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LEGAL UPDATES FOR BUSINESSES

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Welcome to the September 2019 issue of the Schenck Price *Legal Updates for Businesses*. In this edition we provide you, New Jersey's business owners and managers, with important information on possible tax benefits related to real estate; give you a brief outline of how to prepare your commercial real estate for a sale; inform you of the important changes in employee protections from the rapidly changing law on medical marijuana use; and let you know about an important change in the Delaware corporate law that allows the division of Delaware LLC's. The breadth of our articles reflects the constant and important changes in the law that are critical for you to understand in the successful operation of your business. Our Schenck Price colleagues are very knowledgeable and would look forward to providing guidance with your legal needs.

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Proper Planning Before Marketing Your Commercial Property for Sale

By Jason A. Rubin, Esq.

In almost all instances, engaging in proper planning well in advance of marketing your commercial property for sale will lead to a more successful, and less stressful transaction. Establishing an effective pricing strategy, considering property and tenant enhancements, and organizing your property files are vital steps that can be taken to maximize your return and expedite the transaction.

Unless you are a savvy real estate investor, the most effective way to establish an effective pricing strategy is by enlisting the services of a reputable and experienced real estate broker. It is important to consult with a real estate broker who specializes in the same property sector (i.e. – office, retail, industrial, etc.) as your property. Gaining insight on the potential market for your property as well as the current market trends can be invaluable as you consider the listing price for your property and when to enter the market. Many brokers will provide guidance on an informal level to allow you to gauge whether to proceed with the transaction. However, it is important to note that to the extent you wish to engage a broker to formally market the property, prior to entering into a listing agreement you need to carefully review the terms and conditions and make certain that the commission is only due and payable upon the sale of the property. A recent New Jersey Appellate Division case held that a real estate broker was entitled to a commission simply for procuring a willing purchaser that indicated that IT would meet the seller's terms and signed a non-binding letter of intent. The court ruled in favor of the broker despite no closing taking place (or a purchase contract even being signed) because the listing agreement did not specify that the commission would only be earned in the event of a sale of the property.

Property and tenant enhancements can increase the market value of the property significantly. If your property is best suited for an end-user as opposed to an investor, the condition of the property will be particularly relevant. Most purchasers will ask for certain representations and warranties regarding the property in the contract, and to the extent deficiencies exist, resolving them prior to marketing the property will prevent issues during contract negotiation and due diligence that will cost time and money. If the property will ultimately be purchased by an investor, the tenants and cash flow will be key. Extending soon-to-be-expiring leases and filling vacancies at market rates in most cases will increase the marketability of the property, as will seeking to increase net income by curbing expenses and inefficiencies in the management of the property.

Once a contract is signed, the most significant aspect of the deal cycle is the due diligence period. During the due diligence period, the purchaser will be given the right (with certain exclusions) to review every aspect of the property. All sellers should be prepared to provide the purchaser with an organized set of property documents immediately at the commencement of the due diligence period. Planning ahead and assembling copies of all leases (including all amendments, extensions and guaranties), a rent roll (including an accounting of any security deposits), surveys and site plans, environmental documentation (especially if the property is currently being remediated or monitored), historical income/expense statements (past 3 calendar years is typical), statement of recent capital expenditures, certificates of occupancy and the owner's title policy of insurance will expedite the purchaser's review of the property during the due diligence period and ultimately result in a quicker closing.

The sale of commercial real estate can at times be a challenging process, particularly for a property owner with an ongoing business concern. Taking a long view and planning well in advance of marketing the property for sale will simplify the process and result in a more successful transaction.

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New Jersey Appellate Court Rules That Employers May Be Required to Accommodate Employees Using Prescribed Medical Marijuana

By Meghan V. Hoppe, Esq.

