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THE REPORT

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WINTER 2001

IRS PROVIDES SAFE HARBOR FOR "REVERSE" LIKE-KIND EXCHANGES

Internal Revenue Code Section 1031 has been in existence since the early 1920s and has continually allowed for the non-recognition of gain or loss on the exchange of certain property by taxpayers. In its present form, Section 1031 provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for property of like kind to be held either for productive use in a trade or business or for investment. The code section is generally relied upon by taxpayers desiring to defer the recognition of the gain on the sale of appreciated property, and, therefore, payment of federal income tax.

As one might imagine, after the introduction of such a law, creative tax practitioners have continually tried to expand the applicability of this favorable tax treatment. The two principal areas in which taxpayers sought such an expansion have been delayed/multi-party exchanges and reverse exchanges.

Delayed/Multi-Party Exchanges

As originally enacted, Section 1031 contemplated the direct exchange of qualifying property between taxpayers. However, the instances in which two taxpayers wish to exchange qualifying real or business property of a like kind with one and the other were and continue to be rare. Instead, a more common scenario was that a taxpayer would wish to sell appreciated property to one party and replace it with another property purchased from a party other than the taxpayer's purchaser. These delayed or multi-party transactions took place for many years without any legislative or IRS guidance or approval.

Now, both Section 1031 and various Treasury Regulations provide the means for accomplishing such an exchange so as to avoid the

recognition of the gain on the sale of the appreciated property: if a taxpayer sells appreciated property, known as the "relinquished" property, then identifies a "replacement" property within 45 days of the closing of the sale of the relinquished property and closes on the purchase of the same within 180 days of the closing of the sale of the relinquished property, the IRS will treat the transaction as qualifying under Section 1031. There are several other complicating aspects of delayed exchanges. For example, the selling taxpayer may not hold the proceeds from the sale of relinquished property until they are needed for the purchase of the replacement property. Instead, they must be held by a qualified intermediary escrow account or trust. Thus, careful planning is a must.

Reverse Exchanges

The other area of creativity was born in situations where the taxpayer wanted to time the purchase of the replacement property prior to the sale of the relinquished property. Again, these transactions were largely unguided in the past. In fact, the IRS was careful to point out that the regulations promulgated in 1991, in which many matters applicable to delayed exchanges were clarified, were not applicable to reverse exchanges.

However, effective September 15, 2000, the IRS promulgated a new procedure to provide a safe harbor under which the IRS will not challenge the qualification of property either as replacement property or relinquished property for reverse exchanges, if the property is held in a "qualified exchange accommodation arrangement." There are several requirements which each taxpayer must meet for the property to be deemed to be held in a QEAA: (1) the arrangement must be in writing, (2) the

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indicia of ownership must be transferred to a qualified intermediary called an Exchange Accommodation Titleholder, and (3) the 45 day and 180 day time limits applicable to typical delayed exchanges must be complied with. As with all delayed exchanges, both forward and reverse, careful planning is critical.

Since the IRS has provided this safe harbor for "reverse exchanges", each planned purchase of business or investment property should cause the purchaser to ask: "Do I have any appreciated property of a like-kind with the property I anticipate purchasing which I may want to sell on a tax-deferred basis?" If the answer is yes, or even perhaps, your time is well-spent to consult with your tax or real estate attorney.

For more information, please contact Craig Stewart, Carol Sheehan, Mike Smith, Tim Long or your CPM attorney.

EMPLOYMENT RIGHTS OF MILITARY PERSONNEL

In light of recent events, employers of military reservists or persons called up for active duty should be aware of their rights and obligations under the federal Uniformed Services Employment and Re-Employment Rights Act ("USERRA"). USERRA was implemented after the Gulf War to insure that military personnel are not discriminated against in their ability to re-enter the workforce after a prolonged absence, on the basis of their military affiliation.

Generally, USERRA mandates that employers continue to offer insurance coverage at the same benefit level (employee premium contribution) for 31 days following the employee's leave for service; thereafter, COBRA-type coverage may be offered at the employee's expense.

USERRA does not require most employers to pay employees for serving; however, many employers permit employees on military duty to use any available paid time off, or create other policies to assist military employees. Employers, who are required to provide prior notice of these

rights, generally notify affected employees through their handbooks.

USERRA also provides that employees returning from service within 31 days be reinstated to their former positions and with the same benefits, if they return to work as soon as practicable upon completing military duty. Employees gone for 31 to 180 days must re-apply for employment within 14 days of returning from duty. If service exceeds 181 days, the employee must submit an application for reemployment within 3 months of return from service. Military personnel have varying degrees of USERRA rights for up to five years of cumulative service.

