LJN LAW JOURNAL NEWSLETTERS

Law Firm Partnership & Benefits Report®

An incisivemedia publication

Volume 14, Number 12 • February 2009

Technology And Law Firm Management

By Jeremy T. Elman

My office is in Miami, yet most of my cases and colleagues are in faraway states. How can I practice law this way? One word: technology. My files are all maintained electronically, I correspond with other lawyers using video and Web conferencing, and my court filings are done via the Internet. Technology enables me to work anywhere. People like me are changing the practice of law because we use technology in our practice every day. Technology innovations in legal practice will become standard as my generation moves into management and leadership roles.

One of my mentors was told when he was a young lawyer that the road to partnership was "paved" with paper cuts. Those lawyers spent years digging through boxes of documents and thumbing through legal texts. No more. Now that road is increasingly paved with computer clicks. The traditional law office, with a receptionist, secretary, paralegal and attorney writing longhand briefs is disappearing. In its place is a whole new world.

Here are a few major technology-related changes:

Paperless Offices

Many lawyers store files electronically on password-protected Web sites or in databases. No more overflowing paper files stored in cramped file rooms. This not

continued on page 6

Does Your Partnership Agreement Violate the Rules of Professional Conduct?

New Guidance on Rule 5.6(a)

By Timothy J. Dacey

In many industries, non-competition provisions are a typical feature of employment contracts and partnership agreements. Courts will usually enforce such provisions if they protect a legitimate interest of employer and are reasonable in scope, time and geographic area. Non-competition agreements among lawyers, however, have long been condemned as unethical. Such agreements were prohibited by DR 2-108 of the Model Code of Professional Responsibility adopted by the American Bar Association in 1969, and by Rule 5.6(a) of the ABA's Model Rules of Professional Conduct promulgated in 1983. In its current form, Rule 5.6(a) provides:

> A lawyer shall not participate in offering or making:
> (a) a partnership, shareholders, operating, employment, or other similar type of agreement that restricts the right of a lawyer to practice after termination of the relationship, except an agreement concerning benefits upon retirement.

Prohibitions similar to DR 2-108 and Rule 5.6(a) have been adopted in virtually every American jurisdiction.

In their core application, these rules are reasonably clear. They prohibit the typical non-compete provision that restricts a departing lawyer from practicing law in a particular area for a specified period of time. They also prohibit "anti-poaching" agreements that prevent a departed lawyer from soliciting business from clients of his former firm. *See, e.g., Dwyer v. Jung*, 133 N.J. Super. 343, 336 A.2d 498 (1975).

What the States Say

The outer limits of these rules, however, have been harder to pin down. Questions about the scope of the rules began with the decision of the New York Court of Appeals in *Cohen v. Lord, Day & Lord*, 75 N.Y.2d 95, 550 N.E.2d 410 (1989). In *Cohen*, the court invalidated a partnership provision that did not expressly prohibit competition by a withdrawing partner, but that substantially reduced the post-departure payments to which the partner was entitled if the partner joined

continued on page 2

In This Issue

Rule 5.6(a)

continued from page 1

a rival firm. Because the agreement imposed a significant monetary penalty on competition, the court concluded that it was the functional equivalent of a covenant not to compete, and hence prohibited by the DR 2-108. Cohen is now "the strong majority rule in this country." *Pettingell v. Morrison, Mahoney & Miller*, 426 Mass. 253, 256-57, 687 N.E.2d 1237, 1239 (1997). Only California and Arizona have declined to follow *Cohen's* lead. *Howard v. Babcock*, 6 Cal.4th 409, 863 P.2d 150 (1994); *Fearnow v. Ridenour, Swenson, Cleere & Evans, P.C.*, 213 Ariz. 24, 138 P.3d 723 (2006).

New Jersey cases have taken *Cohen's* forfeiture analysis a step further, suggesting that partnership agreements that denied benefits to all or virtually all withdrawing partners violated Rule 5.6(a). *Katchen v. Wolff & Samson, P.C.*, 258 N.J. Super. 474, 610 A.2d 415 (App. Div. 1992); *Weiss v. Carpenter, Bennett & Morrissey*, 143 N.J. 420, 672 A.2d 1132 (1996). In the New Jersey cases, the agreements at issue did not expressly discriminate between partners who left to compete and those who left to engage in other pursuits. The concern of the New Jersey courts seemed to be that the loss of financial benefits discouraged all lawyers from leaving the firm and thereby deterred those lawyers who might want to leave in order to compete with their former firm. The agreements were thus "anticompetitive in the broadest sense." *Katchen*, 258 N.J. Super. at 481, 610 A.2d at 419. The New Jersey decisions lead to the peculiar result that a partnership agreement requiring forfeiture of benefits might be unenforceable against a lawyer who left to join a rival firm, but not against a lawyer who left "to bicycle around the world." *Katchen*, 258 N.J.Super. at 481, 610 A.2d at 419.

