GDB
LEGAL UPDATE
PROVIDING CURRENT INFORMATION ABOUT LEGAL DEVELOPMENTS FOR OUR CLIENTS AND FRIENDS SPRING 2011

Section 1031 Exchanges — Tax Benefits When A Property Owner Exchanges Real Property For Leasehold Improvements On A New (Long-Term) Leased Location

By: Perry L. Mintz, Esq.

While many real estate professionals are familiar with "like kind exchanges" under Internal Revenue Code Section 1031, many are not aware that Section 1031 may provide deferral of gain if the proceeds from the sale of property are used to construct or build-out a new leased location under a long-term lease. Section 1031 only provides this deferral if the lease has a term of 30 years or more, including optional renewal periods.

This deferral of gain under Section 1031 is beneficial because, without such statutory deferral, the seller would be required to pay federal income taxes on the gains from the sale.

For example: A Seller owns an office building used for its trade or business, and the Seller desires to sell the building and enter into or acquire two long-term leases to be used for its trade or business. The Seller plans to construct a new building or build-out space in an existing building at the two locations. The Seller desires to complete a like kind exchange under Section 1031 to defer the gain upon the sale of the office building.

Section 1031 and corresponding IRS Regulations and Rulings allow the Seller to "park" the new (replacement) property with an independent third-party ("Titleholder," generally a new entity established by a qualified intermediary which facilitates Section 1031 exchanges) for up to 180 days prior to the disposition of the relinquished property, and allows the Titleholder to construct improvements on the replacement property during the 180-day period. Only the amount of construction performed up to the date of transfer to the Seller may qualify as replacement property.

Continued on page 3

No Recovery For Contemplated Construction Delays

By: Randy J. Heller, Esq.

Property owners typically require contractors to sign contracts which provide that the contractor cannot sue the property owner for any damages for any delays.

It has been almost three decades since the highest court of New York proclaimed that such "no-damage-for-delay" clauses are enforceable: "a clause which exculpates a contractee from liability to a contractor for damages resulting from delays…is valid and enforceable and is not contrary to public policy."

Since that time, contractors have found some narrow exceptions which permit the pursuit of delay claims despite such a clause. One of the most frequently utilized exceptions involves "uncontemplated" delays. The logic here is that while sophisticated business people are free to contract away any rights or claims they might have, they cannot be said to have done so where the claims "were not within the contemplation of the parties at the time they entered into the contract." Like magic, contractors began contending that all the delays they incurred could not have been contemplated.

Continued on page 3

In this issue

GALLET DREYER & BERKEY, LLP
ATTORNEYS AT LAW

Firm News

Firm Additions

APRIL 1, 2011. The firm welcomed two new attorneys. **Marc J. Luxemburg,** a former partner with Snow Becker Krauss P.C. law firm, brings extensive experience in real estate law, cooperative and condominium law, and civil litigation. **Edward M. Cuddy, III,** also formally with the Snow Becker firm, brings extensive experience in complex commercial litigation, construction law disputes, and drafting/negotiating architectural, construction and management contracts.

Honors and Awards

MARCH, 2011. Partner David T. Azrin was named a "Legal Eagle" by the *Franchise Times* magazine. Legal Eagles are the top 125 lawyers in franchising in the nation, as nominated by their peers and determined by the *Franchise Times* editorial board.

Articles, Bar Activities, and Speaking Engagements

SEPTEMBER 28, 2010. Partner Roger L. Stavis published an article on "Federal Plea Agreements Leave Open Risk of Prosecution in Other Districts," in the *New York Law Journal.*

JANUARY 1, 2011. Partner Jay L. Hack was named second vice chair of the Business Law Section of the New York State Bar Association.

MARCH 2, 2011. Partner Roger L. Stavis spoke as a featured panelist at an American Bar Association Luncheon on the "Proper Role of the Courts in National Security." The presentation received excellent reviews by experienced criminal defense attorneys who attended.

FEBRUARY 4, 2011. Partner David T. Azrin presented a seminar on "Employment Law — Avoiding Common Mistakes Which Subject Employers to Liability" for the New York City Department of Small Business Services, and will be presenting again on April 13.

JUNE 23, 2011. Partner Marc J. Luxemburg and Associates Scott M. Smiler and **Michelle P. Quinn** will be presenting a seminar on "Legal Aspects of Condominium and Homeowners' Associations" as part of the Lorman Continuing Legal Education series.

