

# EQBL LEGAL REPORT

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## Business owners find simplicity, advantages in LLCs

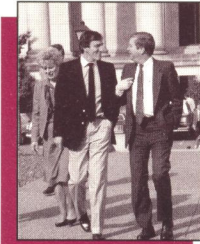
by GARY R. GEHLBACH

Not that long ago, starting, purchasing or continuing a business was simple. The owner or owners could organize the business as a proprietorship, partnership or corporation. Today, however, the number of choices is considerably greater. Owners now can choose among:

- proprietorships;
- joint ventures;
- trusts;
- C corporations;
- S corporations;
- general partnerships;
- limited partnerships;
- family limited partnerships;
- limited liability partnerships; and
- limited liability companies.

Of the newer business forms, one of the most popular is the limited liability company (LLC), which the Illinois General Assembly authorized in 1994. A hybrid between a corporation and a partnership, the LLC combines the most attractive features of both.

Like corporations, LLCs afford the owners, who are called members, insulation from liability. The liabilities of the LLC therefore generally do not extend to the individual members' assets, even if the assets of the LLC are insufficient to cover its debts. This is not the case with proprietorships and general partnerships.



For income tax purposes, the LLC is similar to an S corporation but generally simpler. If the LLC has more than one member, it is taxed as a partnership unless the members choose for it to be taxed as a corporation. If the LLC has only one member, which Illinois law has allowed since 1998, it is a "disregarded entity" for income tax purposes. For those who value simplicity, this may be ideal, as no business income tax returns are required to be filed. Instead, the business's taxable income and deductions are reported on the member's personal income tax return.

Operating an LLC is also simple. An LLC can be operated either by its member(s) or by a hired manager. The members of an LLC, in fact, need not even be persons; rather, they may be corporations, partnerships, estates, trusts or even other LLCs.

LLCs continued on page 2

### Inside

Tax-deferred exchanges .....	2
Protecting non-marital property .....	3
Amendment to Home Repair and Remodeling Act ..	3
Responsibilities under Smoke Detector Act .....	4
In Print & At the Podium .....	4
Deals & Decisions .....	4

## Employers need not be Scrooges to protect themselves from holiday party liabilities

by DOUGLAS E. LEE

As the holiday season approaches, employers frequently worry about whether they can be liable for injuries caused by an employee or guest who becomes intoxicated at a business-related function. While Illinois law offers employers considerable protection from such claims, employers can obtain additional protection by following relatively simple guidelines.

Illinois law is clear that a person or entity that serves alcohol at a social or business event cannot be liable to third persons who are injured by employees or guests who become intoxicated at that event. While other states have recognized such "social host" liability, Illinois courts have refused to do so, saying that any such change in the law must come from the General Assembly. To date, the Illinois legislature has imposed social host liability only against persons who pay for a "hotel or motel room or facility" knowing that the room or facility will be used for underage drinking.

Holiday parties continued on page 3

# Tax-deferred exchanges can assist buyers and sellers

by David W. Badger

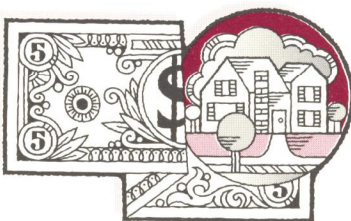
Tax-deferred exchanges under Section 1031 of the Internal Revenue Code are a useful tax-saving technique for buyers and sellers of real estate.

Section 1031 provides that if property held for a productive business use or for investment is exchanged for property of like kind, no gain or loss will be recognized. Instead, the gain is deferred. After the exchange, the replacement property has a tax basis based on the basis of the original property.

For example, assume a person owns farm property that has a tax basis of \$100,000 and a value of \$400,000. The owner desires to buy a new farm costing \$500,000. If the owner sells his or her property and receives cash proceeds, he or she will have a taxable gain of \$300,000 and accordingly will pay income taxes (\$69,000 if the owner has a 20% federal capital gains tax rate and a 3% state tax rate). This tax burden obviously reduces the amount the owner has to reinvest in the new farm. If a Section 1031 exchange is used, however, the owner does not have to pay the tax at the time of the sale. Rather, the tax is deferred until the sale of the new farm. Moreover, if the owner holds the new farm until the date of his or her death, no capital gains tax would have to be paid on the appreciation in value because of the step-up in basis to fair market value that occurs at death.

Originally, Section 1031 required that the exchange had to be simultaneous to qualify for the tax deferral. This meant that an owner wanting to use Section 1031 had to find an owner of replacement property who was willing to accept the owner's property so that the two properties could be exchanged by deed at the same time. This seldom happened, so the practice of using accommodation parties arose to accomplish the simultaneous exchange.

However, it was not always possible to find replacement



property at the time the buyer of the original property had to close on the acquisition of the original property. In the Starker case decided in 1979, a delayed exchange was approved when the replacement property could not be found until after the original property had been sold.