Timothy J. Dacey is a director of the law firm of Goulston & Storrs in Boston. He is a trial lawyer who frequently represents lawyers and law firms in partnership disputes and professional liability matters.

The APICs Saga

Uncertainty about the outer limits of DR 2-108 and Rule 5.6(a) has produced a small cottage industry of challenges to law firm partnership and employment agreements on the grounds that they are anti-competitive and hence unethical and unenforceable. Departing lawyers have, for example, invoked Rule 5.6(a) to attack partnership provisions that required them to remain liable for a portion of the firm's rent and employment agreements that required them to share any fees generated by contingent fees cases that they removed from the firm. An unreported Massachusetts trial court decision involving an employee loan reflects the imaginative uses to which Rule 5.6(a) has sometimes been put. In that case, the firm lent an employee funds to pay for law school tuition, on the understanding that, if the employee returned to the firm after passing the bar, the loan would be forgiven over time. If the employee left the firm before the loan was fully written off, he was obliged to repay the balance remaining. The employee passed the bar but left the firm before serving the required length of time. When the firm sued for the balance, the newly minted lawyer claimed that the loan terms were anti-competitive and violated Rule 5.6(a). The trial judge sensibly rejected the employee's argument.

Against this background of uncertainty, the recent decision of the Massachusetts Supreme Judicial Court in *Pierce v. Morrison Mahoney LLP*, 452 Mass. 718, 897 N.E.2d 562 (2008) provides valuable guidance concerning what Rule 5.6(a) does and does not prohibit. Pierce was the second chapter in a long-running dispute about a type of financial benefit referred to in the firm's partnership agreement as "Annual Partnership Interest Credits" ("APICs"). APICs represented the annual net income or loss of the firm calculated on an accrual basis and allocated among the partners. As originally drafted, the partnership agreement provided that APICs were payable over time to partners who had reached age 60 or served for 20 years as a partner and who retired from the practice of law. The agreement also provided for APICs

continued on page 4

LAW FIRM PARTNERSHIP & BENEFITS Report ®

Law Firm Partnership & Benefits Report® (ISSN 1061-9410) is published by Law Journal Newsletters, a division of Incisive Media.
Telephone: (800) 999-1916,
Editorial e-mail: julie.gromer@incisivemedia.com
Circulation e-mail: customercare@incisivemedia.com
Reprints e-mail: lauren.melesio@incisivemedia.com

Law Firm Partnership & Benefits Report 023147
Periodicals Postage Pending at Philadelphia, PA
POSTMASTER: Send address changes to:
Incisive Media
120 Broadway, New York, NY 10271

Published Monthly by:
Law Journal Newsletters
1617 JFK Boulevard, Suite 1750, Philadelphia, PA 19103
www.ljnonline.com

Law Firms and Social Networking

By Paula Campbell

When today's firms want to recruit new attorneys, obtain new clients, publicize successful representations, take surveys for marketing insight, or simply perform research, most are turning (some exclusively) to the Internet. Along with the viral popularity of social networking Web sites (one of these sites is the fourth most-trafficked Web site in the world), legal blogs, collaboration sites, and informal online education options comes the vulnerability of some risk.

While firms have developed formal guidelines that cover items published by attorneys, do those guidelines also cover staff and non-legal positions at the firm? Does the policy include a detailed list of media types? When was the last time that the media list was updated? Best to check with human resources to verify that the policy relates to all and that it is, in fact, in place.

Marketing to a New Generation of Clients

All organizations, including law firms, are about relationships and a successful network of professionals, employees, and clients. The millennial generation is putting a whole new face on relationship connectivity. Social networking is a great way to nurture, develop, and bring those important relationships up to date. Even the U.S. government is getting into the act. There's a very impressive Federal Housing Administration, social networking page that even directs seekers to related "dot GOV" Web sites for financial monitors and resources. Some organizations have created a dedicated position for social network site administration, research and security, much the same as the position that is responsible for e-mail. The better news is that social networking sites actually cut down on the amount of unsolicited spam.