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New IRS Initiative Targeting Those Hiding Assets Off-Shore

By David N. Milner, Esq.

On February 8, 2011, the IRS announced that it would provide a second (and probably final) opportunity to report the existence of an interest in a foreign account without fear of criminal prosecution.

Federal law requires that all those having an interest in a foreign account at any time during a taxable year must file a Form TDF 90-22.1 ("FBAR") with the IRS on or before June 30th of the following year. Failure to do so is a crime, and may subject the taxpayer to a penalty equal to 50% of the highest value of the account during each of the years for which an FBAR was not filed (**not limited** to the amount on deposit in the account), and a penalty equal to 75% of the taxes owed on the unreported income from the account, plus interest.

they must submit additional documentation, including information regarding their accounts. If the IRS determines that the information was submitted in good faith, the IRS will admit the person into the Program, the person will be absolved of criminal liability, and the penalty for failing to file the FBAR will be reduced to a one-time, 25% penalty computed on the highest amount in the account over the last eight (8) years. In certain instances, this penalty may be reduced to 12.5% (if the highest value of the account was under $75,000),

Persons who qualify under the new Voluntary Disclosure Program (the "Program") which ends on August 31, 2011 will receive immunity from criminal prosecution and be subject to reduced penalties.

Persons who qualify under the new Voluntary Disclosure Program (the "Program") which ends on August 31, 2011 will receive immunity from criminal prosecution and be subject to reduced penalties. A person is not eligible to apply if the IRS is already aware of, or has already begun investigating, the individual. In order to determine if a person is eligible to apply for the Program, the person need only submit their name, address and social security number. If the person receives notice that they are eligible to apply, then and to 5% under limited circumstances. In addition, the civil penalty will be reduced to a flat 20% of the additional tax that is due.

To qualify, all of the required documentation, including all amended returns and related forms required by the IRS, accompanied by the payment of the penalties, tax and interest, must be submitted by August 31, 2011.

Accordingly, we urge all of our clients and friends to contact us if they feel they, or someone they know, may be able to benefit from this Program.

About the author: *David N. Milner is a partner at Gallet Dreyer & Berkey LLP. Mr. Milner's practice focuses on tax law, estate planning, corporate law, and real estate. Mr. Milner, who is also a certified public accountant, helps clients to structure transactions in a manner calculated to reduce adverse tax consequences, and helps families develop estate planning strategies. He is a frequent speaker before community groups and trade organizations on matters relating to estate planning. Mr. Milner can be reached at dnm@gdblaw.com.*

1031 Exchanges (continued from page 1))

A Safe Harbor allows a maximum 180-day period to complete the exchange, with the period commencing upon the sale of the relinquished property. In the case of a "reverse" exchange (i.e., acquisition of replacement property prior to the sale of the relinquished property), the applicable 180-day period commences upon the Titleholder's acquisition of the replacement property.

A SAMPLE TIMELINE FOR THIS EXAMPLE:

- Seller enters into a contract to sell its building on January 1 for closing on July 1.
- Seller arranges for Titleholder to enter into the first lease, the term of which commences on May 1, and Titleholder begins construction of improvements immediately. The lease must be assigned to Seller within 180 days after May 1.
- The sale of the office building is completed on July 1 and the proceeds of the sale are delivered to a qualified intermediary, and Seller timely identifies replacement properties.

Section 1031 may provide deferral of gain if the proceeds from the sale of property are used to construct or build-out a new leased location under a long-term lease

- Seller arranges for Titleholder to enter into the second lease (and the term commences) on July 1 immediately after the closing of the sale of the office building and construction of improvements begins. The lease must be assigned to Seller within 180 days after July 1.
- Subject to applicable requirements and exceptions and assuming all net proceeds from the sale of the building are used for qualifying leasehold improvements, by application of Section 1031 no gain is recognized by Seller upon this exchange for federal income tax purposes.

There are many issues to consider in connection with this type of "like kind exchange" transaction, such as (a) the timing of the transactions, some of which may be, at least in part, outside the control of the exchanging taxpayer; (b) the actual costs that will qualify as "like kind" to a fee interest in real estate ("soft costs," at least certain soft costs, may not), and (c) possible transfer taxes upon the transfer of real property including long-term leases.

