CECB Carnahan, Evans, Cantwell & Brown, P.C.

on the Subject

September 2009

Branson Office of CECB Moves Into New Location

We are pleased to announce that the Branson office of Carnahan, Evans, Cantwell & Brown, P.C. has moved. The Branson office is now located in the Branson Financial Center at 500 W. Main St., Suite 401-A. Currently, Russell W. Cook and Richard T. Ashe both practice full-time at the Branson location and Emily J. Bell will be practicing at the Branson location at least one day each week.


Russell W. Cook

Russ Cook is a shareholder of the firm and a member of the Transactional Practice Group. His practice areas include all areas of real estate development, formation and operation of corporations, partnerships and LLCs, as well as financing, leasing, of condominiums, resorts and other mixed-use regimes He also assists in the development of sales and marketing programs for many projects. Additionally, his practice also emphasizes tax planning, the sale of closely held businesses, and the transfer from one generation to the next. Russ also does extensive consulting in the formation, reorganization, and merger of limited liability companies, as well as private placements and the negotiation and preparation of loan documentation for lenders, timeshare resorts and work on other large financing facilities.


Richard T. Ashe

Ric Ashe is an associate in the Litigation/Dispute Resolution Practice Group. Ric concentrates his practice in a wide variety of business litigation, including the resolution of disputes occurring in all stages of the manufacture, distribution and sale of goods, shareholder disputes, non-competition agreements and trade secrets, trademarks and copyrights, construction contracts and other real estate matters, as well as general business matters.


Emily J. Bell

Emily J. Bell is an associate in the Estate Planning Practice Group. She concentrates her practice in the areas of estate planning and administration, estate, gift and income taxation and probate. Emily has experience in the preparation of Trust Agreements, Wills, Powers of Attorney and Living Will Declarations and experience in the post-death administration of trusts and estates.

Tax Identity Theft

by Frank C. Carnahan

Stolen personal identities are used for three common types of tax identity theft:

1. Filing a false tax return and claiming a refund;
2. Working under the taxpayer's social security number ("SSN") resulting in additional income reported to the IRS; and
3. Employers reporting wages to a person not working for them to reduce the business' taxable income and tax liability.

The thief uses an address other than that of the taxpayer a fraudulent tax return to receive the refund check, and the IRS sends notices to the new false address so the victim does not receive them. Taxpayers typically find out after their tax return is rejected or an expected refund never arrives. If a taxpayer's SSN is used for work, the taxpayer eventually receives a request to file a tax return or notice that their return has been changed, and must prove they did not earn the improperly reported income, usually by obtaining information from the employer reporting the wages or by showing that he did not live in or near the location from which the incorrect income was reported. If collection activity occurs, the victim needs to respond to the IRS immediately and provide documentation demonstrating they own the stolen social security number, e.g., copy of a driver's license or passport, social security card, and a police report or FTC Affidavit of Identity Theft. The IRS should code the taxpayer's account which hopefully protects it in the future. If the IRS determines a taxpayer's SSN has been compromised it will request the above documentation, and if not timely provided freeze the SSN and a new SSN will be issued until the matter is resolved. The IRS has a Protection Specialized Unit and Identity Theft Hotline at 1-800-908-4490. If you are unable to work with the unit, or the unit is not properly handling your matter, taxpayers should turn to the Taxpayer Advocate Service at 1-877-777-4778. ■

in this issue

Use of Short Term GRATs: Now is the Time

by Thomas D. Peebles, Jr.

The Department of the Treasury recently announced the Obama Administration's fiscal year 2010 revenue proposals. Included within those proposals is a change in the current tax law to require a minimum term of ten (10) years for all Grantor Retained Annuity Trusts (GRATs). For this reason, and many more, those clients who expect that the value of their assets at death will exceed the current or projected estate tax exemption levels should seriously consider the implementation of a short term GRAT this year.