Social networking sites are great resources for a lawyer or firm to develop or promote a personal brand. Some sites have powerful marketing components that enable firms to select a specific demographic target, see how many people that demographic will find, and market to that demographic. An attorney could list recent successful representations or transactions. Prospective clients might find interest in one's professional associations or background as well as travels, charitable involvement or personal interests.

Recruiting with a New Twist

Personal social network profiles can serve as a virtual resume for potential firm recruiters. The following legal-blog query from an interested law student seems reasonable enough:

"Basically, I'm a 2L at [xxx] State, and I'm trying to decide whether to accept my offer at [Firm zzz]. I still haven't decided which firm to work for because the firms wanted to "call me back" to their offices to meet everyone who I would be working with, and I wanted to wait until after the semester was over to make this big decision, so now my project during winter break is to go on these "callbacks" and meet everybody and decide which firm I want to work for. What do people *really* think of [Firm zzz]?"

Besides noticing that the law student posted a rambling query (hopefully, not at all representative of his/her legal writing skills — now there's some *risk*), the responses to the request were all over the map. Current staff members, professional colleagues (inside and outside the enterprise), and previous candidates all weighed in on the request for information. Some of the responders were less than flattering (the term for these persons is "Frenemies" since they need to be accepted before being able to post replies), while others' responses seemed to come from well intentioned firm members earnestly trying to disprove a disparager's remarks. Comments regarding the blogger's educational choice were equally as diverse. As a site observer, what conclusion does one draw?

Positive Ways to Begin

Whether you become part of an already established networking group, or if you take the plunge and develop a custom social networking site, to create and maintain a social networking profile for your firm or for yourself follow these important rules:

- Do some research. Take a look at competitors' sites. Join a network based on a geographical region, educational affiliation or workplace. Make sure that positive information is flowing. It's okay to change your status if the mood switches, or better still, do not post or join a site from a defensive posture.
- Create an adept profile. Write about your firm's professional accomplishments, but also include some civic or social items that may help others build a connection with you or your firm. Historical information may be interesting to seekers, but avoid creating a site that duplicates your firm's Web site.
- Post timely content. Add content to a profile that establishes expertise such as links to published articles, attorney bio pages, etc.
- Interact with others. Socializing is the point.
- Extend relationships outside social networking sites. While communicating with other members, see if opportunities exist to enhance the relationships offline. Maybe a lunch while traveling? Importantly, instead of expecting immediate results, be consistent and patient.

Monitor, Monitor, Monitor!

When a busy schedule intersects with technology that requires frequent

continued on page 4

Paula Campbell, a member of this newsletter's Board of Editors. is the Technology Training Specialist for her firm's California offices. She can be reached at iteachpcs@aol.com. The views set forth herein are the personal views of the author and do not necessarily reflect those of the law firm with which she is associated.

Social Networking

continued from page 3

review, the result can be disastrous. For most social networking profiles, privacy settings can be adjusted so that only the people (clients, staff or competitors) who are authorized can see certain parts of the profile. Social network sites can also be designed to be read-only, but what's the point? The general rule is, if you don't want the wrong person to see it, don't post it. Review posts and delete those that are inappropriate.

A common concern is distinguishing between personal and professional content and how that is managed in a social network profile. Side-bar information "Wikis" may be a good way to post data that is brief and interesting, but inaccuracies can proliferate bad press or even become sources for libel. There will come a time when personal and professional profiles merge, but until then be cautious as to what is shared with others via social media.

PDAs and Social Networks

Most new PDA devices now come with social networking software pre-installed. Convenient? Sure. Fast? Absolutely. Scary? Perhaps. Think twice about downloading files or pictures to social networking sites from unsecured devices. Unsecured transmission "hot-spots" can be problematic, as our new Commander in Chief is discovering.

Law.com reminds us: "It may be difficult to imagine life without a BlackBerry. In many organizations, such devices have become vital to the smooth functioning of corporate teams at the highest levels of management, where decisions affecting hundreds of people and involving millions of dollars are made every day. Yet the same concerns worrying Obama's advisers also apply to corporate BlackBerry users. Computer usage, records retention and security have been and continue to be corporate duties. Obama's team is smart to be addressing the issue now, and in-house counsel and information technology departments should follow suit with respect to the use of portable communication devices."

