INSIDE THE LAW

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CONTENTS

The Pass-Through Deduction: Five Misconceptions 1

Residential Security Deposit Law Primer for the Developer Who Decides to Self-Manage Residential Apartments.....3

Hitting "Send" Can Bind You.....6

What Do You Mean "The Contract Is Binding"? 8

Firm News.....9

Upcoming Seminars.....10

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THE PASS-THROUGH DEDUCTION: FIVE MISCONCEPTIONS

By Michael P. Duffy, Esq.
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The Tax Cut and Jobs Act was passed in late 2017, but most of the key provisions did not go into effect until 2018. Given that fact, the impact of the Act's most significant parts is only now being fully realized as most individuals and businesses run up against their 2018 filing deadlines.

One of the most widely recognized but least-understood portions of the Act continues to be the Section 199A "pass-through deduction." As tax returns for last year are being finalized, there is no doubt the actual dollar impact of the pass-through deduction has generated some surprises. The complexity of the deduction, coupled with the fact that the Treasury Department did not release final guidance on how to apply it to real-world situations until late January, has all but guaranteed a chaotic finish for the 2018 tax filing season.

CONSIDER THESE TOP FIVE PASS-THROUGH DEDUCTION MISCONCEPTIONS.

1. "I'm Going to Get a Big Fat 20 Percent Deduction!"

The pass-through deduction can provide a deduction equal to 20 percent of a taxpayer's total "qualified business income." But the deduction is taken against net income, as opposed to typical deductions, which reduce gross income. So if a qualifying business generates $1 million in gross receipts but only $10,000 in net profit, its owner is eligible for a $2,000 deduction. The pass-through deduction may be further reduced if the underlying trade or business performs certain types of services or does not pay any salaries, or the owner has other losses. With all these limitations, many taxpayers are unlikely to be eligible for the full 20 percent deduction advertised.

2. "The Pass-Through Deduction Is a Deduction."

The pass-through deduction is computed by figuring the net business income from all qualifying trades or businesses owned by the taxpayer and then aggregating the totals. Although the pass-through deduction is nominally a deduction from income, it's more helpful to understand the possible benefit by conceptualizing it as a form of rate relief on business income. In this sense, the pass-through deduction should be viewed as something akin to the lower rate on long-term capital gains.

3. "The Pass-Through Deduction Isn't Available for Service Trades or Businesses."

It is commonly believed that the pass-through deduction is not available to reduce business income derived from performing personal services, like the practice of law, medicine, or accounting. But this is only half true. The "specified service trades or businesses" limitation applies if, and only if, the underlying taxpayer also reports total net income over a certain threshold. The threshold for married-filing-jointly taxpayers is currently $315,000. So, assuming a married physician reports $250,000 in practice earnings and reports no other income, no limitation applies.

4. "My Client Is Performing Personal Services for Clients. He or She Must Not Qualify."

Even when a taxpayer is reporting income over the income threshold, it is incorrect to say that service businesses will not qualify for the pass-through deduction. The limitation applies only to specified service trades or businesses. Whether a service business is specified depends on the technical language in the law and Treasury interpretations, not any sort of rule of thumb.

5. "The Pass-Through Deduction Treats All Taxpayers Equally."

What is probably least understood about the pass-through deduction is that most of the limitations are computed at the individual taxpayer level. This fact makes it difficult to predict who will receive relief.

For example, assume Lawyer 1 and Lawyer 2 each own half of a successful law firm generating $200,000 in qualified business income during the year. Lawyer 2 is independently wealthy and has $500,000 of extra income from investments. On these facts, Lawyer 1 is eligible for a $20,000 pass-through deduction, whereas Lawyer 2's deduction is $0.

