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REPORT FROM COUNSEL

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NEW FEDERAL TAX LAW ENACTED

On December 17, 2010, the president signed into law an $858 billion federal tax package. The main elements of the legislation are a two-year extension of the reductions of income, capital gains, and dividend taxes enacted during the Bush Administration and a one-year extension on unemployment insurance benefits that had ended as of December 1. Although many parts of the package are of relatively short duration, below are some highlights of the new tax law:

Your Paycheck

Beginning in January 2011, a 2% drop in an employee's share of the Social Security portion of the FICA tax, from 6.2% to 4.2%, will increase take-home pay for most workers. For example, this means an additional $1,600 in 2011 for someone making $80,000 a year.

There will be a two-year extension of the 2001 and 2003 income tax cuts from the Bush era. This means that, at least through 2012, the tax rates will remain at the current levels, based on income: 10%, 15%, 25%, 28%, 33%, and 35%.

The extension of certain tax benefits also means that for those making less than $90,000 a year ($180,000 for married couples), there will continue to be a $2,500 tax credit to help pay for

college tuition. This American Opportunity Tax Credit had been scheduled to expire at the end of 2010. The Child Tax Credit, which had been set at $500, has been hiked to $1,000.

The new law also lifts the exemption levels for the alternative minimum tax (AMT), sparing millions of middle-income taxpayers from being subjected to the AMT.

Your Investments

Without action by Congress, 2011 tax rates on the profits of assets sold after more than a year would have increased to 20% and dividends would have reverted to being taxed at ordinary income rates. Instead, rates on long-term capital gains and for dividends on certain stocks held longer than 60 days will stay at 15% through 2012. Maintaining the status quo also means that taxpayers in the two lowest income tax brackets will continue to have a 0% capital gains rate.

Your Estate

In 2009, there was a maximum estate tax rate of 45% and a $3.5 million exemption. The estate tax temporarily disappeared in 2010. Under the new law, for 2011 and 2012 the maximum rate will be 35%, with a $5 million personal exemption. Any unused exemption may be passed to a surviving spouse, so that a married couple can exempt up to $10 million. In keeping with the short-lived nature of many parts of the new law, without further legislation there will be a 55% estate tax rate in 2013 and an exemption of just $1 million per person.

Your Retirement

The new tax law continues provisions that permit investors who are 70-1/2 or older to make a qualified distribution of up to $100,000 from an IRA directly to a qualified charity for 2010 and 2011. However, the new law did not preserve what had been a suspension of minimum required distributions (MRDs). To avoid a stiff penalty, retirees generally must take MRDs from their retirement accounts for the year in which they turn 70-1/2, and all years after that, no later than the last day of the calendar year.

REAL ESTATE ROUNDUP

Home Appraisal Fraud

Joseph and Kimberli bought an unimproved lot in a subdivision and then engaged an architect and a contractor to design and build the home of their dreams on it. The lot and finished home together would cost them about $731,000. They borrowed most of the sales price from a bank, which sought and obtained an appraisal from an appraiser regularly used by the bank. Conveniently enough, the appraisal came in at about $731,000 when conducted under both a cost approach and a sales comparison approach.

After the couple had been in their new house about a year, Kimberli lost her job and the couple went back to the bank to apply for a home equity line of credit. This required another appraisal from a new appraiser. To the shock and consternation of the homeowners, the property was appraised this time at only $510,000. To use a term which has come to describe so many, Joseph and Kimberli were "under water." Denied the home equity loan and unable to pay the mortgage, they managed to sell the property for $660,000.

When Joseph and Kimberli sued the first appraiser for intentional misrepresentation, the claim was upheld by a state supreme court, which ruled that the couple had presented enough evidence to warrant a jury trial. A plaintiff suing for intentional misrepresentation must prove that

1. The defendant made a false representation of an existing or past material fact;
2. The defendant made the representation recklessly, with knowledge that it was false or without belief that the representation was true; and
3. The plaintiff reasonably relied on the representation, causing him damage.

The gist of the suit was that the appraiser, to please everyone involved at that moment, intentionally misrepresented the value of the property when he appraised it at a dollar amount

substantially higher than its true value. The defendant appraiser contended that an appraisal is in one sense an opinion, rather than a simple statement of fact. However, for purposes of a claim for fraud, an appraisal can be regarded as a representation of fact.

