

9th Annual Tennessee Commercial Real Estate Seminar

Thursday, May 6, 2010



BRADLEY ARANT
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9th Annual Tennessee Commercial Real Estate Seminar

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AGENDA

7:30 A.M. – 8:00 A.M.	REGISTRATION AND NETWORKING
8:00 A.M. – 8:45 A.M.	THE ABC'S OF BUYING PROPERTY AT FORECLOSURE - CHARLIE SANGER
8:45 A.M. – 9:15 A.M.	PURCHASE AND SALE AGREEMENTS- THE ISSUES YOU NEVER SEE IN THE LETTER OF INTENT (ROLE PLAY) - ANN CARGILE AND CHLOE SHAFER
9:15 A.M. – 9:45 A.M.	WHAT TO DO WHEN YOUR CONTRACTOR GOES UNDER - DAVID TAYLOR
9:45 A.M. – 10:00 A.M.	BREAK
10:00 A.M. – 10:30 A.M.	WHO'S ON FIRST? – CONFLICTING RIGHTS IN TENANT FIXTURES AND OTHER PROPERTY - PETER SALES
10:30 A.M. – 11:15 A.M.	HOW TO PICK THE BEST ENTITY TO OWN COMMERCIAL REAL ESTATE (PANEL DISCUSSION/ROLE PLAY) - ANN CARGILE, MARK MILLER, PETER SALES AND DAVID TAYLOR
11:15 A.M. – 11:30 A.M.	QUESTION AND ANSWER



Buying Real Property At Foreclosure

May 6, 2010

Charles S. Sanger



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Agenda

- Understand Why
- Analysis
- Reserve
- Preparation & Diligence
- Taking Control of the Process

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Agenda

- Understand the Sale Process
- Psychology of Sale
- Special Issues
- Lease Issues
- Recent Developments

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Understand Why

- Overleveraged
- Mismanaged Project
- Defalcation
- Access
- Death or Disability
- Loss of Key Tenant
- Decline of Submarket
- Other

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Analysis

- Remember in Tennessee a foreclosure sale is a specialized form of auction: The Trustee plays the role of the Auctioneer (in fact some Lenders even retain auctioneers)
- e.g. www.auction.com

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Reserve

- As with other auctions, there is a Reserve.
- In a foreclosure context, this is the amount the Lender will credit bid.

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Practical Pointer No. 1

- Know your Seller's philosophy – will the Reserve be reasonable? i.e. Does the Lender have a “sell now” philosophy or a “fix it up” philosophy.

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Preparation & Diligence

- Lender should have:
 - Title Commitment
 - Survey
 - Environmental
 - Structural Report
 - Rent Roll
 - Leases
 - Appraisals

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Practical Pointer No. 2

- Be persistent, you are dealing with harried, over-worked special assets officers. Offer to sign confidentiality agreement, make copies and pick-up documents.

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Taking Control of the Process

- Bid Agreements with Lender
- Buy the Loan
- Buy the Borrower

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Understand the Sale Process

- “Cash” does not necessary mean cash.
- Amount Down and How Paid
- Closing Date
- Closing Expenses

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Practical Pointer No. 3

- Taxes, rents and other costs are usually not prorated after foreclosure sales

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Psychology of Sale

- Have a Bid Strategy
- Identify Other Bidders (if possible)
- Controlling the Sale

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Special Issues

- Personal Property
- Franchise Agreements
- Liquor Licenses
- Intellectual Property

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Lease Issues

- Owner Occupied – Eviction
- Tenants – SNDA's
- Allowances
- Other Liabilities

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Recent Developments

- Note on Residential Sales
- Note on Deficiencies

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MAY 1, 2010

Seller, LLC
111 Selling Way
Nashville, Tennessee 37203
Attention: Mr. Wolfe

Re: Letter of Intent - Lot 5, Commercial Subdivision

Dear Mr. Wolfe:

Set forth below is a summary of the basic terms upon which Buyer, LLC (Buyer) proposes to purchase a retail shopping center containing approximately 36,000 square feet located at 111 Shopping Center Way, Nashville, Tennessee (the "Property") from Seller, LLC ("Seller").