A GRAT is an irrevocable trust created by a Client who then transfers assets into the trust which are expected to appreciate in value. There are no restrictions on the type of assets which can be transferred to the GRAT. Marketable securities, family businesses, interests in family limited partnerships and real estate can all be included in a GRAT.

Under the terms of the irrevocable trust, the Client retains the right to receive annuity payments from the GRAT for a fixed number of years. The term of the GRAT which is chosen is influenced by a number of factors, including the Client's life expectancy, but terms of 2 to 5 years are common. The annuity is generally structured so that the value of the right to receive the annuity payments is equal to the value of the asset transferred to the GRAT. In this way, there is no "gift" and federal gift taxes can be avoided on the creation and funding of the GRAT.

During the term of the GRAT, the Client is taxed on all income earned by the trust assets, even if the income is accumulated in the trust. Structuring the GRAT in this manner assists in accomplishing the planning objective since the Client's payment of the income taxes on the income accumulated in the trust allows the trust assets to grow income tax free for the benefit of the remainder beneficiaries, usually the Client's children and/or grandchildren. In essence, it is an indirect "gift" to those remainder beneficiaries.

When the GRAT term expires, the annuity payments to the Client cease and the assets which remain in the GRAT, if any, are transferred to (or held in further trust for) the remainder beneficiaries. All accumulated income and asset growth in the trust which is in excess of the amount required to make the annuity payments to the Client accrues for the benefit of, and is eventually distributed to, the next-generation family members. As a result, when the trust terminates it is possible to transfer substantial assets to family members free from any federal estate or gift taxes.

A GRAT will be successful, however, only if the Client survives the GRAT term. If the Client dies while the annuity payments are still required to be made, the trust assets (or at least the portion needed to produce the retained annuity) are included in the Client's estate for estate tax purposes. In this event, even though the trust beneficiaries will own the remaining trust assets, the estate tax benefit of creating the GRAT (specifically, the tax-free transfer of the accumulated income and appreciation during the GRAT term in excess of the annuity payments) is not accomplished.

The use of short term GRATs (in which the annuity is paid for a term of as little as 2 years) obviously minimizes the risk of the Client's death during the term. It is this technique that the new Treasury proposal is intended to assault. Imposing the requirement that a GRAT have a minimum term of ten years increases the risk of a Client's death during the GRAT term and the resulting loss of any anticipated estate tax benefit. The Treasury's proposal to require a minimum GRAT term of 10 years, if enacted into law, would apply to GRATs created after the date of enactment.

Clients whose families would benefit from the use of a short term GRAT (a GRAT whose term is from 2 to 5 years), now have a window of opportunity in which to implement this estate planning technique. Although changes in tax law are difficult to predict, opportunities exist today that may no longer exist in a few months. Interested Clients should take advantage of current law permitting GRATs with terms as short as two (2) years.

In addition to proposed changes in tax laws, current economic conditions compel serious consideration of the use of GRATs. For nearly a year, we have been experiencing a "perfect storm" of three economic factors which dramatically increase the odds of a favorable tax benefit through the use of GRATs: (1) historically low interest rates; (2) depressed asset values; and (3) increasing valuation discounts based on unstable markets.

For tax purposes, the IRS assumes an expected level of appreciation, called the Section 7520 rate, for any assets placed in a GRAT. The Section 7520 rate varies each month, but the rate has been at historic lows over the last several months. In discussing GRATs, the Section 7520 rate is often referred to as the "hurdle rate".

GRATs are successful if, at the end of the trust term, the Client is still living and there are assets remaining in the trust that can be distributed to the Client's family members. This successful result occurs if the trust assets (including accumulated income) appreciate at a greater rate than the assumed rate of growth under Section 7520. The difference between the actual accumulation in the trust and the assumed accumulation in the trust is removed from the Grantor's taxable estate without the imposition of federal estate or gift taxes. Obviously, GRATs have a better chance of success when the Section 7520 rates are low, since the trust assets have a better chance of "beating" the hurdle rate. Consider the following example:

Client transfers $500,000 worth of assets to a GRAT. The annuity term is 3 years and, at the end of the term, any assets remaining in the trust are to be distributed to the Client's descendants. On the date of the transfer, assume that the Section 7520 rate is 3%. In order to avoid a taxable gift upon the funding of the trust, the annuity payments to be made to the Client must approximately equal the value of the property transferred to the trust. In this instance, each year for 3 years, the Client receives an annuity payment equal to $176,766. If the trust assets actually appreciate at a rate greater than 3% (assume, for example, a growth rate of 5%), then at the end of the annuity term, there will be $81,969 remaining in the Trust to be distributed to the Client's descendants. The $81,969 has been transferred free of federal gift taxes, has been removed from the Client's estate for federal estate tax purposes, and the GRAT has accomplished its planning objective.

In addition to the proposed change in the tax law, there are several other factors which make this an exceptionally good time to use a GRAT. First, as noted above, the Section 7520 rate (the IRS implied interest rate) is at historic lows. The lower the IRS hurdle rate, the better chance the assets in a GRAT have of exceeding that hurdle rate. Second, the value of many assets, including marketable securities, family businesses, and real estate, are at five to ten year lows. Creating a GRAT now and transferring assets to the GRAT with low or depressed values offers tremendous opportunities, then, to

Use of Short Term GRATs: Continued on Page 3

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allow those assets to appreciate inside the GRAT and to transfer the appreciation onto children and/or grandchildren in a tax free manner. Third, if the assets transferred to the GRAT consist of partnership interests, LLC membership interests, minority interests in closely held corporations, or fractional interests in real estate, traditionally accepted valuation principals will permit those interests to be discounted in determining their fair market value for estate and gift tax purposes. Higher discounts (for lack of marketability and minority interests) can be justified in a volatile market.

In short, the convergence of economic factors and the potential for a change in the tax law make this an ideal time to consider the use of a Grantor Retained Annuity Trust. If you have further questions regarding this wealth transfer technique, please contact any member of our Estate Planning Practice Group, and we would be pleased to review with you the use of a GRAT under your specific circumstances.

Out Of State Seller Nexus

by Frank C. Carnahan

States continue to extend nexus to require sales and use tax collection due to concern with loss of tax revenues due to interstate transactions. Tax revenues have further decreased recently in the current economic decline. States are trying to extend nexus to include "economic exploitation" of a state's economy without minimal physical contacts. For example, Amazon.com filed a 2008 lawsuit challenging the constitutionality of a recently enacted New York statutory provision requiring out-of-state Internet retailers with no physical presence in New York to collect New York sales and use taxes. The new statute presumes a retailer "solicits" business in New York if any in-state entity is directly or indirectly compensated for referring customers to the retailer, and Amazon compensates some independently operated, New York-based Web sites that post advertisements with links to Amazon.

Missouri Letter Ruling No. LR5552, Missouri Department of Revenue, dated April 7, 2009, held that an out-of-state vendor ("Vendor") selling tangible personal property to customers and resellers in Missouri established nexus requiring the vendor to collect Missouri use tax, and to obtain signed resale certificates from its resellers and not collect use tax on such sales. The ruling cites 12 CSR 10-114.100(2)(B) defining "physical presence", including having agents, representatives, independent contractors, brokers or others that reside in, or regularly and systematically enter into, this state on behalf of the vendor.

The facts in the PLR include: Vendor operates a website selling products via mail-order, the Internet, telephone, or facsimile, and it delivers products to purchasers by mail or common carrier from out-of-state. Vendor does not send direct mailers to the public or advertise through television, radio, newspaper, or other media. Vendor's customers can purchase the products for their own use, or to sell to others ("resellers"). Resellers receive discounts and other incentives, and there are no sales quotas and there are no restrictions on sales, recruiting activities, or territories. Vendor employs five regional managers based out-of-state who held three one-day seminars to educate on products, but not on sales techniques, and they made approximately nine visits to top sellers in Missouri in 2007. Vendor holds two conventions each year in different cities in the United States, but held no conventions in Missouri in the past ten years. Customers may return products to Seller within 90 days of purchase for a full refund, replacement, or credit, but may not return products to resellers.