On the issue of recklessness, there was evidence for both sides, but the issue needed to be resolved by a jury. Favoring Joseph and Kimberli was evidence that the appraisal request from the bank was for a "Rush!" appraisal, and the appraisal value matched the sales price virtually down to the dollar. Joseph and Kimberli would get their chance in court to prove that, to their detriment, the appraiser was determined to come up with the "right" appraisal to make the deal happen, even if the truth of the property's actual value was a casualty in the transaction.

Noncompliance with HUD

When a home loan is insured by the U.S. Department of Housing and Urban Development (HUD), regulations impose some loan servicing responsibilities on the lender, while also granting certain forms of relief for borrowers facing the prospect of foreclosure. For example, under certain conditions, the lender must initiate face-to-face contact with the borrower before starting foreclosure proceedings. Before a borrower falls behind by four full monthly installments on a mortgage, the lender must evaluate all of the loss mitigation techniques provided for in the regulations.

These regulations have an obvious bearing on the relationship between lenders on HUD-insured loans and the federal government, but it is a closer question of law as to whether a borrower can raise a lender's failure to comply with the regulations as a defense when the borrower defaults and the lender sues to foreclose on the mortgage.

Recently, a state court agreed with a borrower who had defaulted on her HUD-insured mortgage that a foreclosure action by her mortgage company could not go forward until it was

shown that the mortgage company first had complied with the servicing responsibilities imposed by HUD.

The main point of contention in the case concerned the face-to-face contact requirement. This regulation applies only if the mortgaged property is within 200 miles of the lender. The mortgage company in this case was established under the laws of a distant state that was more than 200 miles from the property, but the borrower countered that the company had an office within the 200-mile range, in a neighboring state.

The court ruled that the HUD loan servicing requirements had such importance that the failure to comply with them should be an affirmative defense for a defaulting borrower. Families who receive HUD-insured mortgages generally do not qualify for conventional mortgages. It would make no sense to create a program to aid families for whom homeownership would otherwise be impossible without promulgating mandatory regulations for HUD-approved mortgagees to ensure that the objectives of the HUD program are met. The goal of preventing foreclosure in HUD mortgages wherever possible cannot be attained if HUD's involvement begins and ends with the purchase of the home and the receipt of a mortgage by a low-income family.

CYBERSQUATTING AND THE COURTS

A former employee who refused to give up a domain name that he had registered for the benefit of his former employer has been hit with a sizeable damages verdict. The federal appeals court that heard his case looked unfavorably on his having held the domain name for "ransom," and agreed that the employee had violated the federal Anticybersquatting Consumer Protection Act (ACPA). Meanwhile, an Illinois company was unsuccessful in bringing a claim against a Texas company under the ACPA. Although the Texas company had registered a domain name

similar to one held by the Illinois company, there was not sufficient jurisdiction for the Texas company to be sued in Illinois.

In the first case, an employee of a men's clothing company registered a domain name for the company. The domain name was registered in his name, but that was not the cause of his subsequent problems in court. Some years later, after the company had come to depend on its website for most of its business, the employee left to work for a competitor and, in effect, took the domain name with him.

He shut down the website and declined to give up the domain name unless he was paid commissions that he claimed were due to him. This use of the domain name as a means of gaining leverage over the former employer led to civil liability under the ACPA. The law requires an "intent to profit," but this is broadly construed to include an attempt to procure an advantageous gain or return and it was of no significance whether the employee was, in fact, owed the commissions he was seeking.

Like any other civil lawsuit, an action under the ACPA can proceed only if jurisdictional requirements have been satisfied. This became apparent in the second case when an action filed under the ACPA in a federal court in Illinois against a defendant from Texas was dismissed for lack of personal jurisdiction over the defendant.

The plaintiff, based in Chicago, provided medical services in various other cities, including Houston. When a small Houston company in the same line of work registered a domain name that was very similar to that of the Chicago business, the Chicago firm sued under the ACPA.

The defendant from Texas simply did not have sufficient contacts with Illinois to be sued there. It had no physical presence nor any clients in Illinois, and it certainly had not purposefully directed any of its activities in Illinois. Of course, a website is accessible from all over the world,

but that was insufficient to satisfy the "contacts" requirement for personal jurisdiction over the defendant in Illinois.

The doctor who ran the Texas business was licensed to practice only in Texas, the only telephone number on his bare-bones website was a Houston number, and the site invited doctors in the "greater Houston area" to contract for his services. As the court dismissing the lawsuit put it, if a doctor in Chicago did happen to find the defendant's website and call the Houston business, "their conversation would be very short."