Trendy networking sites where posts can't be longer than 130-150 characters and are shared among selected friends and colleagues who track one another in cyberspace, can be vastly misinterpreted. While the intent may be to explore the cutting edge of new technologies, some information sharing methods carry too great of a risk. Perhaps it is time to draft an enforceable policy that works for your organization.

For a review of popular social networking Web sites, including security, features and demographics, see:

http://social-networking-web-sites-review.toptenreviews.com/

Still curious? Create an alias to join a social networking Web site and see how many site members share similar interests, education or legal practice. The next step is deciding if/what a firm can gain from the immediate connectivity that is electronic social networking.

—❖—

Rule 5.6(a)

continued from page 2

payments to partners who voluntarily withdrew from the firm before becoming eligible for retirement benefits. If, however, the withdrawing partners thereafter engaged in competition with the firm, they forfeited the right to receive APICs.

In the first chapter of the APICs saga, two partners who voluntarily withdrew to form a rival law firm sued to obtain their APICs payments. The Massachusetts court, following *Cohen*, held that the forfeiture for competition provisions of the partnership agreement, as applied to withdrawing partners, violated DR 2-108. *Pettingell v. Morrison, Mahoney & Miller*, 426 Mass. at 255, 687 N.E.2d at 1238.

While the first case was pending, the partners voted to amend the partnership agreement to eliminate the payment of APICs to voluntarily withdrawing partners who left before reaching age 60 or serving as a partner for 20 years. Under the amended agreement, all withdrawing partners were treated alike, regardless of whether they left to join a rival firm or to paint sunsets in Tahiti.

In chapter two of the APICs dispute, several partners who withdrew to join rival law firms and who had not reached age 60 or been partners for 20 years sued to obtain their APICs benefits, claiming that the amended partnership agreement still violated the prohibition against noncompetition agreements. In *Pierce v. Morrison Mahoney LLP*, the court rejected their challenge. The starting point of the court's analysis was the purpose served by Rule 5.6(a). The rule existed, in the court's view, to protect the ability of clients to select counsel of their choice, not to protect lawyers. 452 Mass. at 724-25. The partnership agreement at issue in the *Pettingell* required partners who had withdrawn from the firm to choose between representing clients in competition with the firm, thereby forfeiting their APICs, or refraining from competition and continuing to receive APICs. This financial disincentive limited client choice by discouraging former partners from accepting clients who might jeopardize their APICs payments, thereby "shrinking the pool of qualified attorneys " available to clients. By contrast, the amended partnership agreement, which treated all withdrawing partners alike, did not require departed partners to choose between accepting clients and receiving financial benefits. It therefore did not limit client choice in violation of Rule 5.6(a). 452 Mass. at 725.

In reaching this decision, the court tacitly rejected the reasoning of the New Jersey decisions invalidating agreements that were "anticompetitive in the broadest sense." Rule 5.6(a), the court said, was not intended to protect lawyer mobility. Under the amended partnership agreement, partners who hoped to receive APICs payments might be reluctant to leave the firm until they reached age 60 or had served as partners for 20 years, but that disincentive to departure did not violate the Rule. "There is nothing inherently violative of public policy," the court said, "in partners agreeing to such disincentives in the interests of the long-term financial and professional health of their enterprises." 452 Mass. at 726.

continued on page 6

Rules Governing Fax and E-mail Ads

Offer an Opt-out, or Prepare to Pay Out

By James H. Laskey, Fernando M. Pinguelo, and Andrew D. Linden

The importance of having a robust compliance policy to review the content of proposed advertisements is well-known and widely accepted. But what may not be as familiar is the need for a separate policy focused on the means of disseminating such advertising. In a technology driven world, it makes sense for businesses to capitalize on the use of electronic communications to increase the number of consumers they reach, and businesses more than ever rely on direct advertising through e-mail and fax promotions. However, an advertisement that would raise no issues if disseminated by mail or in the print media can create major headaches for in-house counsel if the means of distribution is fax or e-mail.

Unlawful Direct Advertising

Unlawful direct advertising through e-mail and fax promotions can be financially devastating, and cases that have made the headlines illustrate the potential devastation. For example, in a well-publicized case from Georgia, 1,321 recipients of improper unsolicited fax advertisements sued a Hooters restaurant under federal law and received a $12 million jury verdict against the chain. Similarly, the Dallas Cowboys and the AMF bowling alley chain each settled cases involving unsolicited faxes for over $1 million. To further accentuate the timeliness of this issue, on the day we sent this article to the publisher, a class action suit was filed in the federal District Court of New Jersey alleging defendants "sen[t] out thousands of unsolicited fax advertisements to the plaintiff and class without permission."

