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An Overview of Current Legal Events of Concern and Interest

From the Attorneys of Strauss & Troy, Cincinnati, Ohio, and Northern Kentucky

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New Ohio Real Estate Broker's Lien Law

by Michael A. Ruh

On August 28, 1997, Substitute House Bill Number 158 became effective in Ohio to create new lien rights for real estate brokers on certain commercial real estate. The lien is not available for all situations, but pertains only to services provided by a broker pursuant to a written agreement for the sale, lease, or conveyance of an interest in "commercial real estate." Ohio is the eighth state to enact such a law.

Under this new provision, "commercial real estate" is defined as any real estate in Ohio other than that containing one to four residential units. It does not include single-family residential units such as condominiums, townhouses, manufactured housing, or homes in a subdivision when sold, leased, or otherwise conveyed on a unit-by-unit basis, even though these units may be a part of a larger building or parcel of real estate containing more than four residential units. Certain property owned by a public authority is also excluded.

The written broker agreement must be signed by the broker or the broker's agent, and the owner or owner's agent. Only the broker named in the agreement has the lien (not any employee or independent contractor of such broker). The lien is only for the amount due to the broker *prior* to or upon conveyance; and the lien only attaches to the interest that is the subject of the agreement.

The lien is perfected only after: (1) the event has arisen when the broker is entitled to receipt of the fee under the agreement; and (2) the broker files a lien affidavit. The lien affidavit is recorded in the county where the real estate is located. The affidavit must contain the name of the broker and the owner; a legal description; the lien amount; date and written summary of the agreement; the real estate license number of the broker; a statement that the information above is true and accurate; the signature of the broker (or his agent); and a verification.

In the cases of a sale, the lien must be recorded prior to conveyance. For commissions based on a lease, the lien must be recorded within 30 days after the first rental payment is due. If the owner notifies the broker of the signing date of a lease by certified or registered mail at least 10 days in advance of signing, the lien affidavit must be filed prior to the date of the signing. The broker must serve copies of the lien affidavit on the property owner and the transferee if the transferee is known.

The lien must be enforced by filing a complaint in the applicable Common Pleas Court within one year following the affidavit filing date, and if not, the lien is extinguished. An owner may demand, by written notice (personal delivery or certified mail), that the lien claimant commence suit within 28 days from receipt of such notice, and if that doesn't occur, the lien is extinguished. The act also creates the procedures for recording a release of the lien, and also for closing without the release being recorded (*e.g.*, establishment of an escrow account).

This new lien will give brokers protection not previously available. However, since the lien affidavit must be recorded *prior* to the conveyance, this new lien should not create any unusual problems, but rather should be treated as other perfected liens. In fact, this lien should be less troublesome than most due to the statutory procedure to close a real estate transfer in spite of the lien.

Organizing As a Limited Liability Company

by Marshall K. Dosker

Business owners have gained more flexibility in structuring their businesses since the advent of the limited liability company. A limited liability company, or LLC, is a hybrid between a partnership and a corporation. Every state now allows LLCs, creating an attractive option for many business owners.

The LLC first appeared in the United States in 1977, when Wyoming recognized it as a business

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structure. But LLCs did not really catch on until 1988, when the Internal Revenue Service (IRS) announced that, within certain parameters, it would tax LLCs as partnerships rather than as corporations. This opened the door to a new area of business and estate planning, and within a few years many states passed laws authorizing the creation of LLCs. Both Kentucky and Ohio began allowing LLCs in 1994.

Benefits from forming an LLC. There are several benefits to organizing your business as an LLC. An LLC is similar to a partnership — all of the "members" of the LLC have an ownership interest in the company. And, like a partnership, the federal government typically taxes the individual members, not the company itself. Under the new "check-the-box" tax rules that went into effect in January 1997, a business entity may elect its federal tax treatment (unless it is required to be classified as a corporation under the new rules). Therefore, unless the members *choose* to be taxed as a corporation, a two-member LLC generally will be taxed as a partnership.

The biggest difference between a partnership and an LLC is that, in a partnership, each partner is personally responsible for the debts and liabilities of the business. But an LLC's members are shielded from personal liability, much like a corporation's shareholders. This limited liability can be extremely important if the company is sued for a large amount of money or if the company simply cannot pay its debts.