On July 11, 2019, the New Jersey Supreme Court agreed to review an Appellate Division's decision in *Wild v. Carriage Funeral Holdings, Inc.*, 458 NJ Super 416 (App. Div. 2019), which involves an employee's claim under the New Jersey Law Against Discrimination ("NJLAD") against its employer for failing to accommodate out-of-office use of medical marijuana.

Justin Wild, a licensed funeral director who was prescribed medical marijuana for cancer treatment, was employed by Carriage Funeral Holdings, Inc. ("Carriage"). Wild was in a car accident during working hours and disclosed that he had a license to use medical marijuana. Carriage required Wild submit to a drug test before he could return to work. After failing the drug test, Carriage terminated Wild's employment.

The trial court dismissed Wild's NJLAD claim citing New Jersey's Compassionate Use Medical Marijuana Act, which stated that "[n]othing" would "require… an employer to accommodate the medical use of marijuana in any workplace." However, the Appellate Division reversed the dismissal finding that NJLAD may require employers to reasonably accommodate employees who use medical marijuana, as permitted by the State's Compassionate Use Medical Marijuana Act, when the employee was not seeking to use marijuana during work. The New Jersey Supreme Court will now review whether the New Jersey Compassionate Use Medical Marijuana Act precludes a claim by an employee against an employer based on, among other things, NJLAD. The Supreme Court's ruling will be particularly informative in light of recent amendments to the New Jersey Compassionate Use Medical Marijuana Act.

On July 2, 2019, Governor Phil Murphy amended the New Jersey Compassionate Use Medical Marijuana Act by signing the Jake Honig Compassionate Use Medical Cannabis Act (the "Act") into law. The Act deletes the statutory language that was at issue in the *Wild* case and replaces it with new provisions expressly protecting employees who are authorized users of medical marijuana. The Act prohibits employers from taking adverse employment actions against employees solely based on their status as medical marijuana patients (i.e., for off premises and non-working hour consumption of medical marijuana). In addition, the Act establishes a procedure that employers must follow when an employee tests positive for marijuana. Nevertheless, the Act does not prohibit employers from taking disciplinary actions for possession or use of medical marijuana during work hours or on work premises and exempts employers that would lose a federal contract or federal funding, would be in violation of federal law, or would result in a "loss of a licensing-related benefit pursuant to federal law."

Employers should take note to ensure that their policies and procedures are compliant with New Jersey's expanded medical marijuana law.

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Amendments to the Compassionate Use Medical Cannabis Act Afford Employment Protections

By Cynthia L. Flanagan, Esq.

New Jersey Governor Phil Murphy signed into law on July 2, 2019 the Jake Honig Compassionate Use Medical Cannabis Act ("CUMCA"), which expands patient access to medical marijuana and substantively changes New Jersey's medical marijuana program. Those amendments also now provide employment protections to an employee's medical marijuana use. Prior to this new amendment, neither the CUMCA nor New Jersey's Law Against Discrimination (NJLAD) required that an employer accommodate an employee's use of medical marijuana.

The CUMCA provides employment protections in two ways. First, the law prohibits employers from taking adverse employment action against an employee or applicant based solely on his or her medical marijuana use. An "adverse employment action" is defined by the law as "refusing to hire or employ an individual, barring or discharging an individual from employment, requiring an individual to retire from employment, or discriminating against an individual in compensation or in any terms, conditions, or privileges of employment." The law specifically identifies the prohibited adverse employment action as one "based solely" on the employee's registry as a qualifying medical marijuana patient. Employers should revise workplace drug and alcohol-free workplace policies to reflect these protections with their limited scope.

Employers are not prohibited from taking adverse employment action against an employee for possessing or using marijuana substances during work hours or on work premises outside of work hours. The law also specifically provides that nothing in the law allows the operation, navigation, or physical control of any vehicle, stationary heavy equipment or vessel while under the influence of marijuana.

