Schlossberg & Associates, P.C.

Report From Counsel

Insights and Developments in the Law **Fall 2008**

FDIC Bank Account Protection

By Michael T. O'Neil, Esq.

The Federal Deposit Insurance Corporation ("FDIC") insures deposits in most banks and savings associations located in the United States. Over the last several years depositors have not paid much attention to their potential FDIC coverage, however, in light of the recent dramatic economic downturn and related bank failures, bank customers have started to ask questions regarding their FDIC protection.

The FDIC protects depositors against the loss of their savings if an FDIC insured bank fails. The primary purpose of the FDIC is to give bank depositors comfort that their savings will not be lost in the event of a bank failure, thereby, preventing mass withdrawals from weak banks in economically challenging times. In order to give depositors additional comfort, on October 3, 2008, President Bush signed H.R. 1424, the Emergency Economic Stabilization Act of 2008 (the "Act") which, in part, temporarily increased the FDIC deposit insurance limit from $100,000 to $250,000. The increase will be in effect only until December 31, 2009. These dollar limitation amounts represent the maximum amount of coverage a depositor would receive for money in deposit accounts (including deposits in checking, NOW, and savings accounts, money market deposit accounts, and certificates of deposit) held in a single insolvent bank. The FDIC does not insure money invested in stocks, bonds (including securities issued by the U.S.A.), mutual funds, life insurance policies, annuities, or municipal securities, even if these investments were purchased from an FDIC insured bank.

Multiple accounts in a single bank (irrespective of whether the accounts are held at separate branches of a bank) are *not* separately insured, *e.g.*, if you had ten accounts in a single bank with $100,000 in each, you are only entitled to $250,000 of FDIC coverage. Some deposit accounts, however, even if maintained at the same bank, if structured properly, can obtain separate insurance and therefore obtain coverage in excess of $250,000. Therefore, it is possible to have deposits greater than

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New Requirements for Massachusetts LLCs and Partnerships

By Marissa Soto-Ortiz, Esq.

In an effort to make the Massachusetts Limited Liability Company Act and Massachusetts Uniform Limited Partnership Act more analogous to the Massachusetts Corporations Act, Massachusetts General Laws c. 156C and c. 109 have been amended to include the following changes, effective July 1, 2008:

- Domestic and foreign *limited partnerships* are now required to file annual reports with the Secretary of the Commonwealth.
- The Secretary of the Commonwealth now has the authority to administratively *dissolve limited liability companies and limited partnerships* that fail to file their annual reports for two (2) consecutive years.
- Foreign limited liability companies and limited partnerships that fail to file their annual reports for two (2) consecutive years will not have the authority to transact business within the Commonwealth.
- Registered Agents must provide written consent to their appointment.

It should be noted that the office of the Secretary of the Commonwealth sent notices to all delinquent limited liability companies in July of this year providing a 90 day deadline to file their annual reports. According to legal counsel at the Secretary's office it appears as though those entities will more than likely be dissolved at the end of this year or the beginning of 2009.

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Landowner Gets Settlement for "Taking"

When the government takes aim at private property to be taken for some public purpose, more often than not any resulting litigation is a contest over how much the property owner should be paid, rather than whether the exercise of the power of eminent domain was appropriate in the first place.

From the landowner's standpoint, it is important to realize that adequate compensation is not determined simply on the basis of the current use of the property. Instead, the landowner is entitled to the value of the property based on its "highest and best" use (whether that use already exists or is only in the eye of a developer), so long as such a potential use is not too speculative or otherwise foreclosed by applicable laws and regulations.

A landowner is entitled to the value of the property based on its "highest and best" use, whether that use already exists or is only in the eye of a developer.

The importance to a property owner of negotiating compensation on the basis of a best-case, but realistic, development scenario for the property is illustrated by a recent case in which the owner of a vacant, 22,000-square-foot lot settled with a town for compensation in an amount that was about 27 times higher than the amount initially offered by the town.

The lot was zoned for residential use, although at the time of the condemnation action the owner had no building or development plans. Appraisers hired by the town offered an opinion that the vacant lot's best use was only as open space, or as a buffer for an abutting lot. They reasoned that compliance with the town's lot area and frontage requirements, as well as with its road standards for improving the dirt road on which the lot was located, would be so burdensome as to make any development of the property prohibitively expensive. They also indicated that extensive development costs would preclude development even if the lot was considered to have grandfathered status that would protect it from certain town requirements.