For more information on USERRA, please contact Joëlle Khouzam, Kristine Hayes, or your CPM attorney.

HIPAA Update

The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") was enacted to assure easier entry into employer group health plans for employees with preexisting conditions. In conjunction with this objective, the HIPAA rules required that additional measures be taken to protect an individual's health information. As a result, the Privacy Rule became effective on April 14, 2001.

This long, complex, and controversial Privacy Rule applies to all "covered entities" with respect to protected health information. Covered entities are defined as health plans, health care clearinghouses and most health care providers. In addition, the Rule applies indirectly to "business associates," entities which perform certain functions on behalf of, or provide certain services for, covered entities.

Most covered entities have until April 14, 2003 to comply with the Rule, while small covered entities will have an additional year. The level of compliance will be determined by the size and nature of each covered entity. While the compliance deadline is not imminent, the Rule's complexity has begun to cause concern. In an effort to clarify some of the confusion, the Department of Health and Hu-

man Services ("HHS") published guidelines on July 6, 2001, and HHS expects further clarification and revision in the coming months.

The Privacy Rule focuses on how protected health information may be used or disclosed by a covered entity. Restrictions include requirements related to notifying individuals of the covered entities' privacy practices, and seeking consent from individuals before using or disclosing protected health information in any manner. The Rule contains documentation requirements and records retention policies related to tracking how protected health information is used and disclosed. The Rule also vests individuals with rights that enable them to manage and control the health information maintained by their health care providers.

The civil and criminal penalties associated with violating the Rule are significant. Civil penalties may be as high as \$25,000 for each requirement or prohibition that is violated. HHS has broad authority to investigate complaints, conduct compliance reviews, and obtain access to records. In addition, the Department of Justice may enforce substantial criminal penalties, ranging from a \$50,000 fine and a one-year prison term to a \$250,000 fine and a 10-year prison term.

For more information on complying with HIPAA and the Privacy Rule, please contact Kristine Hayes or your CPM attorney.

Mileage Reimbursement Rates

Due to fluctuating gasoline prices, the IRS has once again adjusted the mileage reimbursement rates. Effective January 1, 2002, the standard mileage rate for the cost of operating a car for BUSINESS is 36.5 cents a mile (2001 rate was 34.5 cents). The rate which can be claimed for SERVICES TO CHARITY remains unchanged at 14 cents a mile. The rate which can be claimed for driving for MEDICAL REASONS is increased one cent to 13 cents a mile. The rate for qualifying MOVING EXPENSES is also increased one cent to 13 cents a mile.

SECURED PARTIES FACE NEW CHALLENGES

On July 1, 2001, the revised version of Article 9 of the Uniform Commercial Code became effective in most states, including Ohio. Article 9 controls security interests in personal property relative to lending and other transactions. A creditor who properly takes security interests in the personal property of the debtor will generally have a preferred position over unsecured or later-secured creditors. Revised Article 9 (“RA9”) implements many changes which enhance the law, but also create some risks for secured creditors. Practically speaking, former Article 9 (“FA9”) contained only 55 substantive sections, while RA9 contains 126 substantive sections.

Under FA9, a security interest was generally created by having the debtor sign a security agreement and a financing statement, unless the creditor actually retained possession of the collateral. In Ohio, FA9 required the financing statement to be filed in various places, depending on the type of collateral given as security by the debtor. Although RA9 keeps the basic general requirements of a security agreement and a financing statement, the minimum standards for validity of those documents are significantly relaxed under RA9.

For example, in an effort to acknowledge technological advancements and paperless transactions, RA9 implements a concept known as “medium neutrality.” Neither the security agreement nor the financing statement need to be in a tangible written form – all that is required is a “record.” A “record” is defined as paper documents and information “stored in an electronic medium” that is “retrievable in perceivable form.” RA9 thus de-emphasizes the storage mechanism. Commentary on the revisions to the law notes that the storage method for a security agreement or a financing statement need not be permanent or indestructible, but that human memory is not sufficient. Moreover, the comments also suggest that even recorded oral statements may qualify under the relaxed standards.

Experience with the Ohio Secretary of State’s office indicates that paper financing statements are still required. If that changes, the medium neutral documentation requirements could permit the electronic filing of digitized voice records or electronic documents to replace paper counterparts. And because a security agreement need not be filed with the Secretary of State, the more liberal requirements may be practically applied to those documents.