IN CLOSING

The takeaways are clear: The pass-through deduction is complicated, and estimating the potential benefits can be challenging, even for an experienced tax professional. On the other hand, commonly held misconceptions may actually present opportunities for CPAs, as the Treasury Department has indicated it will permit taxpayers to file refund claims that are based on pass-through deductions. In any event, this will be a challenging area of focus for many tax professionals through at least the end of 2025. **FT**

Michael Duffy is a tax and corporate attorney at Fletcher Tilton PC. On February 21, 2019, he hosted a webinar titled *Section 199A Bootcamp*, which discussed the pass-through deduction in greater detail and with great clarity. The webinar, which is available for viewing and qualifies for Massachusetts CPA continuing professional education credit, can be accessed at the following link:
https://fs11.formsite.com/fletchertilton/qw8obhb2e0/index.html

Or visit Michael Duffy's page on our website:
FletcherTilton.com/michael-p-duffy

RESIDENTIAL SECURITY DEPOSIT LAW PRIMER FOR THE DEVELOPER WHO DECIDES TO SELF-MANAGE RESIDENTIAL APARTMENTS

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You are a real estate developer and have recently developed a mixed-use or residential apartment complex that contains residential apartments. You went through the difficult process of planning, permitting, and building your state-of-the-art development. Now, rather than development and construction, your focus turns to filling each unit with occupants to maximize your return on investment. You are now becoming the owner-landlord. Though there are still many pitfalls on the road ahead, some of the most significant ones can arise when developers decide to self-manage an income-producing property. What you can do and cannot do as a residential landlord is heavily regulated by statutory requirements, common law, attorney general guidelines, and other laws.

The most common problem for landlords relates to the security deposit and typically arises when they try to evict a tenant for nonpayment of rent or other lease breach. G.L. c. 186, § 15B, sets out the Massachusetts Security Deposit Law (hereinafter "the Security Deposit Law"). It is absolutely imperative that a landlord understands and executes the Security Deposit Law correctly. Otherwise, the profits of development will slowly be eroded by litigation and settlement costs due to noncompliance.

The Security Deposit Law governs what monies a landlord may accept at the inception of the tenancy, which sounds simple. But even the most minor mistake by the landlord in handling the security deposit may automatically result in penalties, potentially including an award of three times the amount of the security deposit plus attorney's fees and costs incurred by the tenant. In fact, "The legislative history of G.L. c. 186, § 15B, conclusively shows that the Legislature intends any violation of G.L. c. 186, §§ 15B(6)(a), (d), and (e), to result in the imposition of treble damages." *Mellor v. Berman*, 390 Mass. 275, 283 (1983).

"The Security Deposit Statute is intended to afford protection to both the landlord and the tenant. It protects the landlord by allowing it to charge certain advances of money prior to the commencement of the tenancy; the statute also limits the up-front charges that the landlord legally can collect from the tenant in order to prevent unfair or deceptive charges." *Jinwala v. Bizzaro*, 24 Mass. App. Ct. 1, 7, 505 N.E.2d 904 (1987). See also: *Hermida v. Archstone*, 826 F. Supp. 2d 380, 386 (2011).

The whole purpose of collecting a security deposit is to allow a mechanism by which the landlord has the funds to make repairs for unreasonable damages–not normal wear and tear--caused by tenants. The security deposit can also be used to reimburse the landlord for unpaid rent at the end of a tenancy. Therefore, the Security Deposit Law's intended purpose is to help the landlords and protect the tenants. But, in so many cases, the landlord's mistakes can turn the security deposit into a way for tenants to get big cash awards.

WHAT MONIES CAN A RESIDENTIAL LANDLORD ACCEPT FROM A TENANT AT THE START OF THE TENANCY?

Under the Security Deposit Law, at the start of the tenancy a landlord may request and accept only the following: (1) first month's rent, (2) last month's rent, (3) a security deposit, and (4) the cost of a new lock. See G.L. c. 186, § 15B(1)(b)(i)-(iv).

Sounds simple, but it is not. Neither the last month's rent nor the security deposit can exceed the amount of the first month's rent. And the cost of a new lock must be reasonable.

Some of the most significant pitfalls can arise when developers decide to self-manage an income-producing property.

THE PROPER WAY TO ACCEPT A SECURITY DEPOSIT FROM A TENANT

By breaking down the Security Deposit Law into a checklist format, the landlord can use it for its actual purpose and benefit, rather than falling afoul of the Security Deposit Law and having tenants use it to gain monetary damages.

