



LEGAL NOTES

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PROPERTY CONDITION DISCLOSURE STATEMENTS: FRAUDULENT MISREPRESENTATIONS SURVIVE “AS IS” DISCLAIMERS IN REAL ESTATE CONTRACTS

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Article 14 of the New York Real Property Law contains the New York Property Condition Disclosure Act (the “Act”), which provides (subject to a few narrow exceptions) that every seller of residential real property must complete, sign and attach to the sale contract a property condition disclosure statement that describes the condition of the property. The realtor representing a seller of real property has a duty to inform the seller of its obligations under the Act. In the event a seller fails to provide the property condition disclosure statement prior to the signing of a binding contract, the Act requires that the buyer shall receive at closing a credit of five hundred dollars against the purchase price.

New York has traditionally followed the doctrine of “*caveat emptor*” with respect to an arms-length real property transfer. In fact, under the merger doctrine, all prior negotiations

and agreements, including the contract of sale, are merged into the deed. This merger extinguishes all obligations under the contract of sale, except for provisions in the contract that are specifically earmarked to survive after closing. However, fraudulent misrepresentations made in the contract of sale, including representations made in the property condition disclosure statement, are deemed to survive general “as is” disclaimers contained in the closing documents. A seller may be held liable for failing to disclose material information if the conduct constitutes active concealment. The court in *Pettis v. Haag*, 84 A.D.3d 1553 (3rd Dept. 2011) discusses whether representations made by the seller in a property disclosure statement constitute active concealment, and if so, whether the sellers could be held liable for fraud.

To prevail on a fraud claim under these circumstances, the purchasers must demonstrate not only that the false representation prevented them from satisfying their own due diligence requirements under the *caveat emptor* doctrine, but also that they were justified in relying upon the representations made by the seller. Justifiable reliance will not exist where a party has the means to ascertain the misrepresentation by the exercise of ordinary intelligence, but fails to do so.

In *Pettis*, the sellers executed a property condition disclosure statement stating that there were no material defects in the roof, electrical wiring and that there was no flooding on the property. After the closing, the purchasers experienced wiring problems, excessive flooding, and the roof lost an abundance of shingles. With respect to the roof and breaker box wiring, the court determined that although the sellers represented in the property disclosure statement that there were no material defects, since the purchasers had obtained their own inspection report that addressed these issues, the purchasers were on notice regarding these defects. Therefore, the court ruled, the purchasers could not prove justifiable reliance on the sellers' misrepresentations. However, the court *did* determine that there were questions of material fact with respect to the seller's knowledge and/or misrepresentation of flooding and electrical issues regarding the property, where the ordinary home inspection report did not reveal these problems.

The decision in *Pettis* and similar cases makes clear that in order to protect yourself from liability when selling your home, it is essential that you consult with your attorney regarding your obligations under the Act. Indeed, it is customary today for many attorneys to recommend that a seller *not* provide to the purchaser a property disclosure statement, but rather issue the \$500 credit to the purchaser at closing as required under the Act.

***LEASE ASSIGNMENTS:
LANDLORD BEWARE!***

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Most commercial leases contain a provision that restricts the tenant's ability to assign the lease.

The most commonly used provision states that the tenant "cannot assign the lease without the consent of the landlord, which consent shall not be unreasonably withheld." This provision provides the landlord some control over who may succeed the tenant as the occupant of the leased premises, while affording the tenant the ability to transfer the leased premises to a party that can fulfill the obligations to the landlord under the lease.

An assignment of the lease will not relieve the tenant of its obligations to the landlord for any breaches of the lease by the new tenant *unless* there is a release of the original tenant by the landlord. The landlord has no obligation to release the original tenant unless expressly provided for in the lease. The obligation to not unreasonably withhold consent to an assignment does not infer the obligation to release the original tenant upon assignment of the lease. If a landlord in fact consents to an assignment of the lease by the initial tenant, one might assume that the landlord retains the same consent rights to any future assignments of the lease. Surprisingly, however, the assignment restriction is deemed "dispensed with forever" and is eliminated from the lease! Any further reassignment of the lease by the new tenant may be made *without* landlord's consent.

Further, in a case where a tenant breaches a restrictive covenant against assignment by assigning the lease without first obtaining the landlords' consent, the landlord's right to deny the assignment is deemed waived by a landlord *if* rent is accepted from the new tenant. And, just as in the case where the landlord has actually granted consent to the assignment, the restrictive covenant is deemed eliminated from the lease, and all subsequent tenants may freely assign the lease without the landlord's consent.

In order to protect against the "single assignment" rule, a lease should provide that a landlord's consent, or waiver of consent, to an assignment will not relieve a new tenant from obtaining the landlord's consent for future

assignments of the lease. The lease should further provide that a new tenant will sign an agreement assuming all obligations under the lease, *including* the obligation to obtain the landlord's consent for a subsequent assignment of the lease. This requirement should be deemed to apply even when the proposed assignment is by an individual tenant to a corporation owned by the individual.

