

Garnishment that requires a debtor's employer to pay salary — or a portion of it — to you to satisfy a debt.

Receivership that designates a third party to sell a debtor's seized property to satisfy a debt.

Lien that attaches an ownership interest in a debtor's property in your behalf. If the debtor sells that property, you can share in the proceeds. But beware: Filing erroneous liens can lead to civil or criminal sanctions against you.

These are often complex legal proceedings and require professional legal assistance.

State by State

Each state has statutes governing the relationship between creditors and debtors. Become familiar with yours, as well as the FDCA (online at www.ftc.gov/os/statutes/fdcpa/fdcpact.htm), before you take aggressive collection action. Aside from laws and rules concerning collection activities, you should proceed professionally to preserve your reputation and business relationships. And call us for information. 📖

A Charitable Remainder Trust Offers a Wealth of Tax Benefits

Let's see how financially savvy you are. What's better than donating money to your favorite charity, deducting the amount donated from your current-year income and reducing the size of your taxable estate by that amount?

For many people, what's better is donating money to a charitable remainder trust (CRT), deducting some of the amount donated from current-year income, reducing your taxable estate by the donated amount, and earning income on that amount every year until death (or until the CRT terminates). At that point — your death or trust termination — the trust's remaining assets go to your favorite charity.

But that's not all. If you fund your CRT with assets that have appreciated in value, you (or your trustee) can

sell the assets without incurring capital gains tax — and then reinvest the proceeds in income-producing assets.

CRT Mechanics

To create a CRT, you simply donate assets to an irrevocable trust, name a charity as the remainder beneficiary, and name yourself or your spouse as the income beneficiary. Although the trust is irrevocable, the law allows you to draft the trust so that you may change charitable beneficiaries whenever you wish. The CRT trustee — which could be you — chooses the beneficiary and is responsible for investing trust assets.

You can structure the trust so that either a fixed percentage of the assets or a fixed dollar amount will be distributed to the income beneficiary each year. The IRS has established minimum and maximum annual distribution amounts. (See “Maximum and Minimum CRT Distributions” on page 7.)

The rules regarding distribution taxation are quite complex. Contributing factors include amount and composition of trust earnings and the composition of assets initially transferred to the trust.

Two additional considerations regarding taxation of CRT distributions:

1. You can draft a CRT to allow the trustee to defer distributions.
2. Distributions aren't guaranteed, and exhaustion of CRT assets will end distributions and leave nothing to be distributed to the charity.

You can specify that the CRT will terminate on your death or after a specified number of years — known as the term limit.

Calculating the Deduction

When you contribute assets to a CRT, you can take a same-year tax deduction. Calculating the exact deduction is tricky, because it's based on the present value of the



assets projected to be passed along to the charity when the trust terminates.

If you specify a fixed number of years as the term limit, present value is fairly easy to project using an IRS-determined discount rate. For a lifetime trust, your tax advisor will estimate present value using actuarial tables.

Trust Combinations

CRTs work well in tandem with some other kinds of trusts. For example, you can provide for your children's inheritance by creating a "wealth replacement trust."

Here's how it works: With the income that you receive from your CRT, you buy life insurance and place the insurance policy in an irrevocable life insurance trust (ILIT). On your death, the ILIT proceeds pass to your designated beneficiary estate-tax free.

Here's another way to combine the advantages of a CRT with another kind of trust. If you have a disabled child, you can create a special-needs trust to ensure that your child is financially secure after your own disability or death. A special-needs trust (also called a support trust) provides annual funds to care for a disabled beneficiary throughout his or her lifetime. After setting up the special-needs trust, name it as the CRT's income beneficiary. The CRT will not terminate until both you and your disabled child die.



Choose Wisely

If you would like to donate large sums of money to one or more charitable organizations, choosing the proper strategy will maximize your tax benefits. The CRT is one way to gain tax benefits, but others may also fit your needs. We can help you determine the best tax strategies for making charitable gifts. 📖

Maximum and Minimum CRT Distributions

The amount of the annual cash distribution to a charitable remainder trust's income beneficiary depends on the trust's structure. You may choose from two primary structures: a unitrust or an annuity trust.

A charitable remainder unitrust (CRUT) pays out a fixed percentage — 5% at minimum — of the fair market value of the trust's assets, as determined each year. Thus, as the assets grow (or shrink), so will the distribution. And the law allows you to make additional contributions to a CRUT.

On the other hand, a charitable remainder annuity trust (CRAT) pays out a fixed percentage — again a 5% minimum — of the initial value of trust assets, so that the payout dollars remain constant throughout the trust's life. But, unlike a CRUT, the law doesn't permit additional contributions.