STEP 1: When the landlord accepts the value of one month's rent (and no more!) as a security deposit, the landlord MUST:

Give the tenant a "receipt" signed by him or her, which must state:

- the amount of the deposit and what it is for,
- the name of the person receiving it (if an agent receives it, then also the name of the landlord or owner),

- the date on which it was received, and
- a description of the premises. (See G.L. c. 186, § 15B(2)(b).)

Once the landlord has accepted the money, it must be properly handled and deposited. Again, beware: You cannot just deposit a security deposit into any old bank account you may have.

STEP 2: The landlord must hold the security deposit in an account that is

- separate,
- interest-bearing,
- located in a bank in the Commonwealth of Massachusetts,
- not subject to claims by the landlord's creditors, and
- transferable to a subsequent owner. (See G.L. c. 186, § 15B(3)(a).)

STEP 3: WITHIN 30 DAYS from accepting the security deposit, the landlord must give the tenant a receipt, typically referred to as the "Rent and Security Deposit Receipt," provided in conjunction with the written tenancy agreement/lease which was signed at the beginning of the landlord-tenant relationship. The receipt should include:

- the name and address of the bank where the money is located, and
- the amount held and account number. (See G.L. c. 186, § 15B(3)(a).)

STEP 4: At either the time of receiving the security deposit or within 10 days after the tenancy begins, the landlord must give the tenant a "Statement of Conditions Form," signed by the landlord, which must contain a list of all damage then existing, and the following statement in 12-point boldface type at the top of the first page:

> "This is a statement of the condition of the premises you have leased or rented. You should read it carefully to see if it is correct. If it is correct, you must sign it. This will show that you agree that the list is correct and complete. If it is not correct, you must attach a separate signed list of any damage which you believe exists in the premises. This statement must be returned to the lessor or his agent within 15 days after you receive this list or within 15 days after you move in, whichever is later. If you do not return this list within the specified time period, a court may later view your failure to return the list as your agreement that the list is complete and correct in any suit which you may bring to recover the security deposit." (See G.L. c. 186, § 15B(2)(c).)

STEP 5: Within 15 days after the tenant moves in, the tenant must return a copy of the Statement of Conditions Form and any separate list of damages he or she has found, and then the landlord has 15 days to provide a signed document expressing agreement or disagreement with the list. (See G.L. c. 186, § 15B(2)(c).)

WHAT HAPPENS AT THE END OF ONE YEAR FROM ACCEPTANCE OF A SECURITY DEPOSIT?

If the deposit is held for more than one year, the landlord must pay the tenant interest on the deposit at either 5 percent or the same rate as that paid by the bank that was holding the deposit, if it is less than 5 percent, together with a receipt indicating the same. (See G.L. c. 186, § 15B(3)(b).) Please note that interest is payable each year on the anniversary date of the tenancy.

The above is only a review of accepting, depositing, and maintaining a security deposit. The Security Deposit Law also has specific procedures and requirements for returning the security deposit at the end of the tenancy, and the rules and procedures of accepting, maintaining, and returning the last month's rent, which may also be collected at the inception of the tenancy. Reading G.L. c. 186, § 15B, and getting help from qualified professionals are key for any landlord who does not want to suffer the harsh consequences of failure to comply with the Security Deposit Law. **FT**

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For better or worse, we now live in a technology-driven world. The speed at which binding real estate deals can be made may prove to be exhilarating or devastating, depending where at the table on sits. The two articles that follow, written by attorney Nisha Koshy, demonstrate the benefits and pitfalls of such speed.

— William D. Jalkut, Esq., chair of Fletcher Tilton's Litigation Practice Group

HITTING "SEND" CAN BIND YOU

By Nisha Koshy, Esq.