Purchase Price: \$15.50 per square foot
Earnest Money: \$15,000.00
Inspection Period: The "Inspection Period" shall be the period commencing upon the Effective Date and expiring one hundred twenty (120) days thereafter.
Closing: The closing and consummation of the sale of the Property (the "Closing") shall occur within thirty (30) days after the expiration of the Inspection Period.
Brokers: At Closing, Seller shall pay a real estate commission equal to six percent (6%) of the Purchase Price to Sell It, LLC ("Seller's Broker") and Buy It, Inc. ("Buyer's Broker"), which amount shall be divided equally between Seller's Broker and Buyer's Broker.

This letter is not intended to be a binding letter of intent, contract or agreement except that, by acceptance of this letter, Seller agrees to: (i) negotiate in good faith the provisions of the Purchase Agreement; and (ii) remove the Property from the market as long as this letter or the Purchase Agreement is in effect.

VERY TRULY YOURS,

Buyer, LLC

By: _____

Agreed and accepted this ____ day of May, 2010:

Seller, LLC

By: _____

Preliminary Attorney/Client Conversation

1. Who has the Power?

- (a) Who needs this deal more?
- (b) Are there other prospective buyers out there?
- (c) Is the buyer looking at other sites?

2. Is the Closing Date Critical?

- (a) Does seller's loan mature near the closing date?
- (b) Are the sale proceeds necessary for the seller's immediate business plans?

3. Are the Parties Known to Each Other?

- (a) Is the opposing party a repeat player in the market?
- (b) Do you expect the buyer to flip the contract?
- (c) Do you expect the buyer will need closing extensions?

4. Where is the Money Coming From?

- (a) Should a financing contingency have been included in the LOI?
- (b) What is the source of buyer's funding?

5. Is the Property Known to the Parties?

- (a) Any expected diligence hiccups- environmental issues?
- (b) Has the buyer conducted any pre-contract diligence?

6. Any Third Party Issues?

- (a) Are tenant estoppels required (which tenants, quantity, form of estoppel provided)?
- (b) Will lender require SNDAs from tenants (who is lender, which tenants, what form)?
- (c) Government approvals (subdivision, rezoning, permits)?
- (d) Operating or management agreements to be terminated?

Negotiation Issues

1. Earnest Money

- (a) Who Holds It?
- (b) Is It refundable?

2. Timing

- (a) When Will Title Be Supplied?
- (b) When Will Survey Be Supplied?
- (c) When Will Due Diligence Items be Supplied?
- (d) What is the Review Period?
- (e) Duty to Cure?
- (f) What Happens Upon Failure to Respond (deemed to be approved or not)?

3. Who pays Closing Costs

- (a) Title Commitment and Title Policy Premium
- (b) Survey
- (c) Environmental Reports
- (d) Transfer Tax (\$0.37 per \$100)
- (e) Escrow Agent Fees
- (f) Escrow for Property Condition

4. Closing Conditions

- (a) Adverse Change in the Condition of the Property (physical or financial)
- (b) Requirements Satisfied (estoppels, permits, etc. received)
- (c) Casualty or Condemnation (any thresholds)

5. Type of Deed

- (a) Special or General Warranty
- (b) Quitclaim Deed (if survey description is different)

6. **Tenant issues**

- (a) Any Outstanding Sums Related to Tenants (TI allowances, commissions)
- (b) Limits on Ability of Seller to Affect Leasing Matters or Other Contracts prior to closing

7. **Diligence Conditions**

- (a) Require Buyer Have CGL Insurance Naming Seller as Additional Insured
- (b) Limits on Diligence Permitted (invasive testing)

8. **Representations and Warranties**

- (a) Limitations (knowledge, name persons)
- (b) Survival and Limitation on Damages
- (c) Types of Representations and Warranties

9. **Default**

- (a) Specific Performance?
- (b) Damages?