EMPLOYMENT RETALIATION CLAIMS SURGING

The case can be made that discriminating against an individual in the workplace because of the person's gender, race, religion, and similar characteristics is something of a behavioral aberration that is not a part of human nature—or at least most people would like to think that is the case. But what about the scenario in which a manager takes it out on an employee who has sued or threatened to sue the employer (and maybe the manager, too) for some type of discrimination? Such retaliation may not spring from the most noble of instincts, but it is rooted in common human emotions.

Psychological theorizing aside, the fact is that retaliation claims brought against employers have become the single largest type of claim filed with the federal Equal Employment Opportunity Commission.

Whether grounded in a statute or court-made law, practically any recognized form of employment discrimination is accompanied by a prohibition against any form of retaliation against the person who has complained of the discrimination. Until recently, the claim for a prohibited form of discrimination typically was the main act, with a retaliation claim sometimes

thrown in for good measure, and maybe even as an afterthought. However, retaliation claims increasingly are taking center stage.

Recent U.S. Supreme Court cases have stimulated the filing of more such claims. In 2009, the Court broadly construed the anti-retaliation provision in Title VII of the Civil Rights Act of 1964 as protecting workers who answer questions as part of an internal investigation by the employer, even though the statute uses an arguably narrower term in prohibiting retaliation for "opposing" unlawful employer practices. According to the Court, the verb "oppose" extends beyond active, consistent behavior. For example, it would be "opposition" if an employee took a stand against an employer's discriminatory practices not by instigating an action, but by standing pat and refusing to follow a supervisor's order to fire a subordinate worker for discriminatory reasons.

A prudent employer should take some basic measures to reduce the chances of liability for retaliation. Adopt a written anti-retaliation policy. Train managers in how to respond to complaints of discrimination. Document all investigations of employee complaints clearly and thoroughly. Finally, keep complaints of prohibited discrimination confidential, not as fair game for water-cooler conversations—a supervisor who does not even know about a complaint of discrimination cannot take action in retaliation for that complaint.

DIFFERENT WAYS TO HOLD INVESTMENT PROPERTY

Convinced that property values have finally bottomed out in your area, you decide to take the plunge and buy some real estate as an investment. As the saying goes, buy low and (hope to) sell high. In such ventures, one of the earliest and most important decisions concerns which type of ownership entity is best suited for raising capital and securing the financing to fund the acquisition or improvement of the property.

There is an extensive array of possible forms of ownership. They include individual ownership, tenancy in common, joint venture, general partnership, limited partnership, limited liability partnership, limited liability limited partnership, C corporation, S corporation, limited liability company (LLC), business trust, land trust, or real estate investment trust.

For the most part, the limited partnership has been the entity most preferred by investors because it best combines the tax advantages of a partnership with the nontax advantages of corporate ownership. However, the LLC is also a good fit for some real estate investors because, as a hybrid entity like the limited partnership, it has desirable features of other options. Some of the more common forms of holding investment property are discussed below.

Outright Ownership

Simply holding the property in the name of an individual buyer gives maximum control and flexibility in calling all the shots, assuming the individual has the financial resources to go it alone in making the investment. In this situation, having adequate liability insurance should be a high priority.

Joint Ownership

Married couples especially may like the option of joint tenancy, with right of survivorship. When one spouse dies, the property can pass directly to the surviving spouse, avoiding the expense and time involved in going through probate. Of course, the other side of the same coin is that the property cannot be inherited by other heirs when a spouse dies.

General Partnerships

Using a collection of partners increases buying power and, with it, the range of properties that can be bought. As with any general partnership, there may arise some discord and disagreement among the partners concerning all manner of decisions that need to be made, and each partner's personal assets could be at risk to satisfy partnership debts.

Limited Partnerships

The legal status of limited partners may appeal to some real estate investors. Limited partners have no say in the management of partnership assets, but they also have potential liability only for the capital they contribute or for any notes they sign. Any real estate losses are allocated to the limited partners, for tax purposes.

Limited Liability Companies (LLCs)

An LLC offers some of the best features from all of the possible choices. An LLC member benefits from the "pass through" of any income or loss from the real estate to his or her tax return. LLC members also enjoy the same kind of limited liability that a corporation's shareholders have, thus safeguarding their other personal assets.

Any determination of this kind should always involve careful balancing of the specific competing tax, financing, and legal attributes that characterize each entity. What is otherwise suitable from a legal or financing standpoint is often a nonstarter from a tax perspective, or vice-versa. Given the sums of money that can be in play, prospective investors are well advised to spend some additional money on professional advice when choosing the ownership vehicle as they take on the role of real estate investor.