

Corporate Conversions to LLC's – Proceed with Caution

Limited liability companies (“LLC’s”) have exploded in popularity due to their combined attributes of limited liability and tax flexibility. As the use of LLC’s has grown, so have the misconceptions over conversions to the LLC form and merger and acquisition transactions involving LLC’s. The partnership sections of the Code generally govern multi member LLC’s; they do not always mix with the corporate reorganization provisions of the Code, which did not contemplate LLC’s when written.

There are several ways that corporations can engage in tax free reorganizations, including for example, a state law merger. However, while the Illinois Limited Liability Company Act (the “Act”) and other state limited liability company statutes provide for the merger of LLC’s and corporations, the Code does not treat these transactions as tax free reorganizations. The Code treats a “merger” of a corporation with and into an LLC as a liquidation of the corporation, followed by a transfer of the corporation’s assets to the LLC. If the corporation has appreciated assets, the transaction may result in taxable income to the corporation, followed by a second level of tax to the corporation’s shareholders.

This second level of tax generally would be avoided if the corporation is a Subchapter “S” corporation. The contribution of the corporate assets to the LLC should not trigger further tax, based upon the nonrecognition provisions of the Code applicable to partnerships.

Interestingly, a corporation can change its legal status to an LLC for state law purposes, and choose to continue its taxation as a regular or “C” corporation or a Subchapter “S” corporation under the Code without triggering tax. The change from corporation to LLC is merely a change in form, (and in the case of an “S” corporation, so long as the LLC continues to meet the Subchapter S eligibility requirements), the reorganization is accorded tax free treatment under the reorganization provisions of the Code.

LLC’s offer tremendous flexibility for structuring transactions. However, conversions and reorganizations involving corporations and LLC’s may present difficult and undesirable tax consequences that may be avoided with proper planning.

by Kenneth W. Clingen



**Clingen Callow
& McLean, LLC**

Attorneys & Counselors

specializing in

general business and corporate law

commercial litigation

business and succession planning for family businesses, corporations and limited liability companies

banking and finance matters

commercial real estate

estate planning and settlement

income, estate and gift tax

intellectual property matters

employment litigation and labor law

2100 Manchester Road
Suite 1750
Wheaton, Illinois 60187
Telephone 630.871.2600
Facsimile 630.871.9869
www.ccmlawyer.com

Kenneth W. Clingen
Mary E. Callow
Timothy M. McLean
Paul M. Fullerton
Ross I. Molho
Kenneth J. Vanko

Deven S. Kane
Cristal J. Gerrick

Delrose Ann Koch
Deanna M. Quinn-McCollian
Laura A. LeDoux

OF COUNSEL

FIRM HIGHLIGHTS

Timothy M. McLean,
Kenneth J. Vanko and
Ross I. Molho will be presenters at a seminar in Arlington Heights, Illinois on March 30, 2006 entitled *Common Misconceptions in Human Resources in Illinois*. Please contact CCM if you wish to attend. Ross will also be a presenter at a seminar in Rockford, Illinois on May 11, 2006 entitled *Advanced Employee Discharge and Documentation*. Please contact CCM if you wish to attend either of these seminars.

Ross I. Molho was recently hired as general counsel for the Proviso Township Mental Health Commission, further demonstrating CCM's commitment to its municipal law practice.

Deanna M. Quinn-McCollian and her husband Jeff had a health baby boy on November 26, 2005. At 8 lbs., 3oz. John William McCollian is a welcome addition to CCM's clients and friends.

Employers Beware – Part 2

The Illinois Legislature is in Session

At the close of 2004 we opined that “[t]he number of new laws passed in Illinois in 2004 that are designed to protect employees is startling.” This is equally true of 2005.

Amendments to the Illinois Human Rights Act:

1. “Speak English Only” work rules prohibited. The Illinois Human Rights Act now prohibits “speak English only” work rules unless an employer has a business necessity for imposing them. Fortunately, this rule does not prevent employers from prohibiting slang, jargon, profanity or vulgarity. 775 ILCS 5/2-102(A-5).
2. Discrimination based on sexual orientation is illegal in Illinois as of January 1, 2006. Sexual orientation includes: heterosexuality, homosexuality, bi-sexuality, or gender related identity, whether or not traditionally associated with the person's designated sex at birth. 775 ILCS 5/1-101.1.