With appropriate advice and planning, construction exchanges — including the exchange of real estate owned in "fee" for leasehold improvements under a long-term lease — can be accomplished under Section 1031.

About the author: *Perry L. Mintz is a partner at Gallet Dreyer & Berkey LLP in our real estate department. Mr. Mintz represents real estate owners, developers, managers and investors in the acquisition, sale, development, operation and financing of real estate properties including conversion to cooperative and condominium forms of ownership, and numerous cooperative corporations and condominium boards of managers. Mr. Mintz can be reached at plm@gdblaw.com.*

Construction Delays

(continued from page 1)

In one such case, a contractor argued that his encountering of underground utilities, and the unwillingness of the utility company to move them, was "uncontemplated," entitling him to damages for delay.

The court was not persuaded. It held that the very existence of a clause in the contract addressing the possibility of finding underground utilities rendered such delays "contemplated." Moreover, it stated that as an experienced excavator, the contractor should have reasonably foreseen the possibility of the utility company being unable or unwilling to move its lines and pipes.

These days, pursuing a claim for delay damages requires a skillful navigation through the narrow exceptions carved out by the courts. It is not a journey for the faint of heart.

About the author: *Randy J. Heller is a partner at Gallet Dreyer & Berkey LLP. His practice focuses on construction law and litigation, representing contractors and owners in construction related matters. Mr. Heller has been named a* Super Lawyer *in* The New York Times Magazine *as one of the top attorneys in construction law in the New York metropolitan area, and in* New York *magazine as one of the* Best Lawyers of New York. *Mr. Heller can be reached at rjh@gdblaw.com.*

Severance Agreements

By David T. Azrin, Esq.

Although there is no legal obligation to pay any severance to an employee who is terminated (unless an employment agreement or union contract requires severance), companies often offer a severance payment to employees in return for signing a severance agreement which includes a release of possible claims.

RELEASE

The release must be properly worded to ensure that it is valid. It should recite all of the possible specific statutory claims which are being released, and it should state that the employee had the opportunity to review the agreement and to consult with an attorney.

AMOUNT OF SEVERANCE

While there is no legal requirement for any specific amount of severance, larger companies sometimes use formulas such as one week for each year of employment.

The only legal issue regarding the amount is that, if the company has a policy of paying a certain level of severance, this policy should be applied uniformly as much as possible, to avoid a discrimination claim that a member of a protected group (race, age, sex, national origin, etc.) received less than other employees normally receive.

There is no legal requirement that employees must be paid for unused vacation or personal time. But, if the company has an announced policy on this issue, the company must abide by that promise.

TIMING

The employee should be given a reasonable time (at least a few days) to read and consider the severance agreement.

Special rules apply if the employee is 40 years old or older. For a release of age discrimination claims to be considered valid, the employer must give the employee 21 days to consider the agreement. Despite this 21-day requirement, an employer can cancel and withdraw the offer entirely prior to the end of the 21-day review period, without liability. Also, for employees who are at least 40 years old, after the employee signs, the employee must be given 7 days to change his mind and to revoke the agreement, known as a revocation period. If the termination is part of a group layoff, the severance agreement must specify the ages and positions of other people being laid off as well.

NON-DISPARAGEMENT, NON-COMPETITION, AND CONFIDENTIALITY

The severance agreement should include a provision which prohibits the employee from saying anything negative about the company in the future, known as a non-disparagement clause. The agreement should also require the employee to acknowledge that the employee has returned all company property, and that the employee will not disclose any confidential company information or trade secrets. Also, the agreement should re-confirm the employee's continuing obligations under any existing non-competition agreement.

RESPECT

During the entire process of terminating the employee and offering the severance agreement, the employer should treat the employee with respect. Employees often decide to bring legal action because they feel they were not treated with respect. The termination news should be conveyed in private, preferably at the end of the day, to avoid embarrassment, with a third person in the room to act as a witness. All personal belongings should be returned to the employee.

There is no legal obligation to give specific reasons for the decision, and often employers get themselves into trouble by mentioning certain reasons, but leaving out others. Therefore, we recommend a more general statement of reasons, such as that things have not worked out, without naming specific issues. Problems with performance should have been documented in memos to the employee's file when the problems actually occurred, rather than at the last minute before the termination, or after the termination.

The only legal issue regarding the amount is that, if the company has a policy of paying a certain level of severance, this policy should be applied uniformly as much as possible.

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