James H. Laskey (jlaskey@nmmlaw.com) is a member of Norris McLaughlin & Marcus in Bridgewater, NJ. He practices in the firm's Corporate Department. **Fernando M. Pinguelo** (fmpinguelo@nmmlaw.com) is also a member of the firm and Co-Chair of its Electronic Discovery Group. **Andrew D. Linden** (adlinden@nmmlaw.com) is an associate and practices in the Litigation and Appellate Practice groups.

Federal Law

Federal laws governing e-mail and fax promotions regulate both the content of such advertisements and also to whom such advertisements may be sent. Violators may be subject to significant financial penalties. Here's what you should know.

Faxes

The Telephone Consumer Protection Act of 1991 (TCPA), which now includes the Junk Fax Protection Act of 2005, and corresponding federal regulations prohibit sending an unsolicited advertisement to a fax machine unless the recipient has granted the sender implied or express consent to receive the advertisement.

Implied consent comes from an established business relationship between the sender and the recipient. "Established business relationship" is defined as "a prior or existing relationship formed by a voluntary two-way communication between a person or entity and a business or residential subscriber with or without an exchange of consideration, on the basis of inquiry, application, purchase or transaction by the business or residential subscriber regarding products or services offered by such person or entity, which relationship has not previously terminated by either party."

Express consent may be communicated in writing or orally, but the sender bears the burden of proving that consent was provided. It is important to note, however, that otherwise lawful faxed advertisements become unlawful if they do not inform the recipient how to avoid receiving such faxes in the future. This information, called an "opt-out" notice, is required to be provided with every faxed advertisement, even one that was expressly authorized by the recipient.

In order to comply with the TCPA and federal regulations, an advertiser's opt-out notice must:

- appear on the first page of the advertisement in a clear and conspicuous fashion;
- state that the recipient may request that the solicitor not send any future faxed advertisements and that the failure to comply with such a request within 30 days is unlawful;
- set forth the requirements of a valid opt-out request as articulated by the TCPA and applicable regulations; and
- include a domestic telephone number and fax number for the recipient to send its opt-out request, as well as a separate cost-free mechanism to send an opt-out request, such as a Web site or e-mail address.

The telephone numbers, fax numbers, and cost-free mechanisms must be available for recipients to make an opt-out request 24 hours a day, seven days a week. In addition, any message sent via fax must contain in the top or bottom margin the time and date it was sent, an identification of the sender, and the telephone number of the sending machine, individual, or entity. Under the TCPA, a state may bring a civil action against an advertiser to recover $500 in damages for each non-conforming advertisement or the actual amount of loss caused by the non-conforming advertisement. If the court were to find that the sender willfully failed to include a compliant opt-out notice, it can increase the award up to three times. Individuals and entities receiving faxed advertisements lacking proper opt-out notices may also sue to recover the greater amount of actual monetary loss or $500 for each violation. As a result, penalties can add up quickly. This private cause of action has given rise to a new wave of class action litigation which has produced some of the large verdicts and settlements referred to above.

E-mails

Similarly, the CAN-SPAM Act, which governs the sending of commercial e-mails, requires that commercial e-mails contain a return address or comparable mechanism that allows the recipient to send a request not to receive future advertisements. Specifically, commercial e-mails must clearly and conspicuously:

- display a functioning return electronic mail address or other Internet-based mechanism

continued on page 6

Fax and E-mail Ads

continued from page 5

for recipients to submit an opt-out request; and
- inform recipients that an opt-out request may be submitted in the manner specified in the e-mail message.

The return e-mail address or other Internet-based mechanism must be capable of receiving opt-out requests for at least 30 days after transmission of the commercial e-mail.

The CAN-SPAM Act permits the state to bring a civil action against persons violating the aforementioned provisions for damages in an amount that is the greater of the actual monetary loss suffered by the recipients of the messages or an amount equal to the number of violations multiplied by up to $250, limited in some but not all cases to $2 million aggregate. Like the TCPA, the CAN-SPAM Act authorizes a court to increase such damages up to three times if it were to determine that the sender willfully or knowingly committed the violations. Attorneys fees may also be awarded to the state. In contrast to the TCPA, the CAN-SPAM Act limits the private right of action to providers of Internet access services and reduces damages in such cases to $25 for each violation, and no more than $1 million in the aggregate in some but not all cases.