Marijuana use under any circumstances is still illegal under federal law, and businesses that contract with, or receive funding from, the federal government are often required to have "zero tolerance" workplace drug and alcohol policies. If employers that engage in business with the federal government were required to comply with the new CUMCA, they would run afoul of federal law and risk losing their federal work. Thankfully, the New Jersey Legislature recognized this quagmire and the new law provides an exception critical to employers that have federal law compliance obligations. The law states that it does not "require an employer to commit any act that would cause the employer to be in violation of federal law, that would result in a loss of a licensing-related benefit pursuant to federal law, or that would result in the loss of a federal contract or federal funding."

An additional employment protection under the new law relates to drug testing of an employee or applicant. The new law does not limit the circumstances under which an employer may drug test an employee or applicant, but the law does create new procedures for the testing. When an employee or applicant tests positive for marijuana, that person is now entitled to provide the employer with a "legitimate medical explanation" for the result, i.e. authorization for medical marijuana use. The employer must provide the employee or applicant with written notice of the positive test result and explain the person's right to explain the reason for the result. The new amendments provide specifically that within three days, the employee or applicant can provide the employer with information to explain the positive test result or request a new test at the employee or applicant's own expense. Employers should revise any drug testing policies to reflect these new procedural requirements.

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Tax Preferential 1031 Real Estate Like Kind Exchanges and Delaware Statutory Trusts

By Douglas R. Eisenberg, Esq.

The real estate industry enjoys certain preferential tax treatment with one example found in Internal Revenue Code (the "IRC") Section 1031 a/k/a "Like Kind Exchanges". Essentially, this IRC section provides that real estate may be swapped or exchanged for other real estate on a tax-free basis. Personal property is excluded. This article is intended to be a primer of the current like kind exchange rules and also discusses the use of a relatively unknown form of investment known as the Delaware Statutory Trust in § 1031 exchanges.

Like Kind Exchanges

In general, IRC § 1031(a)(1) provides that no taxable gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business, or for investment. Certain property is excluded from the benefits of § 1031. For purposes of this discussion, the most noteworthy is (i) stock in trade or other property held primarily for sale; (ii) stock, bonds, or notes; or (iii) interests in a partnership.

IRC § 1031 was designed to defer the taxation on a property disposition in situations where a taxpayer relinquished his or her investment or business asset and received a similar asset in return. The logic behind the deferral of tax was that the taxpayer was basically in the same economic situation before and after the exchange. In addition, the statute acts as an incentive for the acquisition of new modern equipment and the relinquishment of old, outdated equipment.

The drafters of the statute envisioned that the exchange would be more or less simultaneous. That is, the new property would be received as the old property was relinquished. However, this did not always occur, and when it didn't, the IRS would argue that the transaction did not comply with the provisions of IRC § 1031. As a result, the transfer was then deemed a taxable exchange. Litigation followed, and Congress thereafter amended the statute to allow § 1031 deferral benefits to apply if the new exchanged property is (i) identified within 45 days after the day the taxpayer transfers the property relinquished in the exchange, and (ii) actually received by the taxpayer by the earlier of 180 days after the date which the taxpayer transfers the property or the due date of the transferor's income tax return for the taxable year in which the transfer of the relinquished property occurs (determined after including an appropriate extension).

In order to constitute a deferred exchange, the transaction must be an "exchange" (i.e., a transfer/swap of property for property), as distinguished from a transfer of property for money.

The regulations provide rules for identifying the replacement property to qualify for the preferential treatment. Replacement property is deemed to be properly identified only if it is unambiguously designated as replacement property using either a legal description or an address in a written document signed by the taxpayer and delivered or otherwise sent before the end of the identification period to a person involved in the exchange other than the taxpayer or related party, often a Qualified Intermediary (as defined in the appropriate regulations).

It is permissible to identify more than one property as replacement property. When identifying potential replacement properties in writing to a Qualified Intermediary, the taxpayer has the following options: (i) the Three Property Rule, which allows any three properties to be identified regardless of their individual or aggregate value; or (ii) the 200% Rule, which allows the identification of more than three properties, provided that their aggregate fair market value does not exceed 200% of the fair market value of the relinquished property; or (iii) the very rarely used 95% Rule, which allows any number of properties to be identified with no restriction on individual or aggregate value, provided that the taxpayer also acquires other properties whose value equals or exceeds 95% of all properties identified.

