

An electronic newsletter for real estate professionals

From the desk of:

The Real e-ditor



We are already two weeks into the New Year. So, how are you coming with those pesky resolutions? A successful businessman once said, "The harder I work, the luckier I get." The point is, resolutions mean nothing, without backing them up with persistent effort or, as my late father, used to say, 'stick-to-itiveness'".

If you are still thinking about making meaningful resolutions for 2005, or for those of you who have already broken your resolutions, this edition of Real e-State offers some suggestions for improving your financial health; no dieting or exercise required.

In this issue, we focus on how to protect your and your clients' hard earned money and real property assets. Interested in protecting your right to be paid a real estate commission? This issue includes summary of several recent legal decisions that will compel you to take a critical look at your listing agreements, and to consider with whom you might have to share your next commission. If you are interested in transferring real estate to your heirs, this issue discusses some creative estate planning techniques that can substantially reduce future tax liabilities. Finally, in order to be better prepared to draft and negotiate tax payment and proration clauses in leases, we continue our discussions of some of the effects of new Public Act 357 of 2004, on real property leases.

Now for that resolution . . . We here at Maddin Hauser resolve to keep working hard, to continue bringing you a quarterly newsletter with topical articles of interest to you, our select readers. All we ask in return is that you resolve to read future issues of Real e-State as part of a plan to stay better informed in 2005 about legal issues affecting the real estate business. I wish each of you a belated, but heartfelt best wishes for a prosperous 2005.

Steven D. Sallen
Shareholder

Self-Confidence

"If you hear a voice saying, "you're not a painter," then by all means paint and that voice will be silenced."

-Vincent van Gogh, *artist*

LEGAL DEVELOPMENTS:

ANTICIPATING THE EFFECTS OF PA 357 ON COMMERCIAL LEASES

BY: STEVEN D. SALLEN
AND DANIELLE M. SPEHAR

In our October, 2004 issue of Real e-State, we discussed the effects that Public Act 357 of 2004 will have on real estate purchase and sale transactions closing on and after July 1, 2005. PA 357 accelerates the due date for county real property taxes, from December 1 to July 1, commencing July 1, 2005, over a three year phase-in period. This article addresses some of the implications of this new legislation on lease transactions, including:

- Tax Proration Methods in Leases
- Tax Due Dates in Leases
- CAM and Tax Reconciliation Dates in Leases

Typical triple net commercial leases require tenants to pay their proportionate share of real estate taxes during the term of the lease at varying frequencies (monthly, quarterly, semi-annually or annually). Sometimes taxes are paid in estimated payments in advance, and some-

"PA 357 accelerates the due date for county real property taxes..."

times upon presentation of the tax bills. Typically, such leases provide either that the tenant is responsible to pay real estate taxes which become due during the lease term, or which have been paid by the Landlord during the calendar year.

These leases also typically contain a provision stating that during the first and last years of the lease term, the tenant's liability for taxes in those years shall be subject to a proration based on the number of days that the lease term coincides

EYE ON THE COURTS

BY: DAVID M. SAPERSTEIN

If you are a real estate broker, you work hard for your clients, and you want be compensated for your efforts. But you have a client who is wavering on his commitment to sell, or an unlicensed third party claims to be entitled to part of your commission. Three recent, decisions of the Michigan Court of Appeals address these situations, and suggest strategies for the savvy broker.



In two recent cases, brokers unsuccessfully sued to obtain commissions on listings. In *Century 21 Chalet v. New American Co., L.L.C. (Decided 11/16/04)*, the parties entered into a real estate listing agreement to sell a car wash and associated property for \$3.6 million. The broker produced an offer to purchase the property for \$2.25 million. The parties disputed whether the seller then made a counter-offer for \$2.55 million. It was undisputed that the seller revoked this counter-offer (if it was actually made) before it was accepted. Under these facts, the Court ruled that the broker had not earned its commission by finding a buyer at the price and terms agreed upon in the listing agreement

A similar result was announced in *State Business Brokers v. H&K Associates, Inc., (Decided 4/13/04)*.