Asset Protection Trusts Under Missouri Law

by Emily J. Bell

Many of our clients are concerned with protecting their assets from potential creditors, and we are often asked what planning techniques may afford such protection. Missouri law, as compared with other states, provides fairly generous protection to would-be debtors by endorsing "asset protection trusts".

An "Asset Protection Trust", or "APT", is a trust that is protected from a beneficiary's creditors—in other words, the trust assets are beyond creditors' reach. Such protection can be had if the APT meets the requirements set forth under the Missouri Uniform Trust Code.

First, in order to be afforded such protection, the APT must be irrevocable. That is, once an APT is executed, it may not be amended nor terminated. This is very important, and is often times the "sticking point" for clients interested in this technique.

Second, an APT must contain a "spendthrift" clause. This is a simple requirement to meet—the APT only needs to contain language to the effect that a beneficiary's interest is held subject to a "spendthrift trust".

Third, the APT must have more than one beneficiary. It is preferable that it be another current beneficiary, albeit a discretionary one. Many times, a client desires to create an APT for his or her own benefit. Missouri law permits these "self-settled" APTs, however, distributions to the settlor-beneficiary must be wholly discretionary, not mandatory. Otherwise, creditors can reach at least a portion of the trust's assets. Additionally, the transfer of assets to an APT by a settlor-beneficiary may not be in fraud of his or her creditors. If a lawsuit has been threatened, for example, it is too late to create an APT to protect one's assets.

Missouri law not only permits a settlor to create an APT for his or her own benefit, but also permits that same individual to serve as Trustee. Although this is permitted, it is not highly recommended, and we suggest that clients engage the services of a third-party Trustee. Finally, it is important to keep in mind that APTs are not a panacea. If the arrangement seems over-reaching, it probably is, and a more modest approach is usually best. On this point, we recommend that a client retain sufficient assets outside of the APT to continue to pay bills as they come due. We also advise clients to refrain from using assets transferred to an APT to qualify for a loan, as this constitutes fraud. It is important to be very careful in utilizing APTs to ensure that they comply with the Missouri Uniform Trust Code.

If you would like to discuss the potential use of an APT in your particular circumstances, please contact a member of the CECB Estate Planning Practice Group.

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Acceleration Clauses in Commercial Lease Agreements: Getting Your Future Lease Payments Paid

by John L. Waite III

Can a commercial landlord sue for lease payments upon a tenant's default when those payments are not actually due? The answer is maybe. As a general matter, landlords have more freedom under Missouri law when negotiating the terms of a commercial lease agreement with prospective tenants versus residential landlords. Furthermore, so long as both the landlord and tenant are sophisticated parties, Missouri courts will likely uphold any provision that is negotiated in good faith between the parties. One limitation is where a provision may act as a penalty against the tenant for breaching the term(s) of a lease agreement. In other words, if the provision provides a financial windfall to the landlord as opposed to an attempt to compensate the landlord for the damages caused by the tenant's default, then Missouri courts are unlikely to enforce such a provision. One provision that falls somewhere in the middle and which are becoming more common in commercial lease agreements is the Acceleration Clause. This provision allows a landlord to accelerate all future lease payments upon a tenant's default and demand immediate payment. However, Missouri courts have yet to recognize or enforce such a provision. Currently, Missouri law recognizes three options available to a landlord upon a tenant's default. First, the landlord may remain out of possession and sue to recover the rent as it becomes due. Second, the landlord can give notice to the tenant of its decision to resume possession and re-let the property in an effort to mitigate the damages caused by tenant's default, but reserving landlord's right to sue for unpaid rent as it becomes due. Finally, the landlord may reenter and resume possession of the property and close the term of the agreement thereby terminating the tenant's rights to possession.