As mentioned above, not only must the replacement property be identified, it must be received within 180 days. The identified replacement property is deemed received before the end of the 180-day exchange period if (i) the taxpayer receives the replacement property before the end of the exchange period; and (ii) the replacement property received is substantially the same type of property as the relinquished property.

The regulations also provide that gain may be recognized if the taxpayer actually or constructively receives money or other property (known as “boot” and includes liabilities assumed by the other party or debt attached to the property surrendered) in the full amount of the consideration for the relinquished property before the taxpayer actually receives like kind replacement property. In such situations, the transaction will constitute a sale and not a deferred exchange, even though the taxpayer may ultimately receive like kind replacement property. If cash or other property is received in the original sale transaction, the gain realized must be recognized to the extent of the amount of cash or the fair market value of the other property received.

Delaware Statutory Trusts

Some like kind exchanges are securitized. This is now a multibillion-dollar industry with Delaware Statutory Trusts (“DSTs”) accounting for most of this market. DSTs were developed in order to deal with the stringent requirements of the Tenants in Common legal structure. Although the details of establishing or using a DST are beyond the scope of this article, the DST investment is extremely useful for the exchanger in various circumstances, including for an exchanger who (i) is having problems identifying replacement property; (ii) needs a filler for replacement property to make up the gap between the amount realized and the identified replacement property; (iii) desires to “cash out” to the largest extent possible while not incurring any tax; or (iv) wants to invest for a relatively short time as death may occur, giving rise to increased or stepped up basis.

DSTs are invested in varied properties from apartment buildings to office buildings and everything in between. Although the tax benefits are significant themselves, some DSTs may have the potential to be excellent long-term investments as well. In short, the 1031 tax free exchange, including the use of a DST, is a legal option worth exploring for the real estate exchanger.

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What Are Short-Term and Long-Term Tax Abatements?

By Matthew P. Posada, Esq.

The many challenges that developers and property owners encounter when they attempt to improve or construct projects in distressed areas have long been recognized in New Jersey. To encourage development in distressed or blighted areas and afford investors with a prophylactic measure to hedge economic volatility, State statutes offer tax abatement programs to qualifying applicants through both the short-term tax abatement and the long-term tax abatement.

The short-term tax abatement statute et seq., or the so-called “Five-Year Exemption and Abatement Law,” allows municipalities to grant five-year tax abatements and/or exemptions for the rehabilitation, conversion, or construction of residential, commercial, and industrial projects. These projects must be located within “areas in need of rehabilitation” or “areas in need of redevelopment” designated pursuant to the Local Redevelopment and Housing Law. The municipality where the designated area is located must have an enacting ordinance which identifies the eligibility criteria and application procedures for the short-term abatement. Upon adoption of an ordinance authorizing a tax agreement for a particular project, the governing body may enter into a written tax agreement with the applicant for the exemption and abatement of local real property taxes.

That tax agreement will identify the terms of the contract including the payment in lieu of taxes (“PILOT”) paid by the applicant. The PILOT may be based on any one of three formulas: gross revenue; project cost; or phase-in where taxes on the improvement are exempt during the first year and are “phased-in” during years two through five (20%, 40%, 60%, and 80%). The type of PILOT formula available is contingent on the nature of the project being sought. Although short term abatements are limited to five years, they are still attractive to developers and property owners. Municipalities have limited discretion to deny the abatement provided the applicant satisfies all statutory and local ordinance requirements.