An LLC is similar to a limited partnership, but with two major differences. Unlike an LLC, a limited partnership needs one general partner who is personally liable for the entity's obligations. And a limited partner cannot actively participate in the management of the business without risking personal liability, while LLC members can participate in management without being personally liable.

Businesses most likely to organize as an LLC are small to medium size companies that otherwise might be organized as sole proprietorships, partnerships, or even C or S corporations. Originally, the limited liability aspect of an LLC was seen as a benefit primarily for risky operations such as oil exploration or mining. But as LLCs have become more popular, all types of businesses have used the LLC form.

Statutes authorizing LLCs usually allow an existing business to convert to the LLC form. An existing partnership or sole proprietorship can rather easily convert to an LLC. But, while converting a corporation to an LLC is possible, the corporate conversion most likely will trigger a significant one-time tax liability for the corporation and its shareholders.

LLC characteristics. Some states allow one person to form an LLC, but many require that an LLC have two or more members — much like partners in a partnership or shareholders in a corporation — who have ownership interests in the company. Both Kentucky and Ohio require that an LLC have two or more members. Members may be individuals, corporations, or even trusts. The members' ownership interests can be unequal in the rights granted to various members, unlike shares in an S corporation. The members of an LLC may choose to have a member-managed organization, much like a partnership, or to hire managers (which do not have to be members of the LLC), as in a corporate structure.

Typically, an LLC member cannot transfer his or her *ownership* interest as freely as s/he could if it were corporate stock. A member is permitted to transfer his or her *financial interest* in the company, but the new member cannot participate in the LLC's management unless the other members vote to allow it.

Like a partnership, the LLC dissolves when a member dies or leaves the company, unless the remaining members vote to continue it.

Estate planning. The flexibility of an LLC makes it a particularly attractive option for passing on the ownership of a family business. For example, a senior family member can include a relative as a member of the LLC with a small ownership interest, and the relative can participate in management while learning the business. At the senior family member's death, the remaining members of the LLC can then vote to continue operations.

The LLC can also be a vehicle for a senior family member to give a part of the business to family members while the senior family member is alive. By making small annual gifts of portions of his or her ownership interest, the senior family member can avoid gift tax and reduce estate tax. And the senior family member can give a relative a *financial* interest in the LLC without surrendering management control.

Depending on the goals of each business owner, the LLC is an option worth considering for a new or existing business. If you would like more information about forming an LLC, please feel free to contact Marshall K. Dosker.

How the Taxpayer Relief Act of 1997 Impacts Your Estate and Financial Planning

by Thomas C. Rink

Big changes are coming. That statement pretty much sums up the effect of the Taxpayer Relief Act of 1997. This new law, signed by President Clinton on August 5, is the first major tax cut legislation in 16 years. It is a complex law, featuring numerous changes to the federal estate and gift tax rules and other rules affecting individual financial and retirement planning. This article will highlight a few of those changes.

Financial Planning

The Individual Retirement Account (IRA) has been a valuable financial planning tool for many years. A taxpayer generally may contribute up to $2,000 annually to an IRA, and the contributions may or may not be deductible, depending on the taxpayer's level of income. The funds in the IRA grow tax-free. Distributions from the account, which may begin when the taxpayer reaches the age of 59 1/2, *are* taxed.

New deductible IRA rules. Currently, if an individual is an active participant in an employer-sponsored retirement plan *and* also makes contributions to an IRA, the deductibility of the IRA contributions is eliminated at a fairly low income level. If the individual is a single tax filer, the deduction for the IRA contributions starts being limited if s/he has an income of $25,000 and is phased out completely at an income level of $35,000. If the individual is married filing jointly, the deduction for the IRA contributions starts being limited if the married couple together has income of $40,000, and is phased out completely at $50,000.

Beginning in 1998, the new law will gradually increase the income phase-out ranges for deductible IRAs of individuals who *also* actively participate in an employer-sponsored retirement plan. By 2005, the income phase-out ranges for deductibility of IRA contributions will increase to $50,000-$60,000 for single tax filers and, by 2007, to $80,000-$100,000 for married couples filing jointly.

In contrast to current law, the new law also provides that an individual is *not* considered an active participant in an employer-sponsored retirement plan simply because his or her *spouse* is an active participant. For

such individuals, the maximum deductible IRA contribution will be gradually phased out if the couple has a combined income of $150,000-$160,000.

Roth IRA. The new law introduces a brand new option for retirement planning — the Roth — that promises to be extremely popular.