The bottom line: careful drafting of the lease will allow the landlord to reasonably control who may occupy its property over the entire term of the lease.

THE ESTATE FREEZE: WHY BUSINESS OWNERS AND OTHER HIGH NET WORTH CLIENTS NEED TO CONSULT THEIR ESTATE PLANNER BEFORE 2013

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The federal estate and gift rules were drastically changed by the Tax Relief and Job Creation Act signed into law on December 17, 2010 (the "Tax Act"). One of these changes in particular, the increase in the lifetime gift tax exemption amount, offers a great opportunity for business owners to save big tax dollars.

First, it is important to understand why gifting is such a critical factor for business owners. Many of our clients, regardless of net worth, are fiscally responsible and have assets that grow in value over time. Business owners tend to have much of their net worth in their business(es), which often appreciate in value more rapidly than other assets. If a client already has an estate that would be subject to estate tax if he or she died tomorrow (i.e., an estate valued at \$1 million or higher under New York law), it is almost certain that his or her estate will continue

to grow and incur even more tax if left unaddressed. Absent a comprehensive asset transfer strategy, that client can expect as much as **half** of the increase in value of their wealth to go straight to the government upon death. For most clients, this is not an acceptable outcome. This unpleasant result, however, can be avoided by engaging in a technique known as an estate "freeze."

An estate freeze is a strategy that seeks to "freeze" the growth of a client's estate by removing appreciating assets from his or her estate through planned gifts of the assets to children or other beneficiaries. A simple example that utilizes the estate freeze involves the gift tax "annual exclusion amount" by which a taxpayer is permitted to make gifts of \$13,000 per person per year. In enacting this exclusion amount, Congress has essentially said, "we don't want the IRS to expend time or resources to be trying to track and enforce taxation on gifts in amounts under \$13,000 per year." Therefore, a client with a taxable estate can simply give his beneficiaries \$13,000 each, and do so every calendar year. Without gifting the assets, the assets would accumulate in the client's estate and grow from ongoing investment; essentially 35% (as of 2011) of the client's assets would be subject to estate taxes upon death, after taking into account the federal and state exemptions then in effect (currently \$5 million federal and \$1 million New York State). By engaging in the gifting strategy, however, the assets don't accumulate in the client's estate, but instead the growth is transferred for the benefit of the individual(s) that would presumably benefit from the assets anyway. And, income on the gifted assets is often subject to lower tax rates if the beneficiary of the gift (often a child) is in a lower tax bracket than the donor (usually a parent or grandparent).

Estate freeze strategies are key for business owners because business assets (stocks, partnership interests, membership interests, etc.) are usually illiquid, and business owners tend to invest a great deal of their personal assets in

their business. Therefore, such a client may not have a comparatively large amount of liquid assets with which one could pay gift or estate taxes. Therefore, not only is paying a gift or estate tax unpleasant, but it can financially cripple a family-owned business. If the tax is due upon the death of the business owner, and the estate's liquid assets are insufficient, a partial or total "fire sale" of assets may be the only solution.

The higher the net worth, the less impact will be achieved by use of the annual exclusion. In making annual gifts of business interests, the business would need to be revalued every year that a gift is made to determine the actual value of the gifted business interests. Business valuations can be time consuming and costly, and it is not practical to have them performed annually. Fortunately, in addition to the annual exclusion, each taxpayer is allowed a lifetime "exemption" from gift tax. From 2001 - 2010, that amount was \$1 million. The Tax Act increased that amount to \$5 million. This dramatic increase in the lifetime gift exemption

offers an unprecedented opportunity to take advantage of estate freeze planning. Large assets can be gifted out of one's estate to either freeze its value to avoid additional taxation, or in some cases (typically clients with net worth between \$1 million and \$5 million) to reduce the estate to a level where no tax will be incurred at all.

The need to address your estate plan prior to 2013 arises because the Tax Act expires on December 31, 2012. It is not known what the gift tax rules will look like after that date, and we may very well be seeing a much lower exemption amount. If Congress does nothing, the lifetime gift tax exemption will revert back to \$1 million, and the opportunity to avoid pass significant amounts of assets between the generations with the imposition of few if any gift taxes will be lost.

EDUCATIONAL WORKSHOPS

Estate Plans That Work™

September 20, 2011 and October 20, 2011 (3:00 p.m. to 6:00 p.m.)

Elder Law and Long-Term Care Planning

September 26, 2011 (4:00 p.m. to 6:00 p.m.)

All workshops are held at the BSRB Education Center, 10 Matthews St. Goshen, New York, 1st Floor

To register for a workshop, call Donna at 291-0011 x.242, or register online at www.mid-hudsonlaw.com by going to the "Event Calendar" link.

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