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Technology is advancing at a breakneck pace. Our use of email and text messaging has drastically altered the way we communicate with each other. This is true not just in our personal lives but in our professional lives as well. Remember when it took days or even weeks for communications pertaining to a real estate transaction to be delivered and a response received? This time lag gave the parties to the deal time to carefully collate all the communications ultimately into one formal Purchase & Sale Agreement. Today, however, when an email or text is sent, the expectation is often that a response will be arriving immediately. As a result, you may not be giving the proper time and attention to the potential consequences of your hasty communications.

In today's commercial real estate world, it is commonplace for brokers, sellers, buyers, and developers to communicate with each other and with their respective clients via email and text. Understandably, everyone wants to get over the finish line as expeditiously as possible. Communicating electronically helps. You should be mindful, however, that you may unwittingly become obligated to carry out a sale of property based on terms laid out in an email or text chain.

The bottom line is that brokers, developers, sellers, and buyers should be aware that their electronic communications may create contractual obligations.

Indeed, in 2016, a Massachusetts court determined that text messages between a seller's and a buyer's real estate agents could create a binding contract *St. John's Holdings, LLC v. Two Electronics, LLC*, 2016 WL 1460477. In that case, the texts, when read together, outlined the terms of the deal. The buyer subsequently delivered a signed Letter of Intent based on those terms. The seller attempted to get out of the deal by refusing to sign the Letter of Intent and, instead, signed a Purchase & Sale Agreement with a third party. The seller argued the parties had merely been engaged in negotiations. The buyer contended the parties' messages gave rise to a binding contract to sell the property to the buyer. The court sided with the buyer, finding that the text strings, when read together, sufficiently outlined the terms of the parties' deal and evidenced that the seller intended to sell, and the buyer intended to buy, the property on those terms.

Although this is a simplified summary of the facts, the bottom line is that brokers, developers, sellers, and buyers should be aware that their electronic communications may create contractual obligations. To avoid this pitfall, when emailing or texting regarding a real estate deal, it is essential that you clearly identify all contingencies that remain to be met and all essential terms remaining to be negotiated, and expressly outline the exact method by which an offer can be formally accepted and thus become binding. To further protect yourself, you should consider adding your real estate legal counsel to the communications so he or she can help you negotiate the deal's essential terms and ensure that you are not potentially binding yourself to a deal when you are not yet ready to commit. **FT**

WHAT DO YOU MEAN "THE CONTRACT IS BINDING"?

By Nisha Koshy, Esq.
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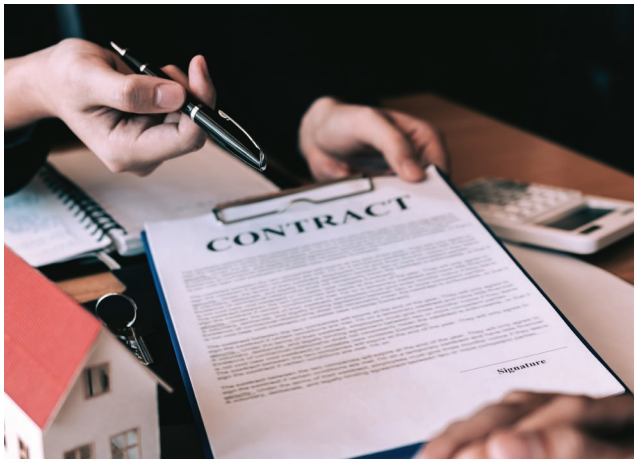
With very few exceptions, any agreement for the purchase or sale of real estate in Massachusetts must be in writing to be enforceable. For decades, real estate agents, developers, sellers, and buyers have used preprinted forms titled "Offer to Purchase" to set forth the essential but initial terms of the deal. The Offer to Purchase forms typically include the address, price, anticipated closing date, inspections to be conducted, and other fundamental terms. Offer to Purchase Forms often, however, state that the ultimate transaction is subject to the execution of a more comprehensive and superseding Purchase & Sale Agreement. Usually, the execution of a mutually satisfactory Purchase & Sale Agreement follows without any problems. The terms of the detailed Purchase & Sale Agreement then will supersede the relatively skeletal terms of the Offer to Purchase. Sometimes, however, issues arise that derail the execution of a Purchase & Sale Agreement. When that happens, one party often points to the Offer to Purchase form and seeks to enforce its terms notwithstanding the absence of a Purchase & Sale Agreement.