For its part, the landowner retained experts who opined that the lot was, in fact, suitable for residential purposes and should be valued as such when arriving at a compensation figure for the taking. As the town's experts had noted, there were various requirements on the books that, in theory, could be costly to comply with. However, an examination of past rulings by the town's zoning and conservation officials showed that the lot was likely to be exempted from some of the requirements. Moreover, improvement of the dirt road, which would have been an especially big-ticket item, was not likely to be required.

Both sides were necessarily looking into the future to some extent, but the landowner was able to depict a scenario for the lot that was optimistic enough to bring about a favorable monetary settlement with the town.

Cyber Insurance for Businesses

Businesses have been dependent on computerized information for some time now, but it has been only relatively recently that insurance companies have devised and offered insurance policies specifically tailored to the potential losses from a variety of problems that can affect a computer system.

An early impetus for cyber insurance was anticipation in the late 1990s of losses associated with the coming of "Y2K." That concern turned out to be overblown, but the threats that have spurred cyber insurance offerings since then are real enough, including viruses, hackers, and legal injuries to others from information on a company's website. One study has found that the average annual technology-related financial loss for United States companies more than doubled just from 2006 to 2007.

Another development that prompted more cyber insurance policies was the realization, which sometimes came as a surprise to insured businesses, that general liability policies did not cover computer problems. Cyber insurance is a good idea for all of the usual reasons associated with insuring against business losses. But it also makes sense because of the particular costs associated with responding to a computer data breach, especially now that many states have adopted data breach notification laws.

This kind of postmortem after a breach could include such measures as notifying affected customers, paying for credit monitoring for those customers, replacing compromised credit or debit cards, and undertaking forensic analyses of affected databases. All in all, there are some expensive scenarios to insure against.

Categories of Losses

The losses covered by cyber insurance generally fall into two categories:

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LLC Ruling Favors Taxpayers

Anna was the mother of three children and the widow of the man who invented the heart defibrillator implant. In 1992, she created a trust for each of her daughters and gave a portion of her substantial interests in patent licenses to the trusts. In 2001, she created a limited liability company (LLC), to which she made some large transfers. She then gave a 16% interest in the LLC to each of the trusts, keeping a 52% interest to herself. Only four days later, Anna died suddenly and unexpectedly.

The IRS claimed a deficiency of millions of dollars in estate taxes. It pointed to a part of the Internal Revenue Code that provides that all property is to be included in a decedent's estate to the extent that the decedent has transferred an interest in the property while retaining for life the possession or enjoyment of, or income from, the property. There is an exception to this general rule in cases of a bona fide sale for full and adequate consideration in money, but the IRS argued that the exception did not apply in the case of Anna's estate.

In a somewhat surprising decision, given a recent trend favoring the IRS in such disputes, the United States Tax Court sided with the estate and kept the LLC assets out of the gross estate for estate tax purposes. The court ruled that the bona fide sale exception applied, notwithstanding that the LLC activities were not in the nature of a "business." It was sufficient that Anna had "legitimate and significant nontax reasons" for creating and funding the LLC, including joint management of family assets, pooling family assets to maximize investment opportunities, and providing for each of her daughters on an equal basis.

Some practical lessons for minimizing estate tax liability while using family LLCs emerge from the case of Anna's estate. They include the following: (1) document the legitimate and significant motivations, unrelated to estate taxes, for forming such an entity; (2) continue the entity after the decedent's death, to avoid the appearance of an ordinary trust; (3) if, as in Anna's case, the donor dies unexpectedly a short time after the gifts, be prepared to demonstrate that the death was unexpected; and (4) keep sufficient assets outside of the entity to cover the donor's living expenses, to avoid the possibility that the donor will treat the assets of the entity as her own. The planning, drafting, and advice associated with a family LLC entails resolution of complex issues and requires the guiding hand of a knowledgeable professional.

Federal Estate Tax

The federal estate tax credit, currently at $2 million, is set to increase to $3.5 million in 2009. This means that in 2009 you can leave up to $3.5 million to your heirs without any federal estate tax liability.

If Congress takes no action, the federal estate tax will be repealed altogether in 2010. While this is an unlikely scenario, it does underscore the uncertainty involved in estate planning over the next few years. Make sure to meet with a professional to review your plan.

Cyber Insurance

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first-party losses, meaning those affecting the business itself; and third-party losses, meaning incidents mainly affecting outside parties, including the customers of a business. Of course, the same underlying problem can cause both kinds of losses, such as when unauthorized access to a computer system shuts down the computer system of a company whose customers or clients rely on that system through an extranet.

