



Spring 2008

BUSINESS LAW WATCH

TABLE OF CONTENTS

ENVIRONMENTAL REALM.....	1
<i>Environmental Law 101.....</i>	<i>1</i>
<i>New Environmental Law Impacts Cleanup.....</i>	<i>2</i>
TAX TAKES.....	3
<i>Realty Transfer Tax on Assignment of Purchase Agreements.....</i>	<i>3</i>
<i>Federal Tax Breaks for Business</i>	<i>3</i>
<i>IRS and S Corps: The Hunt is On.....</i>	<i>4</i>
BUSINESS LAW	4
<i>Respect Your Entity.....</i>	<i>4</i>
<i>Personal Liability and Nonprofit Service</i>	<i>5</i>

ENVIRONMENTAL REALM

Environmental Law 101

As noted in this Law Watch, Patrick Zaepfel recently joined KKAG. In addition to a well rounded background in business and corporate law, Pat is an experienced environmental lawyer, with experience as a DEP lawyer and as in-house counsel to the P. H. Glatfelter Company. Because Pat brings a new skill set to the firm, we thought it would be useful to summarize the types of matters typically handled by environmental lawyers.

Real Estate

- Review Phase I and Phase II Reports coincident with the sale or purchase of land
- Advise developers and municipalities regarding planning of sewerage facilities (Act 537 in PA), storm water issues and wetlands regulation

Corporate

- Direct audits of Environmental Management Systems, including ISO-certified systems, for legal vulnerabilities
- Conduct environmental due diligence for mergers and acquisitions
- Draft environmental provisions for stock and asset purchase agreements
- Provide SEC disclosure advice, especially with regard to setting reserves for contingent liabilities and adhering to reporting obligations

“Straight” Environmental

- Advise manufacturing clients with regard to compliance with environmental laws
- Lead environmental permit application processes
- Manage remediation of contaminated properties, including removal of underground storage tanks, asbestos, and mold
- Direct environmental consultants and negotiate with the governments regarding Brownfields protection and Superfund liability

Environmental Litigation

- Prosecute and defend toxic tort and asbestos claims
- Litigate appeals of government compliance orders and permits
- Litigate contract claims related to environmental indemnities and contribution actions related to cleanup costs



- **New Environmental Law Impacts Cleanups**

Effective as of February 19, 2008, the Pennsylvania Uniform Environmental Covenants Act (UECA) formalizes the process for implementing controls on the use of a contaminated property. Based on a model statute adopted in over 20 states, UECA requires that a covenant be placed in the chain of title when engineering or institutional controls are necessary to demonstrate attainment of an Act 2 remediation standard, whether or not the cleanup is performed under Act 2. Engineering controls are generally physical barriers between existing contamination and those that use the property, such as fences and macadam. Institutional controls include legal restrictions on the use of a property, such as a deed restriction.

As a basic matter, an environmental covenant is an agreement or concession that implements land use restrictions - for example, a deed restriction prohibiting the use of groundwater. Under UECA, the "holder" of an environmental covenant may be the owner of the property or the person remediating the property. The Pennsylvania Department of Environmental Protection (DEP) has provided a form on which an environmental covenant can be based, and UECA requires that the current owner of the property, the holder and any other party specified by the DEP be signatories to the covenant. Placed into the chain of title for the property, the agreement runs with the land, binding successive owners of the property unless it is terminated as set forth in the statute. While the agreement can terminate under its own terms (after a set duration of time, or upon the occurrence of specific

events), it can otherwise only be terminated by consent, by judicial order, or by the foreclosure of an interest with priority over the covenant.

DEP must approve a covenant for it to be effective and UECA allows DEP to impose conditions on its approval. The approved covenant is to be filed in the Recorder of Deeds Office in the county in which the property is located, within thirty days of the DEP's approval. DEP is directed to maintain a registry of all approved environmental covenants. While the state may promulgate regulations to implement UECA, it is more likely to implement the statute through guidance documents.

DEP clearly means to make complying with UECA as painless as possible, but troublesome issues have already arisen. First, UECA requires that engineering and institutional controls previously implemented at Act 2 and Storage Tank cleanup sites be converted into environmental covenants within five years of the statute's effective date. Second, if groundwater contamination extends off-site, covenants may need to be obtained from landowners adjacent to a contaminated site. Third, the model covenant released by the DEP requires that the owner and subsequent owners submit compliance reports documenting whether or not the environmental covenant is being followed. This ongoing obligation may prove to be difficult to implement, and will likely have to be revisited by the DEP. As the UECA program matures, its success or failure will largely depend on whether DEP focuses on the practical impacts of its decisions.