Another RA9 change is the elimination of the requirement of the debtor’s signature on both the security agreement and the financing statement. RA9 merely requires that a record of the security agreement be “authenticated” by the debtor. “Authentication” includes signing, adoption of a symbol, encryption, or similarly processing such record with the present intent to identify oneself and to adopt or accept the record. Further, so long as the debtor authorizes the filing of an authenticated financing statement, RA9 entirely eliminates the need for a debtor’s signature on the financing statement. In fact, the new UCC-1 forms do not even contain signature blocks. A debtor’s authentication of the security agreement automatically constitutes authorization of the secured party to file a financing statement covering the collateral described therein as well as proceeds of that collateral. Notably, a creditor must obtain separate authenticated authorization if the financing statement describes collateral more broadly than the description contained in the security agreement.

RA9 also contains detailed requirements for contents of the security agreement and financing statement. Particularly noteworthy is that RA9 now specifically permits “super-generic” collateral descriptions (e.g. “all the debtor’s assets”) in the financing statement. However, such super-generic description is not sufficient for the collateral description in the security agreement, and in a consumer transaction, the collateral must be described more spe-

cifically that merely by collateral type (e.g., “Model 2400 Washing Machine,” instead of merely “consumer goods, and “Microsoft stock” instead of merely “securities”).

Another major change is that financing statements are now filed only centrally for most transactions. In Ohio, this will now generally be just the Secretary of State’s office. Note that the new place-of-filing rules do not depend on the location of the collateral, as was generally the case for most tangible property under FA9. The location of the *debtor* now generally controls place of filing for all collateral types. A registered organizational debtor (such as a corporation or a limited liability company) is deemed to reside in its state of original registration, while an individual is deemed to reside in his or her place of residence. Exceptions to the central filing rule still exist – primarily in the case of fixture filings and filings involving minerals to be extracted or timber to be cut.

RA9 has also expanded the categories of collateral that can be listed in a financing statement to include “commercial tort claims,” as well as non-consensual “agricultural liens” and “deposit accounts.” It also adds a new type of semi-intangible collateral called “letter of credit rights,” as well as two new types of accounts (“health care insurance receivables” and “lottery winnings”). Also, RA9 adopted two new sub-types of general intangibles: “payment intangibles” and “software.” Notably, RA9 actually expanded the definition of “accounts” to include some rights which could have been classified as “general intangibles” under FA9. These collateral description changes present traps for the unwary security agreement drafter.

This article merely provides a partial overview of the significant changes in Revised Article 9. For more detailed information, please contact Mike Smith, Leon Friedberg, Dave Jackson or your CPM attorney.

PEOPLE ON THE MOVE

Robert Barnett was appointed Chairman of the Columbus Bar Association's Probate Court Committee.



Joe Patchen will be speaking on representing creditors in bankruptcy and debt collection, and related ethical concerns, as part of a National Business Institute Seminar on March 19, 2002. For more information, contact Joe at 628-0779.



CPM's librarian *Sherry Poston* was appointed to the Ohio State Bar Association's Law Libraries and Legal Information Services committee by the OSBA president.



Dave Jackson will be speaking at a luncheon of the Columbus Chapter of the International Association of Business Communicators on February 5, 2002, where he will address developments affecting trademarks and cybersquatting.



Connie Hammerschmidt of HR Access and *Joëlle Khouzam* were roundtable moderators at the November meeting of the Central Ohio Society of Certified Public Accountants, where they discussed current topics in employment law and retention of the workforce.

Boyd Ferris was a guest speaker at the Ohio Trucking Association's November meeting. Boyd, who focuses his practice on the transportation industry, advised the group about recent litigation on civil forfeiture that has affected trucking businesses.



Dave Ferris has been appointed to chair the Transportation Lawyers' Association Committee on Motor Carrier Transportation.



Alysha Clous will be training recently admitted lawyers on probate law and practice at the Columbus Bar Association in January 2002.



Mike Smith, who heads the Firm's Business Law group, was recently appointed to the Orange Township Zoning Commission in Delaware County.



Leon Friedberg is a co-presenter at a day-long seminar on February 12, 2002, entitled "Ohio Bankruptcy." This program is well-suited for financial institution professionals. For more information, contact Leon at 628-0760.

We are thankful...

We take time during this holiday season to be thankful for our loyal clients, our hardworking employees, and our supportive families. We are thankful to be graced with safety and comforts in a time when others struggle to rebuild their lives, deal with pain, or put themselves at risk to defend our freedoms. Freedom and generosity are, indeed, gifts we value year-round.

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