A comprehensive cyber insurance policy should encompass both kinds of risks. These are the typical categories of coverage:

- First-party business interruption, covering lost revenue experienced during downtime due to accidents or security breaches (but typically not losses due to catastrophic regional power outages);
- First-party electronic data damage, such as the compromise of data from a virus infection;
- First-party extortion, including the demands made by hackers;
- Third-party network security liability, arising from compromise and misuse of data stemming from identity theft and credit-card fraud;
- Third-party network liability in the form of court judgments obtained by persons harmed by problems originating with a business's computer system; and
- Third-party media liability, aimed at the full range of potential liability from matter published in interactive online communications.

Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects, but rather to provide insight into legal developments and issues. The reader should always consult with legal counsel before taking action on matters covered by this newsletter.

FDIC

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$250,000 at a single bank and still be fully insured. Some examples are discussed below:

Joint Ownership

Each co-owner of a co-owned account (*e.g.*, a traditional joint account) is eligible for separate insurance allowing co-owners to "stack" their coverage, *i.e.*, if all other FDIC requirements are met, all of the co-owner's shares are aggregated. For example, a husband and wife could have up to $500,000 in one or more joint accounts at the same insured bank and the deposits would be fully insured. The husband's ownership share is insured up to $250,000 and the wife's ownership share is insured up to $250,000.

Corporations

Corporations and other business entities and associations are subject to a single depositor's coverage amount of $250,000. However, a corporation and its shareholders may stack business and personal accounts and obtain additional coverage. For example, ABC Corporation may have a $250,000 deposit account that is fully insurable, and, at the same time, ABC Corporation's sole shareholder may have a personal money market account that is also eligible for up to $250,000 of FDIC coverage in the same bank. Obviously, the shareholders have to keep in mind that they should not co-mingle personal and corporate assets for purposes of obtaining additional FDIC coverage.

Trust Account

Certain deposit trust accounts may be eligible for coverage in excess of $250,000. Eligible accounts fall into 3 categories: 1) payable on death accounts ("PODs"), 2) in trust for accounts ("ITFs") and accounts established in the name of a formal revocable trust.

PODs and ITFs are often referred to as testamentary or "Totten Trust" accounts. The names and signature cards of the accounts are literally set-up to read "John Smith payable on death to Jane Smith" or "John Smith in trust for Jane Smith". Formal revocable trusts, such as living trusts or family trusts, are established by written trust agreements.

In the event that all other FDIC requirements are met, the amount of FDIC coverage on eligible trust accounts is equal to $250,000 *per beneficiary* of the trust, up to maximum amount of $1,250,000.

Co-Op Banks

Some banks are charted as "co-operative banks" as opposed to traditional banks or savings and loans institutions. The practical differences are usually indistinguishable to the average bank customer, however, with respect to deposit insurance coverage, Massachusetts Co-Operative Banks offer a significant benefit to its deposit customers. The Share Insurance Fund of The Co-operative Central Bank insures all deposits in Massachusetts Co-Operative Banks dollar-for-dollar without limitation. This means that a deposit account in a Massachusetts Co-operative Bank would receive protection from the FDIC with respect to the first $250,000 lost, and then the accountholder would receive full protection on any amount lost above the federally insured $250,000.

New Massachusetts Prohibition on 401(k) Deductions

By Michael T. O'Neil, Esq.

For tax years beginning on or after January 1, 2008, partners of a partnership (including general partnerships, limited partnerships, limited liability partnerships and limited liability companies taxed as partnerships) and sole proprietors will no longer be able to take deductions for Massachusetts State Income Tax purposes with respect to contributions made to their 401(k) plan. Conversely, the distributions taken by the effected partners and sole proprietors from their 401(k) plans will not be taxed by Massachusetts assuming that the partner or sole proprietor has records to show that the contributions were not deducted. Obviously, this new directive issued by the Massachusetts Department of Revenue is yet another reason to maintain meticulous records in connection with your 401(k) plan.

If you have any questions regarding please contact Michael T. O'Neil, Esq., your CPA or Financial Advisor.

Beware Corporation Compliance Scam

By Michael T. O'Neil, Esq.

Some of our corporate clients have recently received correspondence from an entity calling itself "Massachusetts Corporate Compliance". The correspondence consists of documents labeled "Annual Corporate Minutes Compliance Filing". The correspondence also contains implications that the entity is somehow related to the Office of the Secretary of the Commonwealth. The entity offers to complete corporate meeting minutes on behalf of the corporation for a fee.

Despite the misleading statement contained in the solicitation, Massachusetts corporations are not required to file minutes of meetings with the Secretary of the Commonwealth and a recent post on the Secretary's website indicates that the Secretary's office has no affiliation with the entity in question.