TAX TAKES

Realty Transfer Tax on Assignment of Purchase Agreements

Despite a Pennsylvania Supreme Court case to the contrary, the Pennsylvania Department of Revenue has enacted regulations that may tax an assignment of a purchase agreement for real estate. Under these regulations, if a buyer in a purchase agreement assigns the agreement to another party for a profit, then the realty transfer tax would be calculated not just on the price in the purchase agreement but also include the “profit.”

For example, Alice enters into a purchase agreement to sell a piece of real estate to Ozzy for \$100,000. Ozzy then assigns his rights in the purchase agreement to Floyd for \$100,000. When Alice transfers the property to Floyd, realty transfer tax would be owed on \$200,000 not \$100,000. Under the Supreme Court case, realty transfer tax would be owed on only \$100,000. Alice and Ozzy are liable for the realty transfer tax on the original \$100,000 purchase price, and Ozzy and Floyd are liable for the \$100,000 paid for the assignment.

The Department of Revenue in recent guidance has also suggested that an assignment of a purchase agreement to a related party, even if not for a profit, may trigger additional realty transfer tax. The Department has suggested that if a person enters a purchase agreement, forms an LLC, then assigns the purchase agreement to the LLC, that there are two taxable transfers.

For example, Alice enters into a purchase agreement to buy a property from Ozzy for \$100,000. Alice forms an LLC and assigns her rights to the purchase agreement to the LLC. Under the Department guidance, two \$100,000 transactions would be subject to the realty transfer tax. To avoid this result, Alice should form the LLC early and have it enter the purchase agreement as buyer, or establish a clear written straw party relationship between herself and the LLC.

Federal Tax Breaks for Business

Newspapers have repeatedly touted the individual tax rebates in the federal Economic Stimulus Act of 2008. The Act also includes a number of business-oriented tax breaks and incentives.

Business Assets: For tax years beginning in 2008, the Act temporarily increases the amount of capital investment that can be expensed (rather than depreciated) to \$250,000. The Act also temporarily increases the number at which the Section 179 deduction starts to phase out in 2008 from \$510,000 to 800,000.

Special Depreciation Allowance: The Act provides an additional first-year depreciation deduction equal to 50% of the adjusted basis of qualified property for both regular and alternative minimum tax purposes for the tax year in which the property is placed in service. This is similar to the bonus depreciation that first appeared in 2002. There are a number of requirements that must



be satisfied to qualify. Please contact your accountant or KKAG for more details.

IRS and S Corps: the Hunt Is On

The IRS has become increasingly concerned that S corporations are being misused, particularly to avoid federal employment taxes. This results, in the IRS's view, from below market salaries paid to shareholders. Since salaries are subject to employment taxes but corporate distributions are not, the

below market salaries result in reduced payment of employment taxes. As a result, despite relatively few audits of S corporations in recent years, the IRS has announced a focus on this issue. The IRS is studying the issue to attempt to create modeling to identify S corporation tax and financial characteristics that suggest underpayment of employment taxes. The likely result of the modeling is increased audits.

BUSINESS LAW

Respect Your Entity

Setting up a corporation or other entity such as an LLC has many benefits, but primary among these is the protection of an individual's personal assets from the liabilities that may be incurred by the business. In providing counsel to businesses, we often end the conversation with a reminder to "remember the corporate formalities." Rarely, however, have we come across a case that provided such a stark example of the importance of these formalities as *Fletcher-Harlee Corp. v. Szymanski*, recently decided by the Pennsylvania Superior Court.

In *Fletcher-Harlee*, defendant Szymanski was the sole shareholder, director and officer of several companies, including Delmarva Concrete, Inc. Plaintiff Fletcher-Harlee was the general contractor for the construction of a school and subcontracted the project's concrete work to Delmarva. Fletcher-Harlee arbitrated a dispute with Delmarva, but Delmarva refused to participate and the

arbitrator held against Delmarva for \$313,179. In the face of this award, Delmarva declared bankruptcy, while Szymanski continued to do business through several other companies.