What to do When Your Contractor Goes Under

May 6, 2010
David K. Taylor



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“Top Ten” List of What to do When Your Commercial Contractor Goes Under

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“Top Ten” List: #1

**DO EVERYTHING YOU CAN ON THE FRONT
END TO MAKE SURE THIS DOES NOT
HAPPEN: DUE DILIGENCE, BIDDING,
PAYMENT AND PERFORMANCE BONDS.**

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“Top Ten” List: #2

**HAVE AN EXPERIENCED INDIVIDUAL
OVERSEE THE WORK PROGRESS,
APPLICATIONS FOR PAYMENT, CHANGE
ORDERS—NOT WORTH IT TO SAVE A
LITTLE \$\$\$ TO “DO IT YOURSELF.”**

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“Top Ten” List: #3

**KNOW THE PROS AND CONS FOR
CONTRACTS (LUMP SUM, DESIGN BUILD,
COST-PLUS, COST PLUS WITH A
“GUARANTEED MAXIMUM PRICE”) AND
AVAILABLE FORM CONTRACTS (AIA).**

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“Top Ten” List: #4

**LOOK FOR THE WARNING SIGNS OF A
PROBLEM CONTRACTOR—AND ACT—
DOCUMENT, DOCUMENT,
DOCUMENT...DOCUMENT.**

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“Top Ten” List: #5

JUST BECAUSE IT’S A TENANT’S CONTRACTOR DOING A BUILD OUT, A LANDLORD/MANAGEMENT COMPANY STILL NEEDS TO BE KEPT IN THE LOOP—AND GIVE THE RIGHT NOTICES WHEN A CLAIM IS MADE, SUCH AS A NOTICE OF NONPAYMENT/NOTICE OF LIEN.

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“Top Ten” List: #6

IF THERE IS A CONTRACTOR DEFAULT UNDER THE CONTRACT, REVIEW THE EXACT TERMS OF THE CONTRACT AND GIVE THE RIGHT WRITTEN NOTICES OF DEFAULT AND TERMINATION.

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“Top Ten” List: #7

**LAST RESORT SHOULD BE TO ACTUALLY
KICK A CONTRACTOR OFF OF A JOB.**

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“Top Ten” List: #8

**CONTACT YOUR FRIENDLY CONSTRUCTION
LAWYER AS SOON AS YOU THINK THERE
IS A DEFAULT/TERMINATION ISSUE—TO
CREATE THE RIGHT PAPER TRAIL**

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“Top Ten” List: #9

**IF THERE IS A PAYMENT/PERFORMANCE
BOND, READ—GIVE THE RIGHT NOTICES,
OTHERWISE WHAT YOU PAID FOR IS
WORTHLESS.**

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“Top Ten” List: #10

**IF THE SUBCONTRACTORS ARE WILLING,
WORK OUT A DEAL TO COMPLETE THE
WORK, WHILE RESERVING ALL RIGHTS**

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“Top Ten” List: #11

**KNOW RETAINAGE LAWS IN TENNESSEE,
AND WHAT YOU SHOULD GET FOR CLOSE
OUT DOCUMENTS**

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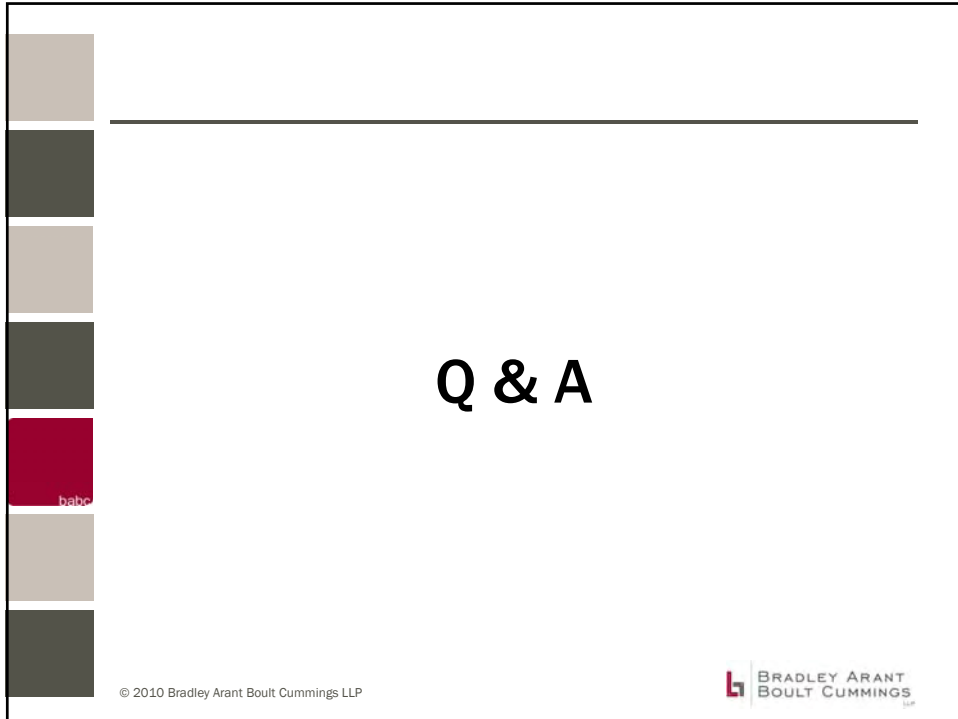