The long-term tax abatement law, the so-called "Long Term Tax Exemption Law" is generally focused on larger-scale projects for the clearance, revised planning, development and redevelopment of blighted areas. The proposed project may include the planning, development, construction, or alteration of residential, commercial, or industrial improvements, or any combination thereof in a single project. Unlike the short-term abatement, the project must be located within an "area in need of redevelopment" or "urban enterprise zone." A developer will have the discretion to develop any use and/or combination of uses identified in the adopted redevelopment plan for the redevelopment area. The developer will be required to create an urban renewal entity, which must be approved by the Department of Community Affairs before an application will be approved and adopted by the municipal governing body.

Although the eligibility criteria and application procedures for a long-term abatement are more stringent than the short-term abatement, the long-term tax abatement can last up to thirty years after the completion of the project. The PILOT formula is based on project costs or annual gross revenues, which may be negotiated with the governing municipality. The terms of the PILOT, permitted transfers, annual reporting requirements, and other contract details will be specified in a financial agreement, which will be negotiated and executed by all parties.

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Creditors Beware of Possible Division of Delaware Limited Liability Companies

By Michael J. Marotte, Esq.

By virtue of a July 24, 2018 amendment to the Delaware Limited Liability Company Act which became effective August 1, 2018, a Delaware limited liability company is permitted to divide into two or more newly formed LLCs. The original company can either continue or terminate its existence. This amendment allows a Delaware LLC to divide its assets among separate LLCs like a reverse merger without the need for an actual asset transfer. Upon the effectiveness of a division, the dividing company's assets and liabilities are "allocated" to the receiving LLCs, as specified in a plan of division. The law does not require identical ownership or management between the transferor and transferee entities.

In order to effect a division, the original company must adopt a plan of division in accordance with its operating agreement (if applicable) and the terms of the applicable statute, § 18-217(g).

A certificate of division is required to be filed with the Delaware secretary of state. Certificates of formation must be filed for each resulting company of the division. For a dividing company that elects not to survive the division, the certificate of division serves as the certificate of cancellation but does not constitute the dissolution of the entity.

Existing creditors are protected by a provision that makes each division company jointly and severally liable for any liabilities that are not allocated in the plan of division, or if the division constitutes a fraudulent transfer with respect to such liabilities. Assuming the division has been properly effected, each resulting company is only liable for the liabilities that have been allocated to it under the plan of division.

For LLCs formed prior to August 1, 2018 and where there are written agreements entered into prior to August 1, 2018 containing restrictions, conditions or prohibitions on mergers, consolidations or asset transfers, such provisions shall be deemed to apply to a division as if it were a merger, consolidation or asset transfer. Therefore, the new law cannot be used to avoid assignment and transfer restrictions in agreements entered into prior to August 1, 2018.

By virtue of the amendment, a Delaware LLC can circumvent assignment and transfer restrictions in agreements entered into after August 1, 2018. Parties that enter into agreements with Delaware LLCs on or after August 1, 2018, that desire to restrict, condition or prohibit divisions must specifically provide for such restriction, condition or prohibition in their agreements. Creditors must be aware that to be enforceable, the restrictions on the rights of a Delaware LLC entity to divide after August 1, 2018 must be expressly set forth in the loan documents, including security agreements, and the entity's organizational or governing documents. Note that Arizona, Texas and Pennsylvania also allow for divisions. Other states will likely follow.

The Delaware amendment provides further protection for creditors by requiring a division contact to be named in the certificate of division. The division contact must provide any creditor of the dividing company with the name and address of the division company to which such creditor's claim was allocated for six years following the division. The division contact can be a person who is a Delaware resident, the surviving company, one of the resulting companies, or any other Delaware business entity.

In accordance with Delaware Limited Liability Company Act, the assets and liabilities of a Delaware LLC can be divided without needing to transfer assets out of the LLC via an asset purchase agreement or other means. This can be useful in a business divorce, a corporate restructuring and in other situations. Lenders and companies entering into agreements with Delaware LLCs after August 1, 2018 will be well advised to address the rights afforded under § 18-217 and plan accordingly.

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