A recalcitrant seller might be surprised to learn that Massachusetts law often allows for the enforcement of an Offer to Purchase form notwithstanding the failure to obtain the stipulated signed Purchase & Sale Agreement. If the Offer to Purchase form contains the essential terms of the transaction, then the seller may confront a lawsuit by the buyer to compel the transfer of the property upon these essential terms. Anyone signing the Offer to Purchase form should be aware of the possibility that the Offer to Purchase could prove to be a dispositive agreement in and of itself.



Anyone signing the Offer to Purchase form should be aware of the possibility that the Offer to Purchase could prove to be a dispositive agreement in and of itself.

Brokers and agents have a business pecuniary interest in garnering both the seller's and the buyer's signatures on an Offer to Purchase form as swiftly as possible. Resist the pressure and the temptation to sign such a form without the guidance of counsel. Do not wait for the Purchase & Sale Agreement stage to engage counsel. Have your attorney review the Offer to Purchase form before you sign.

If you do not want the Offer to Purchase form to be binding without a signed Purchase & Sale Agreement, then you should include an express provision to the effect that "Notwithstanding anything to the contrary stated herein, this document is not intended to be a binding agreement and/or an enforceable agreement."

If you prefer that the Offer to Purchase form does serve as an enforceable agreement even in the absence of a signed Purchase & Sale Agreement, then ensure that all the essential terms are included within the Offer to Purchase. Spell out the deal precisely and completely. Do not leave any ambiguities or vague terms that contradict the notion that the parties reached final agreement on all essential terms.

The lesson here is that the Offer to Purchase form often does not represent a "maybe." Quite often, it represents a commitment. As with all meaningful financial commitments, a prudent person should consult with counsel too soon rather than too late. **FT**

Firm News

JOIN US IN WELCOMING ATTORNEY BETH COHAN

Beth Cohan is of counsel with the firm and concentrates her practice in all areas of real estate. Her work is focused on commercial real estate, particularly in acquisitions, dispositions, financing, and commercial leasing. In addition to practicing law, Ms. Cohan is licensed as a construction supervisor and a real estate broker. She works from the Worcester office and can be reached at 508.459.8017 or bcohan@fletchertilton.com.

UPCOMING SEMINARS

ESTATE PLANNING SEMINARS — *Speaker:* Michael Lahti, Esq.

Tue., May 7: 10 a.m. & 1 p.m.
Location: Lafayette House
Foxboro, MA

Tue., May 28: 10 a.m. & 1 p.m.
Location: Conrad's Restaurant
Walpole, MA

Tue., July 23: 10 a.m. & 1 p.m.
Location: Kirkbrae CC
Lincoln, RI

Tue., Aug. 13: 10 a.m. & 1 p.m.
Location: Blackinton Inn
Attleboro, MA

SPECIAL NEEDS & ELDER LAW UPDATE FOR CPAs AND CFP® PROFESSIONALS

Speakers: Frederick Misilo, Esq., Theresa Varnet, Esq., and Michael Lahti, Esq.

Thu., May 30: 8 a.m. – 11:30 a.m.
Location: Courtyard Marriott
Marlborough, MA

IMPACT 2019 - TAX REVIEW FOR CPAs AND CFP® PROFESSIONALS

Speakers: Dennis Gorman, Esq., CPA, and Michael Duffy, Esq., CPA

Thu., June 13: 8 a.m. – 11:30 a.m.
Location: Beechwood Hotel
Worcester, MA

Thu., June 27: 8 a.m. – 11:30 a.m.
Location: Sheraton Hotel
Framingham, MA

ESTATE PLANNING FOR MA-FL SNOWBIRDS

Speaker: Frederick Misilo, Jr., Esq.
Fri., June 21: 8:30 a.m.
Location: Doubletree Hyannis
Hyannis, MA

For details and to register for these seminars and others, visit, FletcherTilton.com/seminars-events.

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