While this case provided guidance in structuring delayed exchanges, attorneys could not always determine if a proposed delayed exchange would qualify for Section 1031 treatment.

To solve this uncertainty, Congress established certain bright-line rules for delayed exchanges. If those rules were carefully followed, a person could, with the assistance of a qualified intermediary who would hold the sale proceeds, sell the original property outright without having to do a simultaneous exchange. The owner had 45 days after the closing of the sale of the original property to identify replacement property. Three possible replacement properties could be identified in the 45-day period, though more could be identified under certain circumstances. The owner then had 180 days from the date of the closing to close on the replacement property.

The Internal Revenue Service would not pre-approve tax-free treatment when the replacement property was acquired before the original property was sold, a reverse tax-deferred exchange. The IRS, however, recently changed its position and established a safe harbor for reverse tax-deferred exchanges.

Under the new procedure, if the property is held in a qualified exchange accommodation arrangement (QEAA), the replacement property can be acquired up to 180 days before the closing on the original property. The procedure also outlines the parameters that will not invalidate a QEAA.

While a QEAA is not appropriate for every transaction, the creation of this safe harbor for reverse tax-deferred exchanges provides additional flexibility in structuring transactions. By using this technique, the replacement property can be acquired before the original property is sold.



## LLCs . . .

Continued from page 1

Limited liability companies can be used in a variety of situations, from restructuring existing businesses, to forming new businesses, to acquiring on-going businesses, to taking over a farming operation after the parents' deaths. Limited liability companies also can be used in estate planning, such as to serve as a general partner in a family limited partnership.

Forming an LLC is often relatively easy, especially for a single-member LLC. In today's litigious world it is hard to justify operating a business as a proprietorship or general partnership, exposing the owner(s) to unknown and potentially crippling liability. In many cases, the LLC might be the most suitable, easily adaptable business structure available.



## Difference between marital, non-marital assets affects gifts

by Rolfe EHRMANN

A father wants his only son to inherit the family farm but is concerned that, with the son's shaky marriage, the farm could end up as fodder in a messy divorce. An uncle wants to give his favorite niece his shares in IBM but is afraid a divorce court judge might later award them to his niece's husband. For better or worse, the concerns of this father and uncle are justified.

At a time when the country is debating the extent to which death taxes undermine the passage of small businesses and family farms between generations, those thinking of bequeathing or gifting substantial assets — as well as those hoping to receive them — should consider a divorce's effect on family assets.

Normally, all property acquired during a marriage is marital property subject to division by the court. Under this general rule, all assets a couple acquires during the marriage will be divided between the spouses. An exception to this general rule, however, is that property "acquired by gift, legacy or descent" is considered non-marital property not subject to division. This is a powerful exception because it can result in the primary asset of a married couple, such as an inherited family farm or business, going to only one spouse.

In light of this potentially harsh result, courts often look for opportunities to avoid the exception, even if doing so requires them to disregard the donor's intention. Care therefore must be taken by both the donor

and recipient to ensure that the exception continues to apply. To accomplish this, the gift or legacy first must be given clearly to the recipient rather than to the couple. Documentation as simple as a letter evidencing the donor's intent likely is sufficient to prove the property is non-marital. Second, the recipient must continue to treat the property as non-marital. A recipient who places inherited land in joint tenancy with a spouse or who deposits a cash gift into a joint account could unwittingly be turning non-marital property into marital property.

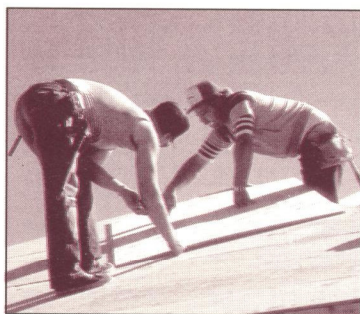
Ultimately, it is best not to try to out-guess the law but to seek the advice of an attorney who can guide donors and recipients away from unintended consequences.



## Amendment gives home repairers more time to get insurance

by MEGAN G. HEEG

As reported in the last issue of the *Egbl Legal Report*, Illinois recently enacted the Home Repair and Remodeling Act, which imposes various requirements on those in the home repair and remodeling business. One of the major requirements is that service providers are obligated to maintain minimum amounts of insurance coverage for public liability, property damage, personal injury and



improper home repair or remodeling.

This Act was amended, effective June 13, 2000, to change the service provider's

insurance requirements. The amendment does not change the type of insurance or amount of coverage required, but the amendment gives service providers additional time — until January 1, 2001 — to obtain the \$10,000 per occurrence public liability and property damage insurance for home repair or remodeling not in conformance with applicable state, county or municipal codes.



## Holiday parties . . .

Continued from page 1

Employers, however, can in some circumstances be liable under the Illinois Workers' Compensation Act for injuries suffered by employees who become intoxicated at business functions. The Act covers such injuries if they arise out of and in the course of the employee's employment. Intoxication-related injuries therefore are covered under the Act if the employee becomes intoxicated during the performance of his or her job duties.