Even with these partial caps, penalties can be astronomical. In May 2008, MySpace received an award of approximately $220 million under the CAN-SPAM Act against users who, among other violations, sent over 500,000 unsolicited commercial e-mails that did not contain satisfactory opt-out mechanisms. Most recently, in November 2008, the CAN-SPAM Act led to a judgment in excess of $800 million in favor of Facebook and against one of its users who had sent commercial e-mails that violated the Act.

Conclusion

Faxed advertisements and commercial e-mails are marketing tools that should help enhance a business' performance. Disseminating fax ads and e-mails that do not contain proper opt-out notices defeat their own purpose by potentially subjecting your business to quickly surmounting penalties. Ensuring that the opt-out notices of your business' fax and e-mail ads comply with the TCPA and CAN-SPAM Act, respectively, will significantly reduce your business' liability and may even increase goodwill. When marketing through e-mail and fax, it is critical that your business do so in accordance with these and other similar state laws. If the recipients of your faxed and e-mail ed advertisements cannot opt-out, you may reluctantly join the club of those having to pay-out.

—❖—

Rule 5.6(a)

continued from page 4

Limits of Rule 5.6(a)

The *Pierce* decision makes it clear that Rule 5.6(a) is not the universal solvent of partnership and employment obligations that some disgruntled lawyers have tried to make it. The Rule prohibits agreements that expressly prohibit competition and financial disincentives that discourage lawyers from engaging in competition after they leave the firm because both types of provisions restrict the pool of available lawyers and limit client choice. The Rule does not, however, prohibit agreements that treat all departing lawyers alike and it does not prevent firms from adopting financial incentives to encourage attorneys to remain with the firm.

—❖—

Technology

continued from page 1

only is efficient for organization, but also environmentally friendly. A few mouse clicks can lead to thousands, if not millions, of files stored in one easily-accessible location.

Instantaneous Communication

Everything in legal practice can now happen with a few computer clicks. Lawyers can now close deals and file briefs electronically. Documents can be sent securely through e-mail without worrying about couriers, Federal Express or unreadable facsimiles. Blackberries and other wireless devices enable conversations and resolutions without unnecessary meetings, phone calls or other activities that add up on a client's bill.

Geographic Flexibility

Remote access to servers and databases means allows lawyers to work from anywhere these days. There is no reason that lawyers are chained to their offices and desktop computers anymore. While this means a vacation may no longer be a vacation, it also means that flexibility across the work week (and weekend) is greatly enhanced.

Those in my generation, so-called Generation X, are comfortable with these innovations. We grew up with the Internet and e-mail. We think that the legal industry is simply catching up with the rest of the world. As Gen-X lawyers continue to mature in their careers, technology use will become the norm rather than the exception. For example, legal assistants will have a new role. They will become database managers and experts in electronically filing documents and no longer taking dictation and answering phones. Law firms will take advantage of innovation to improve efficiency, communication and flexibility. Clients will demand that lawyers cut down on bills involving actions that can be done more efficiently with technology.

But what about those already entrenched in law firm management? Many managers, lawyers and non-lawyers alike, are resistant to technology. Lawyers have long maintained that their skills are from a different era and are not enhanced by technology. After all, providing clients with reasoned judgment is the hallmark of an attorney, not dealing with technology. Soon, however, they will have no choice. Clients will demand that lawyers be as efficient as those in other industries. And the new generation, who is comfortable with technology, will ensure that the necessary investment is made.

continued on page 8

Jeremy T. Elman is a partner in the law firm of McDermott Will & Emery LLP.

The Housing Assistance Tax Act And the Emergency Economic Recovery Act

By Richard H. Stieglitz and Tamir Dardashtian

In response to the nation's economic downturn, former President Bush signed into law the Housing Assistance Tax Act of 2008 ("Housing Act") on July 30, 2008 and the Emergency Economic Recovery Act of 2008 ("Bailout Plan") on Oct. 3, 2008. The new laws have several significant tax-related provisions that affect individual and business taxpayers including law firms, attorneys, their staff, and their clients.