Illinois Family Military Leave Act: Effective August 15, 2005, leave time is mandated for *family members* of persons in the military service. Both employees and independent contractors are covered by this new legislation. 820 ILCS 151/1 *et seq.*

Paid Leave to Vote: Effective August 22, 2005, employers are required to grant employees paid leave to vote. Both general and special elections are covered by this statute. An employee must make application for voting leave *before* the day of the election. 10 ILCS 5/14-4.5.

Privacy: The Personal Information Protection Act requires employers and other entities which collect personal data to notify individuals when there has been a breach of their computer system and where employee personal data may have been stolen. An employer's violation of the Act constitutes an unlawful practice under the Illinois Consumer Fraud and Deceptive Business Practices Act. 815 ILCS 530/1 *et seq.*

Illinois was recently ranked as the 46th best state to do business in by the U.S. Chamber Institute for Legal Reform in part due to its legal climate. Illinois employers have known for a long time how tough it is to run a profitable business in today's super-competitive marketplace. The Illinois legislature does not appear to appreciate this fact.

by Ross I. Molho

The Importance of Earnest Money in the Changing Real Estate Market

The purpose of earnest money in a real estate transaction is twofold. First, it shows that the buyer is “in earnest” for the property described in the contract. Second, it is to be used as liquidated damages in the event the buyer defaults. For the last several years, residential sellers in metropolitan Chicago have typically collected less than 3% of the purchase price in earnest money.

However, as interest rates rise fewer buyers are qualifying for financing. Thus, properties’ market times have increased and there is more supply than demand – a typical “buyer’s market.” Sellers bear a greater risk that the buyer will default in the present market. Buyers default for many reasons ranging from inability to sell their own home (a bigger problem in a buyer’s market) to inability to obtain financing.

In a buyer’s market, sellers must be more selective about who they

contract with, and they must demand adequate earnest money at the inception of the contract. In most of metropolitan Chicago the average home price is in excess of \$250,000. A mere 3% of the \$250,000 purchase price, or \$7,500, would show that the buyer is “in earnest,” and possibly prevent the buyer from defaulting.

We have seen an increasing number of buyer defaults over the past several months. These defaults may in part be due to the fact that buyers are not being asked to forfeit their earnest money. Most sellers will give up the typical \$1,000 or \$2,000 in earnest money that is currently being

collected without pursuing litigation. Yet, the seller has still been damaged in that: 1) the property was off the market; 2) the seller may have purchased a title commitment and survey; and 3) the seller incurred attorneys’ fees.

We recommend that sellers avoid this situation by demanding a larger earnest money deposit. Not only will a larger deposit make a

buyer less likely to default but it will also make court remedies more cost effective should a seller choose to pursue them.

by Laura A. LeDoux

Sellers bear a greater risk that the buyer will default in the present market.

Recent Legislation and Legal News

Increased Annual Exclusion From Federal Gift Tax

Effective January 1, 2006, the annual exclusion from the Gift Tax increased from \$11,000 per year to \$12,000 per year. This means that any U.S. citizen may transfer up to \$12,000 to any individual each year without incurring gift tax. Married couples can agree to “gift split” up to \$24,000 per individual donee each year.

DOL Issues Final USERRA Regulations

Effective January 18, 2006, the U.S. Department of Labor’s final regulations interpreting the Uniformed Services Employment and Reemployment Rights Act (“USERRA”) go into effect. All employers regardless of size must comply with the USERRA.

This publication is intended for general information purposes only and does not constitute legal advice. Readers should not act upon information presented in this publication without individual professional counseling. Readers may consult with the attorneys at Clingen Callow & McLean, LLC to determine how laws, suggestions and illustrations contained in this publication apply to specific situations.

Corporate Conversions to LLC's – Proceed with Caution



Kenneth W. Clingen, a partner in the firm, practices in the area of corporate law, mergers and

acquisitions and estate and succession planning for business owners.

WHAT'S INSIDE? *Articles & Contributors*

EMPLOYERS BEWARE

The Illinois Legislature is in Session: Part 2



Ross I. Molho, a partner at CC&M, concentrates his practice in labor and employment law. He is also certified as a Senior Professional in Human Resources (SPHR).

The Importance of Earnest Money in the Changing Real Estate Market

Laura A. LeDoux is of counsel to the firm and concentrates her practice on the representation of real estate owners, landlords, tenants, developers, corporations and business owners.