“Top Ten” List: #12

**KNOW THAT THERE ARE ALTERNATIVES TO
LAWSUITS TO RESOLVE CONSTRUCTION
DISPUTES, SUCH AS MEDIATION AND
ARBITRATION, WHICH MAY RESOLVE
SUCH DISPUTES FASTER AND CHEAPER.**

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Who's on First? – Conflicting Rights in Tenant Fixtures and Other Property

May 6, 2010

Peter C. Sales



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Agenda

- Today's Environment.
- Fixture or Trade Fixture?
- What Can You Do?
- Q & A.

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■ Today's Environment.

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Fixture or Trade Fixture

- **Generally.**
 - Fixture belongs to Landlord.
 - Trade Fixture belongs to Tenant.
- **Trade Fixture.**
 - Something that tenant has affixed to the freehold, which can be removed without damage, and which was affixed for the purpose of carrying on the tenant's particular line of business.

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Fixture or Trade Fixture

■ Devil's in the details.

- Generally, in determining whether the equipment is a fixture or trade fixture courts will look to a three factor analysis.
 - Annexation;
 - Adaptation; and
 - Intent.

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Fixture or Trade Fixture

■ Annexation.

- Whether the object is actually or constructively joined to the real property.
 - That is – how is the object attached?
 - Is it attached via welding?
 - Is it merely attached via electric, gas or water hookups?

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Fixture or Trade Fixture

■ Adaptation.

- The adaptation test is met when the object is adapted for the tenant's use of the premises.
- For example, if the tenant is a restaurant and the tenant installs an oven hood. That would be an example of an object that has been adapted for tenant's use of the property.
 - Note, I have dealt with this particular piece of equipment on numerous occasions and while it may meet the adaptation test, it rarely satisfies the annexation test because oven hoods are often welded to the structure and could potentially cause significant damage upon removal.

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Fixture or Trade Fixture

■ Intent.

- The “intent” factor is the most important factor.
- What was the intent of the Landlord and the Tenant?
- Very often the intent of the parties is unclear.
- Court's will look to the Lease, Amendments, and Estoppel Letters.

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What Can You Do?

- Protect yourself with a clearly drafted Lease.
- If your Lease contains lien rights to the Tenant's fixtures, properly record your lien.
- If Tenant installs equipment, request an Estoppel Letter clarifying who takes the fixtures.
- If Tenant requests a rent adjustment, negotiate clarity regarding the fixtures.

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Q & A

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CHOICE OF ENTITY 2010 – TAX CONSIDERATIONS

I. GENERAL FEDERAL TAX CONSIDERATIONS.

A. Overview. While numerous entities are available from which to choose under state law, from a federal tax perspective there are basically three types of entities to choose from if full limited liability protection is desired for all owners:

1. C corporation;
2. S corporation; or
3. Limited liability company (“LLC”).

The primary legal reason to use one of these entities, as opposed to a general partnership or sole proprietorship, is to obtain limited liability protection for owners. Each of the three entities provides limited liability protection for its owners, although the shield of liability protection can be “pierced” if the entity is not treated as a separate legal entity apart from its owners. The tax considerations in choosing one of the entities can vary greatly, and some of the primary advantages and disadvantages of each of the three types of entities are discussed below.

B. C Corporation.

1. Advantages.

- a. No shareholder-level tax on undistributed income.
- b. No ownership restrictions apply (in contrast to S corporations).
- c. Multiple classes of stock permitted (not allowed with an S corporation other than voting/non-voting stock classes).
- d. Section 1202 reduced rate of capital gains taxation on the sale of qualified small business stock.
- e. As a general matter, fringe benefits—such as accident or health plans—paid by a C corporation are fully deductible to the C corporation and excludable from the income of the recipient.