More than $15 billion in tax incentives and relief provisions are contained in the housing act and $150 billion in tax cut extensions and changes are included in the bailout plan. These acts cover areas such as a new method for certifying non foreign status on real estate transactions, a new tax credit for some first time homebuyers, excludible gains on the sale of a personal residence, accelerated alternative minimum tax and research credits, a reduction to preparer penalties standard, and a number of other provisions. Here are some highlights.

The Housing Assistance Tax Act of 2008

Alternative Method for Furnishing A Non-Foreign Affidavit

According to the housing act, a new procedure is established for avoiding withholding on real estate sales by having the seller certify his non foreign status through an intermediary. Under the old law, if a seller of U.S. real property provided the buyer with an affidavit stating it is not a foreign person along with its U.S. taxpayer identification number, the buyer did not need to withhold tax (generally 10% of the seller's gain on sale). Under the new law, the seller may as an alternative furnish the affidavit to a "qualified substitute," which then must provide a statement to the buyer asserting, under penalties of perjury, that it has the seller's affidavit in its possession. A qualified substitute is the buyer's agent and the person (including an attorney or title company) responsible for closing the transaction (other than the seller's agent). This method may be more attractive for law firm clients since it gives some sort of assurance to the seller that its private information will be secure. The use of a qualified substitute applies to dispositions of U.S. real property interests after July 30, 2008.

First-Time Homebuyers Tax Credit

In a nutshell, the housing act will allow the federal government to make interest-free loans of up to $7,500 ($3,750 for married taxpayers who file a separate return) for low-to-moderate income taxpayers who buy a primary residence for the first time. The loan is made in the form of a refundable credit that a first-time homebuyer can claim for the year of the purchase and then pay back ratably (*i.e.*, "recapture") in the form of additional tax over the next 15 years. The new credit begins to phase out for married couples filing jointly with modified adjusted gross income of $150,000 and fully phases out at $170,000 ($75,000 and $95,000 for single taxpayers). The credit is allowed for purchases on or after April 9, 2008 through June 30, 2009. Attorneys or their staff who buy a first-time home during the first half of 2009 can elect to treat it as having been bought in 2008 and can claim the credit on their 2008 tax return.

New Limit on the Exclusion for Gain On Sale of a Primary Residence

The housing act modified a tax loophole that could be pertinent to those attorneys with a home office, vacation house, or rental home. Under the old law, an individual qualified for the full housing exclusion if the home was owned and occupied as a primary residence for two years out of five before it was sold. Therefore, an owner of a vacation or rental property could simply convert it to a principal residence for two years prior to its sale and the gain on the sale could be reduced by the entire housing exclusion of $250,000 ($500,000 exclusion on joint returns). An existing rule denies the exclusion to the extent you have taken depreciation on your home. A taxpayer may have been entitled to depreciation either because the house was rented out for some period or because a portion of it was used as a home office. This denial of the exclusion continues under the new law and is applied first.

Under the new law, gain from the sale of a principal residence which is allocated to periods of "nonqualified use" on or after Jan. 1, 2009 is not eligible for the housing exclusion. "Nonqualified use" is the period when the home is not used as a primary residence such as when it is used as a vacation or rental home. The gain on sale is allocated ratably to periods of "nonqualified use" based on a ratio of periods of nonqualified use (on or after Jan. 1, 2009) to total periods of time the property was owned by the taxpayer. For example, a taxpayer purchased a residence on Jan. 1, 2009, used it as a vacation home for two years, converted it to a primary residence on Jan. 1, 2011 and then sold it for a taxable gain of $300,000 on Jan. 1, 2017. In this situation, 25% of the $300,000 gain or $75,000 (two years of nonqualified use divided by eight years of ownership) is allocated to "nonqualified use" and is not eligible for the housing exclusion. The remaining $225,000 would be eligible for the housing exclusion.

Refundable Alternative Minimum Tax ('AMT') and Research Credits

Bonus depreciation was allowed again under the Economic Stimulus Act of 2008 to encourage law firms to increase investment in certain business assets and capital improvements. However, no bonus depreciation can be taken if the company has a loss because bonus depreciation is limited to taxable income. The housing act gives C corporations and S corporations (with tax

continued on page 8

Richard H. Stieglitz, a member of this newsletter's Board of Editors, is a Tax Partner and **Tamir Dardashtian**, **Esq.** is a Tax Manager in the New York accounting firm of Anchin, Block & Anchin, LLP. Mr. Stieglitz can be reached at 212-840-3456 or via e-mail at rstieglitz@anchin.com, and Mr. Dardastian can be reached at tamir.dardashtian@anchin.com.