While these rights are recognized under Missouri common-law, there is no reason to assume they preclude a landlord and tenant from negotiating other, additional remedies. Under Missouri contract law, and as briefly touched upon above, so long as a provision is not akin to a penalty against a defaulting party and instead attempts to compensate the nondefaulting party for damages suffered, then the provision should be enforceable. In many instances it is difficult, if not impossible, to predict the damages caused by another's default. In the case of commercial leases, which tend to include long durations and complicated terms/obligations, it is difficult to predict the costs associated with a tenant's default. And in those cases where the tenant abandon's the property or is unable to make the appropriate lease payment, it is no easier to calculate the time and effort it will take to re-let the property or compensate a landlord for expenses incurred as a result of the vacant property. The term "liquidated damages" is used to define those provisions where parties attempt to predict these costs and place a monetary value to a party's default. In essence "liquidating" the unknown costs to a current dollar amount, thereby removing the potential damages from unknown to known.

An acceleration clause is just such a provision whereby the landlord is unable to predict with certainty the damages they may suffer if tenant abandons the property or otherwise defaults under the terms of the lease agreement. Two types of acceleration clauses have been identified in other jurisdictions. The first type is considered the "most genuine" of clauses and neither causes a termination of the lease nor hinders the tenant's right to occupy the property so long as the tenant pays the accelerated rent to the landlord. The other type includes both an acceleration of the undue lease payment and termination of the lease agreement. In a case decided by the Iowa Supreme Court, an acceleration clause was upheld after the Court found that it was (i) based upon the uncertainty as to the actual amount of damages resulting from a breach of the lease, (ii) the amount of liquidated damages were reasonable, (iii) the clause placed the landlord in a position that it would have occupied had the tenant performed the entire lease, and (iv) the landlord had a duty to mitigate the damages. Another factor, considered by other jurisdictions when upholding an acceleration clause, is where the future stream of lease payments are discounted to a present value to account for the time-value of money.

In short, an acceleration clause that is properly drafted may be enforceable in Missouri. However, until such time as this issue is actually ruled upon by a Missouri court, landlords are encouraged to follow general principles of contract law when drafting such a provision. With appropriate forethought and consideration of the specific factors involved with a particular commercial lease agreement, there is no reason that a landlord should not be allowed to contract for an acceleration clause so long as the clause is in essence a liquidated damage provision and not a penalty as defined under Missouri law. ■

Firm News

Clifford S. Brown

Thomas D. Peebles, Jr.

Joseph D. "Chip" Sheppard III

Carnahan, Evans, Cantwell & Brown, P.C. salutes Clifford S. Brown, Thomas D. Peebles, Jr. and Joseph D. "Chip" Sheppard III on being recognized as three of the nation's most distinguished and respected attorneys in the 2010 edition of *The Best Lawyers in America.*

Mr. Brown and Mr. Peebles were recognized in the specialty of Trusts and Estates and Mr. Sheppard was recognized in the specialty of Securities Law. Selection to *Best Lawyers* is based on an exhaustive and rigorous peer-review survey comprising more than 2.8 million confidential evaluations by the top attorneys in the country. The annual publication has been described by The American Lawyer as "the most respected referral list of attorneys in practice"

When it comes to needing an attorney, trust Cliff, Tom, Chip and the team at Carnahan, Evans, Cantwell & Brown, P.C.

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Updating or Following Buy-Sell Agreements

by John M. Carnahan

A recent decision of the Missouri Court of Appeals for the Eastern District, in Cannon v. Monroe, reaffirms the importance of reviewing and updating your Buy-Sell Agreements on a regular basis, and discussing it as part of your annual Shareholder and Board of Directors' meetings each year.

The facts were fairly straight forward, Mr. Cannon and Mr. Monroe were 50/50 Shareholders in three Missouri Corporations. They had been co-owners for many years. One of the Corporations did have an ownership agreement. The companies had failed to have meetings to elect Officers or Directors for many years, and therefore since the last time they were able to get together and have elections, the same slates continued. Manage-ment of companies became deadlocked over time.