2. Disadvantages.

- a. Income is taxed twice, i.e. the infamous “double taxation;” first at the corporate level (the rate ramps up to 35% very quickly) and second when earnings are distributed to shareholders in the form of dividends (currently at a 15% rate).

- i. Example of double tax: C corporation has \$100,000 of taxable income. That income is first taxed at the corporate tax rates, which for 2010 produces a \$22,250 tax liability. If the full \$77,750 that is remaining is distributed to the entity's shareholders as a dividend, those shareholders are liable for an additional tax at a rate of 15%, meaning that \$11,663 in tax is paid by the shareholders (note that there have been proposals to increase the tax rate on dividends). Bottom line is that \$33,913 in federal income tax is paid on this corporate income (which is an effective tax rate of 33.9%) under the assumptions noted above.
- b. No capital gains rate differential; all income is taxed on the same rate schedule.
- c. Distributions of appreciated property usually triggers gain at the corporate level.
- d. Additional taxes such as the accumulated earnings tax and personal holding company tax.
 - i. Accumulated earnings tax is an additional tax (currently at 15%) that may apply to a C corporation that chooses to retain earnings rather than pay them out in the form of dividends. The purpose for the tax is to deter corporations from unreasonably retaining earnings to avoid the tax on dividends its shareholders would pay on receipt of distributions.
 - ii. The personal holding company (PHC) tax (currently at 15%) applies to C corporations with five or fewer shareholders that own more than 50% of the outstanding stock of the corporation during the last half of the year, and at least 60% of its income is derived from PHC income. Section 543 defines PHC income to include such items as dividends, rents, royalties, use of corporate property by shareholders, personal service contracts, etc.
- e. Shareholders do not benefit from corporate losses.
- f. C corporations generally are required to use the accrual method of accounting, which can result in owing taxes on income that has not yet been received.

- g. Transfer of appreciated property to a corporation will not be tax-free unless certain requirements are met. Generally, a transfer to a corporation is tax-free if the following three requirements are met:
 - i. One or more persons transfer property to a corporation;
 - ii. The transfer is solely in exchange for stock in that corporation; and
 - iii. The transferor or group of transferors are “in control” (i.e., 80% ownership) of the corporation immediately after the exchange.

C. S corporation.

1. Advantages:

- a. An S corporation can easily convert to a C corporation if necessary (e.g., if a public stock offering becomes desirable).
- b. General rule is no double-tax for an S corporation, as it generally does not have to pay any entity-level income tax. Instead, the entity's items of income, loss, deduction, or credit are passed through to the shareholders and are reported on their respective tax returns.
 - i. Example of flow-through tax treatment: Again using the example of \$100,000 of taxable income, the S corporation itself pays no federal income taxes. Rather, the income will flow through and be subject to tax at the shareholder level. Assume the S corporation has only one individual shareholder whose filing status is single, and that shareholder has no other income during the tax year. The shareholder must pay federal income taxes of \$21,720 (equivalent to a 21.7% effective tax rate using 2010 rates) on his or her personal federal income tax return. That is an actual tax savings of \$12,193 from the same entity organized as a C corporation.
- c. Corporate losses flow through, which shareholders may be able to use to offset other income (shareholders can use losses up to their basis in their stock).
- d. An S corporation usually has the option of using either the cash or accrual method of accounting.

- e. S corporation earnings are not subject to self-employment taxes, and amounts paid out as dividends to shareholders are not subject to FICA and FUTA taxes; however, the IRS requires S corporations to pay reasonable salaries to shareholders who work for the corporation.

2. Disadvantages:

- a. Cannot have more than 100 shareholders.
- b. Cannot have as a shareholder a person who is not an individual state, trust, or certain tax-exempt organizations.
- c. Cannot have a nonresident alien as a shareholder.
- d. Cannot have more than one class of stock, except for voting and non-voting stock.
- e. Do not allow for special allocations as do LLCs.
- f. Shareholders obtain basis only for direct loans to the S corporation.
 - i. Shareholders do not obtain basis for any other debt of the entity, which is a distinct disadvantage compared to LLCs.
- g. “Built-in-gains tax” on sale of assets within ten years after conversion from C to S.
- h. Passive investment income tax.
 - i. When an S corporation has C corporation accumulated earnings and profits at the close of a tax year and gross receipts more than 25% of which are from passive income (royalties, rents, dividends, interest, and annuities), it owes a 35% income tax on the net passive income.
 - ii. Three consecutive years of exceeding threshold will cause S termination.
- i. Distributions of appreciated property usually triggers gain at the corporate level.
- j. Same rules as for C corporation on contributions of appreciated above (see above).