2008 Acts

continued from page 7

at the entity level) exclusively a new option to swap otherwise allowable bonus depreciation for immediately refundable AMT and research credits. It increases limitations for AMT and research credits so that unused credits from taxable years beginning before Jan. 1, 2006 can be claimed. This may benefit an attorney's corporate clients since it allows these corporations to treat these credits as refundable credits that can generate an immediate tax benefit.

Other Miscellaneous Changes

Interest on certain types of "private activity" bonds that used to be exempt only for purposes of the regular income tax will now be exempt for alternative minimum tax purposes as well, which can benefit attorneys and their staff. This applies to bonds issued on or after July 31, 2008 if the bonds are used to finance low-income housing, mortgages for homebuyers, or mortgages for veterans.

Under the housing act there is also now more flexibility for law firm clients to lease space in a rehabilitated nonresidential building to tax-exempt tenants without jeopardizing eligibility for the rehabilitation credit. As much as 50% of the space in a nonresidential building undergoing rehabilitation may now be leased to a tax-exempt tenant without forfeiting eligibility for the rehabilitation credit. Previously the limit was 35% of the space. This change is retroactive and covers post-2007 rehabilitation expenditures.

The Emergency Economic Recovery Act of 2008

Preparer Penalties Standard Reduced

Before the bailout plan, taxpayers and tax return preparers were subject to different standards with respect to undisclosed tax return positions, an issue that caused uproar in the accounting and legal community. The new act brings back the old standard for avoiding tax return preparer penalties for undisclosed tax return positions by reducing the standard from "more likely than not" to "substantial authority" for tax preparers. This is effective for tax returns prepared after May 25, 2007. However, the "more likely than not" standard is retained for tax shelters and reportable transactions.

15-Year Straight Line Depreciation Method

The Tax Relief and Health Care Act of 2006 extended the 15-year recovery period (instead of the general 39-year period) for qualified leasehold improvements through Dec. 31, 2007 (see August, 2007 article). The bailout plan further extends the 15 year straight line depreciation method for qualified leasehold improvements placed in service before Jan. 1, 2010.

Other Miscellaneous Changes

Securities brokers will be required to report the cost basis for all stock, debt, commodities, derivatives, and other items specified by the Treasury, along with whether any gain or loss is long term or short term on securities acquired after 2010. In addition, the deadline for furnishing certain statements (*i.e.*, 1099s to law firms) to customers is extended from Jan. 31 to Feb. 15, 2009 for the calendar year 2008.

The new law increased the AMT exemption amount from $66,250 in 2007 to $69,950 for tax years beginning in 2008 for joint returns and surviving spouses (1/2 the amount for married filing separate), and from $44,350 in 2007 to $46,200 for tax years beginning in 2008 for single taxpayers.

The ability for attorneys and their families to use certain nonrefundable tax credits (*i.e.*, the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child tax credit, and the HOPE Scholarship and Lifetime Learning credit) to offset a taxpayer's AMT (in addition to their regular tax liability) is extended through 2008.

As in 2007, distributions from Individual Retirement Accounts (IRAs) can continue to be made through Dec. 31, 2009 of up to $100,000 directly to a qualified charitable organization and will not be included in the IRA owner's income. This only applies to mandatory distributions (made on or after the date the IRA owner turns age 70 ½).

—❖—

Technology

continued from page 6

So how does a manager get his or her firm up to speed? Here are some suggestions for how law firm managers can take advantage of technology:

- Form teams of lawyers and staff to be trained side-by-side in new technology, possibly by using an IT consultant;
- Start a technology committee at your firm to explore how to utilize new products and software and invite vendors who specialize in legal software to speak;
- Speak with younger attorneys at your firm to understand what software they use and how they use it.
- Search the Internet for resources on "legal technology," or read a book on the subject;
- Attend a CLE (continuing legal education) or other course on technology or new software; and
- Join a professional organization with a technology arm.
- There is no one solution to suddenly turn the entire office into tech-gurus. Embracing technology now will benefit the entire office, as every skill learned makes your team that much more valuable. In these uncertain economic times, clients and lawyers are looking for every edge they can get. Managers can ensure that they are offering both their clients and lawyers a new skill set that will serve them well in the future.

—❖—