To prevent social events from rising to the level of covered employment activities, employers should

- state clearly that attendance at the event is voluntary;
- hold the event during non-working hours and off company premises;
- avoid business-related activities, such as announcing awards or distributing bonuses; and
- not pay employees for attending the event.

Even if intoxicated employees at a business-related event are not covered under the Act, their behavior at the event can lead to sexual harassment claims. To help guard against such claims, an employer should emphasize that its sexual harassment policy applies during company social events, remind supervisors and managers that office parties are fertile environments for sexual harassment claims and ensure that any "gag" gifts or awards are free of sexual connotations.



# Landlords, tenants must comply with Smoke Detector Act

by MEGAN G. HEEG

Landlords (and others owning "rooms used for human habitation," including single family residences and multiple family residences) are subject to the Illinois Smoke Detector Act.

Under this Act, a landlord must: (a) supply and install operating, approved smoke detectors within the dwelling unit; (b) make reasonable efforts to test and maintain detectors in common areas; (c) provide tenants with written information regarding detector testing and maintenance; and (d) ensure that the detectors are operating when each tenant takes possession.

Tenants must: (a) test and maintain all detectors in the dwelling unit; (b) notify the owner in writing of detector deficiencies the tenants cannot correct; (c) replace the batteries, if applicable; and (d) provide the owner with access to the dwelling unit to correct detector deficiencies.

The Act also sets out requirements as to the type, number and location of smoke detectors. These requirements vary depending upon, among other things, the number of floors and stairways in the building and the number of rooms used for sleeping purposes. Additionally, dwelling units constructed or substantially remodeled after December 31, 1987, must have a smoke detector that, among other things, is permanently wired into the structure's AC power line.

Failure to comply with the Act is a criminal offense. Moreover, courts are imposing civil liability on landlords and tenants who negligently violate the Act. In one Cook County case, for example, a guest injured in a fire recovered \$125,000 from the landlord prior to trial. The trial then proceeded against the tenant, who ultimately was hit with a \$1,000,000 verdict.



## In Print and At the Podium

**Mr. Gehlbach** has been appointed a co-editor of the Illinois State Bar Association's Real Property newsletter, a publication for which he has authored numerous articles on real estate topics over the past 20 years. In June he was honored at the annual meeting of the ISBA in Lake Geneva for having served for 15 years as a newsletter editor . . . The "Justice Talking" radio program featuring a debate between **Mr. Lee** and Mary Ellen Gale, a professor from Whittier Law School in California, was broadcast nationwide over more than 65 radio stations in June. At issue in the debate was the extent to which the First Amendment protects hate speech. The hour-long program can be heard on the Internet at [http://justicetalking.org/season\\_two\\_shows/hate-speech.html](http://justicetalking.org/season_two_shows/hate-speech.html) . . . **Mrs. Heeg** currently is serving as the Campaign Volunteer for the Legal Division of the United Way of

Lee County . . . **Mr. Gehlbach** recently presented an estate planning seminar to approximately 70 state police officers in Rockford and agreed to speak on estate planning at a seminar to be presented by the University of Illinois Extension Service . . . In one of his most recent commentaries for the web site of The Freedom Forum First Amendment Center ([www.freedomforum.org/first/welcome.asp](http://www.freedomforum.org/first/welcome.asp)), **Mr. Lee** wrote about a California case in which officials of the Department of Housing and Urban Development violated the free speech rights of opponents of a housing project . . . **Mr. Lee** recently was quoted extensively in an article in the *Chicago Tribune* concerning a case filed against one of the Firm's clients . . . **Mrs. Heeg** is chairing the Long Range Planning Committee of the Forreton Mutual Insurance Company.



## Deals and Decisions

**Mrs. Heeg**, representing an individual who suffered a severely broken ankle and post-concussion syndrome after falling on ice, successfully resisted the efforts of the defendant, a national company, to dismiss a lawsuit relating to the fall . . . **Mr. Lee** recently obtained the maximum amount of insurance benefits — under both liability and underinsured motorist policies — for a client injured in an automobile accident . . . **Mr. Gehlbach** is serving as counsel in the development of a new truck stop on the south side of Dixon . . . **Mrs. Heeg** successfully completed her representation of a nationally recognized corporation in a

construction case involving the client's warranty . . . **Mr. Lee**, on behalf of a local company, prepared a comprehensive equal employment opportunity and affirmative action program designed to satisfy the requirements Illinois imposes on companies that contract with the state . . . **Mr. Gehlbach** continues to focus much of his practice on estate planning, including the development of family limited partnerships and a special educational assistance trust . . . **Mr. Lee** recently was retained by a New Jersey company to serve as local counsel in litigation pending in Lee County.