- k. 2%-or-more shareholders of an S corporation may not exclude from income the receipt of fringe benefits such as health and accident insurance, disability insurance, group-term life insurance, cafeteria plan benefits, and expenses for meals and lodging furnished for the benefit of the employer.
- l. LIFO reserve recapture may apply if the S corporation was previously a C corporation and the C corporation inventoried goods under the LIFO method as of its last tax year as a C corporation.

D. LLC (taxed as a partnership, which is default rule).

1. Advantages:

- a. No limitations on the number of members, as is the case for S corporations.
- b. No entity level tax; same flow-through of income, gain, deduction, loss and credit as with an S corporation (see example above).
 - i. Members can use losses of the LLC up to their basis.
 - ii. A member that contributed no capital and was not taxed upon receipt of his LLC interest can receive distributions that are treated as capital gain instead of ordinary income (but note that “carried interest” legislation has been proposed this year which could severely curb this advantage).
- c. Allows for varying classes of membership, almost unlimited flexibility.
- d. An LLC is permitted to specially allocate income and losses among its members, and percentage ownership does not have to match capital, as long as certain requirements in the operating agreement are met.
- e. Members are allowed tax basis for the LLC's debt, which enhances the ability to use losses that flow through.
- f. Tax-free contributions of appreciated property (no “control” requirement as with corporations).
- g. Tax-free distributions of appreciated property.

- h. Ability to elect to step up the basis of members' interests in the LLC assets on certain transactions.
- i. Ownership interests, if structured as "profits interests," can be issued tax-free.
- j. General rule is that a member treated as a general partner is liable for self-employment taxes on his or her distributive share of the LLC's income, but a member treated as a limited partner is not liable for self-employment taxes except to the extent the limited partner receives guaranteed payments.
 - i. Other notable exclusions from self-employment taxes include certain rents, dividends, interest, and capital gains/losses.

2. Disadvantages:

- a. A transfer of 50% or more of the membership interests in a 12-month period terminates the LLC (negative tax effect is a restarting of the depreciation schedule).
- b. Disposition of an LLC interest can result in taxation at ordinary income rates ("hot assets" rule).
 - i. Applies to the extent the LLC has unrealized receivables or inventory items.
- c. Taking advantage of some of the advantages of an LLC, such as special allocations, can be complex, expensive, and time-consuming.
 - i. Quote from United States Tax Court: "The distressingly complex and confusing nature of the provisions of Subchapter K (*i.e., the partnership tax provisions of the Internal Revenue Code*) present a formidable obstacle to the comprehension of these provisions without expenditure of a disproportionate amount of time and effort even by one who is sophisticated in tax matters with many years of experience in the tax field; its most complex provisions may confidently be dealt with by at most only a comparatively small number of specialists who have been initiated into its mysteries."

- d. Generally, 2%-or-more members of an LLC may not exclude from income the receipt of fringe benefits such as health and accident insurance, disability insurance, group-term life insurance, cafeteria plan benefits, and expenses for meals and lodging furnished for the benefit of the employer.
- E. Trusts. A trust is not normally used as a business entity, but note that there may be situations where a trust is an appropriate choice of entity.
 - 1. Depending on how it is structured, a trust can either be ignored for federal income tax purposes or treated as a separate taxable entity.