The businesses appeared to be successful. In 2004 Mr. Cannon filed a Petition under Sections 351.467 and 351.143 of the RSMo. He was seeking dissolution of the corporations, pursuant to the provisions of Missouri law and asking the Court to take jurisdiction and appoint a trustee or receiver to administer and wind up the affairs of the Corporation. The Trial Court appointed a St. Louis attorney as the Trustee, to serve the interests of the shareholders with the authority to run the business and sell the company as a going concern or to liquidate its assets. The Trustee determined that it was in the best interest of the Companies and the parties to have a private sale to conclude the litigation, by having one of the parties acquire the other's interests in the firms. The Trustee accepted written bids from each party, and Mr. Cannon was the successful bidder for $1,755,000, of the interests of Mr. Monroe for all three Corporations. The Trial Court concluded that the remedy of the private sale was appropriate, even though one of the statutory provisions required dissolution. The Court concluded that the Statute required the Trustee, or receiver, to act to maximize shareholder value, which could be through dissolution or selling the company as a going concern, including sale to either one of the existing shareholders.

It is important to note, that the case started in 2004 and it was not resolved until May of 2009 with the decision of the Court of Appeals. The case had already been to the Missouri Supreme Court once, and therefore the decision of the Court of Appeals should be final.

This case serves as a good example, of how not to conduct shareholder relations, and the importance of discussing management, business plan, including Buy-Sell Agreements, and updating them on a regular basis. ■

Oral Contracts: Are Handshake Deals Still Enforceable?

by Richard T. Ashe

As the saying goes, "a handshake just doesn't mean what it used to." This common phrase has some truth to it, to be sure, but it does not accurately reflect Missouri law when it comes to the enforceability of an oral contract.

Yes, there are circumstances where a Missouri court would not enforce an oral agreement. For example, if the oral agreement concerns the sale of real property, a court would not enforce the agreement unless there was some writing evidencing the terms of the agreement.

But generally speaking, an oral contract is just as enforceable as a written contract. This is especially true when the person seeking to enforce the oral agreement has provided goods or services to another who claims they do not owe anything for the goods or services. Missouri courts will not allow a person to accept the benefit of someone else's goods or services without payment.

This remains true even if the parties never actually agreed on a price to be paid for the goods or services.

Under such circumstances, the parties may not have even technically entered into a contract because a key term of the contract—the price—was not agreed to. Nevertheless, Missouri courts will force the person who accepted the goods or services to pay for the "reasonable value" of the goods or services.

A great example of this can be found in a case handled by our firm a few years ago, known as Cotner Productions, Inc. v. Snadon ("Cotner"). In Cotner, our clients introduced the defendants to a well known Las Vegas performer for the purpose of allowing the defendants to pitch the idea of opening a theater in Branson where the performer would be the headlining act. Neither the plaintiffs nor the defendants prepared or signed a written contract. Further, the parties never agreed on a specific price to be paid by the defendants for the introduction. The parties only discussed the idea that the plaintiffs would be paid a percentage of the value obtained by the defendants if they were successful in recruiting the performer for a show in Branson

On this limited evidence, the trial court entered a judgment in favor of our client for more than $300,000, an amount that was later upheld by the Missouri Court of Appeals.

The court's reasoning was simple: the defendants accepted the benefit of plaintiffs work in arranging the meeting between the performer and the defendants; and the value of this work could be quantified based on the testimony of an expert with knowledge of the industry. The fact that the parties had no written agreement had no affect on the outcome of the case.

So the next time you find yourself on the short end of a handshake deal, do not assume that you cannot get your day in court. An oral contract is, for the most part, just as enforceable as a written contract under Missouri law. ■

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Founded in 1979, the law firm of Carnahan, Evans, Cantwell & Brown, P.C. has offices in Springfield and Branson, Missouri. An "A-V Rated" preeminent law firm by Martindale-Hubbell, our attorneys are engaged in the general business practice of law with an emphasis the following areas:

- Business Organization and Planning
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- Mechanics' Liens and Foreclosures
- Pension and Profit Sharing
- Employment
- Zoning and Land Development

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