Contributions. A taxpayer may contribute up to $2,000 per year to a Roth IRA, less any contributions that s/he also makes to some other type of IRA. (A taxpayer cannot contribute more than a total of $2,000 per year to *all* IRAs that s/he owns.) However, a Roth IRA differs from traditional IRAs in several important ways. First, contributions to a Roth IRA are *not* deductible. Second, a Roth IRA grows *tax-free*. Third, qualified distributions from a Roth IRA are *tax-free*.

Availability. However, not all taxpayers are allowed to make contributions to a Roth IRA. For single tax filers, the ability to make contributions to a Roth IRA starts phasing out at $95,000 and is completely eliminated at $110,000. For married taxpayers filing jointly, the income phase-out range is $150,000-$160,000.

Distributions. A Roth IRA must be held for at least five years before a qualified (non-taxable) distribution may be made. Qualified distributions are those made after the taxpayer turns age 59 1/2, as well as those due to the taxpayer's death or disability, or for certain first-time home buyer expenses. There is no required time for distributions to begin. Thus, earnings can be sheltered for the lifetime of the owner.

Transfers. An individual generally can transfer amounts from another type of IRA to a Roth IRA, provided his or her income for the year of transfer is less than $100,000. The taxpayer will be taxed on the transferred amount, but the transfer will be exempt from the 10 percent early withdrawal penalty. In addition, if the transfer is made during 1998, the income realized on the transfer can be spread out over four years.

Estate and Gift Tax Provisions

Federal taxes are imposed on transfers by gift during a person's lifetime and on transfers at death. The Taxpayer Relief Act makes a number of changes to the rules governing federal estate and gift taxes. Because the changes are too numerous to be discussed in their entirety, following are highlights of some of the more significant changes.

Estate and gift tax unified credit increased. Currently, a unified credit, which applies against both estate and gift taxes, effectively exempts from tax the first $600,000 in taxable transfers.

However, the new law calls for an increase in the amount of transfers that may pass free of estate and gift taxes. Starting in 1998, the unified credit will increase gradually until the year 2006, when it will effectively exempt the first $1 million in taxable transfers from estate and/or gift taxes. The increase will be phased in as follows:

1998	$ 625,000
1999	$ 650,000
2000 & 2001	$ 675,000
2002 & 2003	$ 700,000
2004	$ 850,000
2005	$ 950,000
2006	$1 million

Indexing of annual exclusion for gifts. Under current law, a taxpayer is allowed to make gifts of up to $10,000 ($20,000 for married couples) annually to each donee (the person receiving the gift) without incurring any federal gift taxes. The amount is not indexed — or, adjusted — for inflation. Beginning in 1999, however, the new law allows this amount to be indexed annually for inflation.

Special estate tax treatment for family-owned businesses. Beginning in 1998, the new law allows a special estate tax treatment that, when used in combination with the unified credit, provides an exemption from taxes of up to $1.3 million for estates that include a "qualified family-owned business interest."

The qualification rules are complex. Here are just a few of the requirements that are necessary in order to receive this special estate tax treatment.

- ✓ The value of the family-owned business, along with certain interests the decedent (the person who has died) gifted to family members, must account for more than 50 percent of the decedent's estate
- ✓ The decedent must have been a U.S. citizen or resident at the time of death
- ✓ The business must pass to qualified heirs (this includes members of the decedent's family and individuals who have been actively employed by the business for at least 10 years before the decedent's death)

The new law also imposes requirements regarding material participation in the business both before the decedent's death and for 10 years afterward. Also, there can be a recapture of all or a portion of the tax savings in the event that the material participation requirements are not met or the qualified heir sells the business interest within 10 years.

The new tax law is complicated, and careful planning will be required to reap the benefits of its numerous provisions. If you already have an estate and financial plan in place, you should review it in light of the new law. If you do not already have a plan, now is an excellent time to start. If you have any questions about how the new tax law affects you, please contact an attorney with Strauss & Troy.

New Retirement Plan Rules: An Overview

by Claudia G. Allen

Once again, Congress has tinkered with the federal laws governing employee benefits. As you may recall, legislation passed in 1996 — the Small Business Job Protection Act (the '96 Act) — made several changes to the laws governing employer-sponsored retirement plans. Congress continued its efforts this year with the Taxpayer Relief Act of 1997 (the '97 Act), which also contains changes affecting retirement plans. Some of the more significant provisions of both pieces of legislation are summarized below.