The seller rejected the offer and decided that it was no longer willing to consider offers from the buyer. The Court ruled that the seller did not have to pay a commission to the broker because the terms of the offer differed from the terms in the listing agreement.

WEALTH SUCCESSION PLANNING FOR REAL ESTATE OWNERS

BY: GEORGE V. CASSAR, JR.

W e are all familiar with the liability concerns pertaining to the ownership of real estate that can arise from creditors and claimants. Most are also familiar with the notion that these liability concerns can be addressed by simply changing the ownership of the property from an individual to an entity. The options include:

- Corporations
- Limited liability companies
- Limited partnerships
- Certain Trusts
- Various other forms of entity ownership

While liability insurance policies are certainly the first line of defense against many claimants, owning real estate in one's individual name exposes all of one's assets to the claims of potential creditors and claimants, especially for claims above insurance policy limits. By maintaining ownership through a separate entity, the claims against the owner of the property (i.e. the entity) may be limited to the entity's assets, which are typically limited to the real estate itself. When crafted correctly, the individual owner's personal assets will be out of reach of most claimants.

The issues that most of us are not familiar with, however, relate to transferring real estate to one's heirs and beneficiaries. Real estate holdings can account for a significant portion of one's wealth. Most owners want to maintain control over the use and operation of their property during their lifetime, manage the succession of the ownership of the property and provide liquidity for the recipients given that real property is typically an illiquid asset. These concerns can be addressed through proper estate planning documents and wealth transfer strategies.

For some, a proper estate plan may include various trusts, the use of family limited liability companies and gifting of real estate interests or, ideally, the interests of the entity that owns the real estate. Wealth succession strategies provide a way to transfer real estate under terms and conditions delineated by the owner, typically through the use of trusts, shareholder agreements and/or operating agreements, all while retaining control of the property and taking full advantage of the tax laws allowing for the removal of the value of the real estate from the owner's estate. Differing interests of ownership can be created within entities to assign control at one level and simple ownership interests at another. These strategies are often carried out through the gifting of



“Wealth succession strategies provide a way to transfer real estate... all while retaining control of the property and taking full advantage of the tax laws allowing for the removal of the value of the real estate from the owner's estate.”

ownership interests in the entity, but not the control interests, and by taking a valuation discount against the fair market value of the interest due to lack of market-

ability, lack of control and the like. The effect of the discount is to permit the transfer of a larger proportion of the entity (and the underlying real estate) while incurring less or no tax than would have resulted from a direct gift of the real estate itself. Typical discounts can range from 20% - 40%.



Other individuals may be interested in donating real estate to a charitable organization, typically through a comprehensive charitable trust. Donating highly appreciated

real estate that has been heavily depreciated for tax purposes has tax advantages. To sell the same real estate and donate the proceeds to charity, the owner would incur unnecessary capital gain taxes, and expenses associated with disposing of the property. By donating the property to charity, all capital gain taxes and expenses of disposition are absorbed by the charity. The donor can receive a full current charitable deduction against income taxes. The value of the property is then taken out of the owner's taxable estate without incurring gift or other taxes.

Plans for transferring ownership can be implemented at any time, but the optimal time to consider such a plan, so as to maximize future benefits, is at the time of acquiring the property. Various negative tax effects and personal costs may result from waiting until years after the purchase to consider the possibilities of planning for the ultimate disposition of the property. These and other strategies can help property owners manage wealth succession and tax planning in a way not often considered at the time of property acquisition.

“Keep away from people who try to belittle your ambitions. Small people always do that, but the really great make you feel that you, too, can become great.”

-Mark Twain, author

28400 Northwestern Highway
Third Floor, Essex Centre
Southfield, Michigan 48034

Phone: 248-827-1861
Fax: 248-359-6161

The Real e-State Staff:



EDITOR-IN-CHIEF:
Steven D. Sallen



CONTRIBUTING
EDITOR:
Danielle M. Spehar



CONTRIBUTING
EDITOR:
Kas Bagchi



CONTRIBUTING
WRITER:
George V. Cassar, Jr.