A CRUT is more popular than a CRAT because a CRUT offers some protection against inflation by varying payout with asset value.

The IRS recently set maximum distribution percentages for both types of CRTs. The calculations get fairly complex, so make sure your trustee asks a financial advisor to check the math. Basically, the assets remaining in the trust each year must be at least 10% of their value when you contributed the property to the trust. In other words, the IRS won't let you deplete the assets significantly before they get passed to the charity.

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David J. Sutton

David has been representing clients in business and personal matters for more than 20 years. He is admitted to practice law in New York federal and state courts. He holds a BA magna cum laude from the University of Massachusetts, a JD from Hofstra Law School, and a diploma in Advance Trial Advocacy from the National Institute of Trial Advocacy. David's areas of concentration are commercial litigation, construction law, personal injury law, insurance law, environmental law and white-collar criminal law. David is also the Executive Director of an international trade association.

David A. Blansky (Associate)

David received his Bachelor's Degree in Communications, Legal Institutions, Economics and Government from The American University in Washington, D.C., in 1994 and his Juris doctorate Degree from the Northeastern University School of Law in Boston, Massachusetts in 1997. David has extensive litigation experience having served in the Office of the Nassau County District Attorney for nearly four years where he prosecuted both petty and felony crimes during his distinguished career.

David I. Lieser (Associate)

David received his undergraduate degree in Economics and Political Science *magna cum laude* from Binghamton University in 1993 with membership in Phi Beta Kappa. He received his Juris-doctorate degree from University of Pennsylvania Law School in 1996. David has been associated with corporate and defense firms. He has significant experience in insurance coverage, defense and subrogation litigation in connection with general casualty, fidelity and surety bonds.

Larry J. Bonchonsky (Of Counsel)

Larry completed his undergraduate studies at SUNY Albany in 1976. He graduated from the Columbus School of Law at The Catholic University of America, Washington D.C. in 1979 and is admitted to practice in New York and Washington D.C. Larry is a seasoned medical malpractice and personal injury trial attorney in high profile litigation. He has successfully tried numerous multi-million dollar cases in city and suburban venues for some of New York's most prestigious firms.

David S. Feather (Of Counsel)

David graduated from SUNY Binghamton in 1990 and Hofstra Law School in 1993. His goal is to encourage business clients to undertake a course of preventative planning to minimize exposure to future litigation. He was co-editor of *Employment Discrimination Law*, Third Edition, and has lectured before various legal organizations and the general public regarding discrimination in the workplace, sexual harassment and age discrimination.

Daniel J. Osojnak (Of Counsel)

Dan received his Bachelor's Degree in Accounting from Queens College in 1983 and received his Juris-doctorate degree with Distinction from Hofstra University School of Law in 1986. He graduated in the top 5% of his law school class. He was an Associate Editor of the *Hofstra Law Review*. Dan has extensive experience in negotiating business and real estate sales.

Our Firm Commitment to All Clients

1. You will be treated with courtesy and consideration at all times by our lawyers and staff.
2. You will have an attorney capable of handling your legal matter competently and diligently, in accordance with the highest standards of the profession.
3. You will have your lawyer's independent professional judgment and undivided loyalty uncompromised by conflicts of interest.
4. You will be charged a reasonable fee, and your lawyer will explain at the outset how the fee will be computed and billed. You will receive written itemized bills at reasonable intervals.
5. You will have your calls returned and your questions and concerns addressed promptly.
6. You will be kept informed of the status of your matter and be able to request and receive copies of related papers so you can participate meaningfully in the development of your matter.
7. You will have your legitimate objectives respected by your attorney, including whether or not to settle your matter.
8. You have the right to privacy in your dealings with your lawyer and to have your secrets and confidences preserved.
9. Your attorney will conduct himself or herself ethically in accordance with the Code of Professional Responsibility.
10. You may not be refused representation on the basis of race, creed, color, religion, sex, sexual orientation, age, national origin or disability.

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Our first responsibility is to our clients, their businesses and families. Our advice and work must always be of the highest quality. Our work must be promptly, professionally and cost-effectively preformed.

Our second responsibility is to those who work with us. They must have a sense of security in their jobs. Working conditions must be safe, orderly and conducive to working at the highest level of efficiency and professionalism. Our staff must be qualified, dedicated and fair-minded. Our attorneys must be trustworthy persons of talent, education, experience, compassion and common sense. There must be opportunity for advancement for those qualified.

Our third responsibility is to the communities in which we live. We must participate in the promotion of civic improvement and acquaint the community with our activities. We must be responsible citizens by supporting good works and charity and bearing our fair share of taxes.

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