II. TENNESSEE TAX CONSIDERATIONS.

A. Franchise and Excise (“F&E”) Taxes.

- 1. General. F&E taxes generally apply to all entities which do business in Tennessee and provide their owners with limited liability.
 - a. The excise tax is imposed at a rate of 6.5% on the entity’s “net earnings” which generally means income, gain, loss or deduction as determined under the Internal Revenue Code.
 - i. Net earnings are reduced for amounts subject to federal self-employment taxes distributable or paid to each owner.
 - b. The franchise tax is imposed at the rate of \$.25 per \$100 of value of the greater of (i) the entity’s net worth (i.e., excess of the book value of the entity’s assets over the entity’s liabilities) or (ii) the actual value of tangible property owned or used in Tennessee.
 - c. When an entity subject to the F&E taxes has business activities both within and outside Tennessee, the entity must apportion its activities and pay F&E taxes to Tennessee based on the amount of its property, payroll, and receipts in Tennessee as compared to its total property, payroll, and receipts.
- 2. FONCE Exemption from F&E Taxes. To qualify for the “family owned non-corporate entity” exemption, an entity must satisfy the following two requirements:
 - a. The entity must be “family-owned” (i.e., 95% of the interests are owned by related persons as defined under the F&E tax law).
 - i. Trusts do not count as family members.

- b. “Substantially all” (i.e., 67%) of the activity of the entity must be the production of “passive investment income” such as interest, dividends, and royalties.
 - i. Beginning in 2009, commercial rents no longer qualify as passive investment income.
 - ii. Only rents from residential or farm property count as passive investment income (and residential property cannot include more than 4 rental units).
- 3. Obligated-Member Entity Exemption. “Obligated member entities” are LLCs, limited partnerships, and registered limited liability partnership that have filed appropriate documentation with the Tennessee Secretary of State to provide that the partners or members are liable to the same extent as if they were general partners.
 - a. Must file an application for exemption with the Tennessee Department of Revenue.
 - b. An obligated member entity is exempt from F&E taxes for its entire tax year if it makes the required filing with the Tennessee Secretary of State on or before the first day of its tax year.
 - c. If a member is itself a limited liability entity, the obligated member entity must pay that portion of the F&E tax.
 - d. Because this election wipes out all limited liability protection of the owners, careful analysis must be made before making the election (e.g, can insurance provide enough protection to the owners?).
- 4. Other Notable Exemptions from F&E Taxes.
 - a. The Venture Capital Fund Exemption. Applies to an entity that is formed and operated for the exclusive purpose of buying, holding and/or selling securities, including debt securities, primarily in non-publicly traded companies on its own behalf and not as a broker, and the capital of which fund is primarily derived from investments by entities and/or individuals which are neither related to nor affiliated with the fund.
 - b. The Diversified Investing Fund Exemption. Applies to an entity that has (i) no less than 90% of its cost of its total assets consisting of qualifying investment securities, deposits at banks or other financial institutions, and office space and equipment reasonably

necessary to carry on its activities as a diversified investing fund; (ii) has no less than 90% of its gross income consisting of interest, dividends, and gains from the sale or exchange of qualifying investment securities; and (iii) been formed and operated for the primary purpose of buying, holding, or selling qualifying investment securities, on its own behalf and not as a broker, and the capital of which fund is primarily derived from investments by entities or individuals which are neither related to nor affiliated with the fund.

B. Hall Income Tax. Tennessee imposes a 6% tax on certain dividends and interest received by a person domiciled in Tennessee to the extent such interest and dividends exceed \$1,250 (\$2,500 if married filing jointly).

1. Because an S corporation is taxed as a C corporation for Tennessee state tax purposes, distributions from an S corporation are treated as taxable dividends for purposes of the Tennessee Hall Income Tax.
2. S corporations that distribute profits as dividends to shareholders in order to avoid federal self-employment tax can subject its Tennessee shareholders to Tennessee Hall Income Tax on such distributions.

III. MISCELLANEOUS TAX CONSIDERATIONS.

A. Estate Planning.

1. For family-owned entities, S corporations, LLCs, and limited partnerships can all be used to accomplish estate and gift tax savings through the application of discounts to transfers of ownership interests to younger generations.
2. S corporations can create 2 classes of stock – one voting and one non-voting class – but with no differences in financial rights.
 - a. Non-voting stock can be transferred to younger generations at a discount.
3. For a long time limited partnerships were thought of as the ideal estate planning entity because of the interaction of certain estate and gift tax rules with entity structures, but in Tennessee an LLC can now generally accomplish the same goals because of favorable revisions under the Tennessee Revised Limited Liability Company Act.