CONTRIBUTING
WRITER:
David M. Saperstein

LAYOUT EDITORS:
Lawrence J. Straughen
Shilo B. Johnston

I.T. DIRECTOR:
Randall A. Straughen

Announcement:

The Maddin Hauser family is growing.

We are pleased to announce the arrival of Aidan Spehar born to Danielle and Jeff Spehar on December 18, 2004. We look forward to her return.

LEASES (Continued from Page 1)

with the taxing period. PA 357 alters our time-worn understanding of what those taxing periods are, and who should be responsible for taxes during such periods.

A gaze into our crystal ball reveals an array of possible disputes between landlords and tenants, as they grapple with the effects of PA 357. Leases signed even before July 1, 2005 must take into account the effects of PA 357. Consider a 36 month lease signed this year, and fast forward through Act 357's three-year phase-in period to 2008, and assume the lease terminates on July 31, 2008. The tenant may be obligated under the terms of the lease to pay its proportionate share of all real estate taxes which have been levied during the lease term. Should the tenant be responsible for the payment of taxes which become due on July 1, 2008? Remember, county taxes cover the fiscal year of January 1 through December 31 of the *following* year. Or, consider a lease which commences after July 1 but before Dec-

"PA 357 alters our time-worn understanding of taxing periods and who should be responsible for taxes during such periods."

COURTS (Continued from Page 1)

In both cases, the Courts acknowledged that a seller may not avoid paying a commission by wrongfully refusing to complete a sale. However, the Courts looked to the terms of the listing agreement to determine whether the brokers had "earned" their commissions. The Courts' rulings emphasized that the definition of a "ready, willing and able buyer" will largely depend on whether there is a discrepancy between the terms of the offer and the terms of the listing agreement.

In drafting listing agreements, brokers should carefully consider how specific the terms of the agreement need to be. Greater specificity will lessen the likelihood of future disputes over the meaning of the listing agreement. However, greater specificity will also increase the likelihood that a wavering seller will not be required to pay a commission based on discrepancies between the offer and the listing agreement. As there is no magic solution for all situations, when drafting listing agreements, take into account the individual circumstances involving the parties and the property.

In the aftermath of the 2003 landmark decision by the Michigan Supreme Court in *GC Timmis & Co. v. Guardian Alarm Co.*, the law is still unfolding as to when a party needs to be a licensed real estate broker to collect a fee. The Court of Appeals revisited this issue in

ember 31. What portion of the July 1 tax bill should the new tenant be obligated to pay?

With respect to CAM and tax reconciliation dates in leases, many current commercial leases provide a single reconciliation date for

such expenses around 30 to 90 days after calendar year end. At that time, credits for overpayments and invoices for shortfalls during the preceding year are generated. However, some tenants may now demand earlier tax reconciliations, as most real property taxes will be due

July 1 of the preceding year, once the phase in period is completed.

In light of the potential effects of new Act 357, customary and time-worn lease provisions pertaining to the proration and payment of real estate taxes should be thoroughly reviewed and analyzed by both landlords and tenants before entering into new commercial lease transactions.

Lans Development Corp. v. Ronald Lech (Decided 5/25/04).

That case involved an agreement between an unlicensed finder and the owner of real estate. The agreement provided that the finder, a banker, was "to provide specialized financial consulting services to [the owner] intended to provide an introduction to a qualified developer." In

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exchange, the finder was to receive a developed lot and up to \$5,000. The finder did not represent himself to be a real estate broker, and did not participate in the real estate transaction other than to intro-

duce the developer to the owner.

The Court reaffirmed that a license is required only if a person or entity, for a fee, "sells or buys" real estate or "negotiates" a real estate transaction for another. A license is not required if one merely performs one of the "usual functions" of a real estate broker. Specifically, a broker's license is not required to advise a client about a purchase of a business or to introduce a qualified purchaser to the seller.

This case highlights how competitive the marketplace has become. The next person demanding to cooperate on your commission might not be another licensee; it might be someone claiming to have provided "business advice" to the seller.