Less paperwork for benefit plan administrators. Thanks to the '97 Act, employee retirement and welfare benefit plan administrators are no longer required to file summary plan descriptions (SPDs) or summaries of material modifications (SMMs) with the federal Department of Labor (DOL), unless the DOL requests it. However, plans must continue to provide these documents to plan participants and beneficiaries.

This provision became effective on August 5, 1997. The DOL is instructing plan administrators to immediately cease filing SPDs and SMMs with the DOL, even if the event giving rise to the filing obligation occurred before August 5 — for example, if the plan was amended prior to August 5 but, under the pre-Act rules, the plan was not required to send

an SMM to the DOL until after August 5, *the plan is no longer required to send the SMM to the DOL.*

Using new technologies to administer plans. It is not clear under current law whether an employer sponsoring an employee benefit plan may use new "paperless" technologies (such as electronic communications) to comply with the various reporting and disclosure requirements imposed by federal law. The '97 Act directs the federal government to issue guidance on this topic no later than December 31, 1998.

Increase in involuntary cash-out amount. Under current law, a plan may not pay out the accrued retirement benefit of a terminated employee without the consent of the employee and, in most cases, the consent of the employee's spouse, *unless* the lump sum present value of the benefit is $3,500 or less. For plan years beginning after August 5, 1997, the '97 Act increases the involuntary cash-out amount permitted under a plan to $5,000 (which will not be indexed for inflation).

Repeal of "success" taxes. The 1986 Tax Reform Act added a new section of the tax code that imposed two separate excise taxes: (1) a 15 percent tax on distributions from tax-qualified retirement plans (and certain other retirement vehicles) in excess of a specified amount, and (2) an additional 15 percent tax on amounts that a deceased individual accumulates for retirement in excess of a specified amount. The '96 Act waived the excess distribution tax for 1997, 1998, and 1999. The '97 Act went even further — it repeals *both* the excess distribution tax and the excess accumulation tax, effective for distributions after 1996 and the estates of individuals dying after 1996.

In-service distributions after age 70-1/2 no longer required. Under prior law, federal tax rules required all types of tax-favored retirement vehicles to include a provision requiring every participant to begin receiving minimum distributions of the participant's retirement benefit by a certain date (generally, the April 1 following the calendar year in which s/he attaines age 70-1/2), even if s/he is still working on that date.

The '96 Act changed the date by which minimum distributions must begin to the April 1 following *the later* of the calendar year in which the participant reaches age 70-1/2 or the calendar year in which the participant retires from employment with the employer maintaining the plan. Thus, in-service distributions are generally no longer required. *A word to the wise:* This provision has created havoc with some other tax code rules. Since the '96 Act was passed, the IRS has issued four separate guidance documents to assist plans in figuring out how the new rule affects them. Thus, employers would be wise to consult legal counsel before taking any action to implement the new rule.

New definition of "highly compensated employee." The tax code contains a definition of "highly compensated employee" primarily for purposes of applying the nondiscrimination rules that apply to retirement plans. The '96 Act changed the definition for plan years beginning in 1997 — generally, it now includes anyone who is (or was in the preceding year) a 5 percent owner, and anyone who earned more than $80,000 (indexed for inflation) for the preceding year. An employer may elect to limit the latter group to the top 20 percent of employees by pay.

And more . . . The '96 and '97 Acts contain numerous other provisions that affect employer-sponsored retirement plans. For example:

The '96 Act created a new retirement plan for small businesses — the Savings Incentive Match Plan for Employees of Small Employers (a "SIMPLE" plan)

- The '96 Act made several changes to the nondiscrimination rules that apply to retirement plans.
- The '96 Act repealed the family aggregation rules — of particular importance to family-owned businesses.
- The '97 Act limits the ability of certain 401(k) plans to invest more than 10 percent of their assets in employer stock or real property.
- The '97 Act increases the first-tier tax on prohibited transactions from 10 percent to 15 percent.
- The '97 Act makes it easier for courts and federal agencies to attach the retirement benefits of a plan fiduciary who has violated the fiduciary rules.
- The '97 Act clarified the rules governing rollover contributions from one retirement plan to another.
- The '97 Act changed the rules governing employee stock ownership plans (ESOPs) of Subchapter S corporations.

For more information about the '96 and '97 Acts and how they may affect your retirement plans, please contact Claudia Allen or Larry Neuman at Strauss & Troy.

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