B. Like-Kind Exchanges.

1. Generally, any entity can engage in tax-free exchanges of real property.

2. Exchanges of ownership interests in entities are not eligible for like-kind exchange tax-free treatment, whether stock of a corporation or LLC membership interests or partnership interests.
3. There can be certain potential advantages to owning property in an LLC when one or some owners want to cash out and others want tax-free exchange treatment.
 - a. Special allocations to cashed-out owners.
 - b. Method of using installment note to cash out owners.

WHAT STEPS TO TAKE ON THE FRONT END TO ENSURE THAT YOUR COMMERCIAL CONSTRUCTION PROJECT IS ON TIME AND WITHIN BUDGET

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In any commercial construction project, there are many key players who must all work together in order to achieve a common goal. The bank wants to ensure their investment and return. The owner wants to keep within budget and on time. The architect wants to ensure that his design concept is met. Finally, the general contractor wants to be able to finish the work on time and get paid. When any one of these participants fails to perform, for whatever reason, a construction project can grind to a halt. While everyone was the part of the “team” in the beginning, when a major dispute arises, finger-pointing time begins. Legal disputes over commercial construction are also extremely expensive and time consuming.

Here are some of the reasons why work on a construction project is being impacted:

1. There have been substantial changes in the plans, including major change orders, all of which were not contemplated in the beginning of the project;
2. There can be problems with “changed” conditions, such as unexpected soil conditions;
3. The Contractor may be having problems with major subcontractors, and while a contractor is legally responsible for its subcontractors, if in fact a major subcontractor fails to complete its work, or goes bankrupt, there will be an impact on the job;
4. There could be a problem with financing and cash flow, which impacts the “trickle down” impact of the money from the bank to the owner to the contractor to the subcontractors. No money equals no work and delays; and/or
5. The contractor is not managing the project well, has a poor project manager, or has too many projects going on at the same time.

The best way to not have to deal with these problems is to ensure, on the **front end**, that you have taken all proper steps in order to avoid a dispute. Here are some basic tips:

- **Use appropriate Construction Contracts:** For owners, know the advantages and disadvantages of types of contracts: design build; lump sum, cost plus, cost plus with a maximum. There are standardized forms (AIA Forms) that are used in

the industry. However, avoid ambiguity, or using language that is not clear to a third party, because while every one knows exactly what a clause means in the beginning, you can be sure, if a dispute arises, there will be different interpretations. It also does not take a good construction lawyer very long to review proposed contracts and make suggestions.

- **Have Final Design Plans:** It is always best for the designers to have a full and complete set of plans and specifications on the front end—before work starts. While changes are expected as the project moves forward (and flexibility is vital), the worst legal disputes are over problems that arise when work starts and the plans are still a work in progress.
- **Keep Communication Lines Open:** Designate an owner's representative—normally the architect if the owner is paying the architect to perform “construction administration.” Unless the owner has someone who is extremely knowledgeable about construction, and can devote the time to dealing with the contractor, it is worth the money to pay an architect to perform construction administration. Set up and establish weekly and/or monthly progress meetings between the contractor, major subcontractors, owner and architect. This is the only way to identify problems on the front end, and to “track” any of the problems that might arise on a job. The last thing you want to do is to have an issue simmer throughout the course of a project, and then erupt at the end of the project, causing substantial problems.
- **Have the “Best People Working on your Project.”** Every contractor who wants a job will, in the “dog and pony” shows put on for owners, put forward its “best team.” However, the “best people” may not be assigned to your job by the time construction begins. Insist on the front end that the management team, including the project superintendent who will build your job, are the contractor's very best and will work on your project from beginning to end.
- **Consider Contractor performance/payment bonds.** While “bonding” contractors does not ensure that in the event of a default the bonding company will swoop in and save the day, bonds can help take care of mechanic's liens (under Tennessee law an owner may be required to pay twice) and put pressure on the contractor. For any major project if the contractor says it can obtain bonds, that is a good sign of the contractor's financial stability—and vice versa. Depending upon the size of the project, you might also insist that the major subcontractors be bonded. While normally those costs are passed through to the owner, for a substantial, multi-million dollar project, the costs are fairly minimal compared to what will be incurred if in fact there are problems and delays on the project.

Of course, even the best-planned projects can end up in legal disputes. However, the hope is that keeping some of these suggestions in mind will not only avoid disputes, but also ensure that disputes can be resolved quickly and efficiently.