In a suit against Szymanski and his other corporations, Fletcher-Harlee sought to pierce the corporate veil to obtain access to his personal and other corporate assets. On the trial level, Szymanski and his other companies won a dismissal. At appeal, however, the Pennsylvania Superior Court noted that Szymanski was the sole shareholder, director and officer of all the companies, that all the companies were located in the same location, and that he did not keep adequate corporate records. (Apparently, the few records he did keep indicated that he was Delmarva's largest creditor due to outstanding personal loans.) In addition, Szymanski occasionally held out Delmarva and the other companies as being one and the same.



In light of this evidence and the fact that Delmarva was undercapitalized (as demonstrated by its bankruptcy), the Superior Court vacated the trial court decision and remanded it for an entry of a judgment in favor of Fletcher-Harlee. In its lengthy opinion, the Superior Court noted that the crux of the issue is whether equity demands that shareholders' traditional insulation from liability be disregarded due to the corporation being operated as a sham and not as a legitimate entity.

In this case, all of the factors led to the conclusion that the corporate veil should be pierced and that the dominant shareholder should be held accountable for the liabilities of the corporation. These factors - whether adequate corporate records are maintained, whether the company has enough capital to meet its reasonably anticipated debts and liabilities, whether the company's finances have been intermingled with those of a shareholder or other companies - all stand for a single proposition: to assure that a court will uphold its corporate form, a company must be managed as a separate and responsible entity, not as a mere vehicle for a shareholder's whims. Coming back to basics, please remember to honor your corporate formalities.

Personal Liability and Nonprofit Service

Clients of the firm have asked whether they can be held personally liable due to their involvement with nonprofits, whether as a volunteer "in the field" or as a director guiding the organization. The risk created by involvement in a nonprofit is likely minimal relative to the risk arising from driving a car, but in our litigious society, there is no denying the potential for such liability.

Whether the potential risk is significant depends on a number of factors, including nature of the service provided by the organization, the individual's role in the nonprofit and in the facts giving rise to a particular claim.

"Directors and officers" or "D & O" insurance offers protection for the individuals running the corporation, but it does not protect the normal volunteer and nonprofits often decide not to purchase D & O coverage due to its cost. Pennsylvania law, however, provides some measure of protection for those that work for the public good. The Pennsylvania Good Samaritan Law specifically limits the potential liability of uncompensated officers, directors and volunteers of non-profit organizations, requiring a plaintiff to show a heightened degree of negligence before liability can attach. In simplified terms, the law states that no such person shall be liable for civil damages as a result of performing their duties unless (a) their conduct falls significantly below ordinary standards of care and (b) they breached a recognized duty with reason to know actual harm would result. 42 Pa.C.S.A. §§ 8332.2 and 8332.4. "Normal" negligence would not be enough to create personal liability. While no one wants to be in a position to test the difference between normal and extraordinary negligence, the Good Samaritan law does provide some peace of mind against frivolous lawsuits.

Depending on the purpose of the nonprofit and the individual's actions, Pennsylvania law may provide other protections. For example, persons donating food for distribution to the needy are protected from civil and criminal liability arising from the condition of the food, so long as it reasonably appears to be



suitable for household consumption or use, unless such liability arises due to some act or omission that constitutes gross negligence, recklessness or intentional misconduct. 42 Pa.C.S. § 8338.

Volunteering to help a nonprofit can provide immeasurable value both to the individual and the community, but, as with any activity, it necessarily involves risk of potential legal exposure. If we can be of any assistance to you in examining the magnitude of those risks, please feel free to contact us.



KEGEL KELIN ALMY & GRIMM LLP

Business Law Group

(717) 392-1100

KKAG has a substantial business law practice, representing businesses of all sizes.

KKAG advises businesses on mergers and acquisitions, business formation, general contracting and business counseling, financing, distribution and trade regulation, tax, technology law issues, environmental issues, as well as a full range of other legal areas faced by businesses.

D. Mark Grimm, Jr., Clarence C. Kegel, Jr. and Patrick H. Zaepfel are the primary lawyers in our business law group. Other lawyers are involved in business law work as appropriate based on their areas of expertise.

© 2008 Kegel Kelm Almy & Grimm LLP. All Rights Reserved.

All Rights Reserved. These materials may not be reproduced in any way without the written permission of Kegel Kelm Almy & Grimm LLP. This publication is designed to provide general information on the topics presented. If legal or other professional advice is required, the services of a professional should be sought