

REAL ESTATE REPORT

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Tax Implications On Home Sales

You or a family member will probably be involved in the sale of a primary personal residence in the near future. Many people seem to be unfamiliar with the "new" tax law which took effect in 1997.

The old law allowed an owner to roll-over the gain to a newer, more expensive home that was acquired within 18 months after the sale. One tax law provision allowed home owners aged 55 or older to exclude up to \$125,000 of gain. Those factors are no longer relevant. There is no time limit and no requirement that you buy replacement property. Nor does your age matter.

The new (1997) tax law essentially allows you to exclude \$250,000 of gain (\$500,00 for a married couple filing jointly) from your calculation of gross income. The qualifying requirements are quite simple. The property must have been owned and used as your primary personal residence for 2 of the past 5 years. This is not a one-time benefit. You can take advantage of this law as often as every two years.

If your gain exceeds the exclusion limit, then you pay capital gains tax at the applicable rate. Thus, it is still a good idea to save old receipts for home improvements. They could still come in handy to reduce your taxable gain by documenting an increase in your basis.

There are some provisions which could cause troublesome complications for some situations.

Complications of the New Law

Despite the relative simplicity of the new tax law exclusion, there are some provisions

which could cause troublesome complications for some situations.

Depreciation deductions after May 6, 1997 can pose a problem. If the owner has claimed a home office deduction or otherwise used the residence as rental property and taken depreciation deductions, those factors impact the amount of gain that may be excluded.

The amount of depreciation deductions after May 6, 1997 is not excluded from gain, but in effect is recaptured. Also, if part of the property was used for other than a principal residence (e.g., a home office), then only the gain attributable to the residence is excludable.

On the other hand, some good news is that in determining whether the two year occupancy period is satisfied, the IRS ignores short temporary absences such as vacations. That is so even if the residence is rented out during that period of time. Also, for joint returns, both spouses need not be listed on the title to the property so long as both satisfy the occupancy requirement, then each is entitled to a \$250,000 exclusion for a total of \$500,000 on a joint return.

Recent IRS Regulations regarding the Section 121 exclusion make it even more useful. The regulations cover fact situations such as multiple homes, vacant land, joint owners who are not married, ownership in a trust and availability of partial exclusion relief in some cases where you do not meet the two year requirements.

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Mold Checklist for Commercial Tenants

*W*ith multi-million dollar mold cases in the headlines, concerns about the effects of mold contamination have increased exponentially during the past several years. Notwithstanding the hype, there are no indoor air quality standards for molds, in part because each person's reaction to mold exposure is impossible to predict, and also because there are significant gaps in scientific knowledge linking mold exposure to health problems. While exposure to mold does not always result in illness, the Centers for Disease Control and Prevention agrees with the Environmental Protection Agency's (EPA) recommendations to remedy mold contamination in indoor environments to prevent negative health effects.

Molds can be found almost anywhere and grow on most organic substances, as long as moisture and oxygen are present, according to the EPA. In commercial buildings, mold problems are commonly caused by defects in the building envelope that result in the building being tightly sealed and lacking adequate ventilation, moisture retained in porous construction materials, water damage caused by roof or pipe leaks, landscaping or gutters that direct water into or under the building, and problems with the building's heating, ventilating and air conditioning (HVAC) system.

In selecting a site for a business and in negotiating a lease or lease renewal with a landlord, the commercial tenant should consider several important issues in order to protect itself from potential mold exposure liability to its employees, customers, guests and the landlord.

HVAC Systems

HVAC systems can contribute to the growth and dispersion of mold throughout a building. HVAC systems may produce condensation, which contributes to the growth of mold. In addition, HVAC drain pans, blower housings, baffles and louvers can also foster mold colonization. During the site selection process, a prospective tenant should investigate the building's HVAC system and the landlord's HVAC maintenance practices to look for red flags. Such inquiry and investigation could include inspection of the HVAC system by a qualified HVAC contractor or service provider. While landlords may be reluctant to negotiate HVAC provisions in commercial leases because the same HVAC standards will typically apply to all of the tenants in the building, tenants should insist that the HVAC system be operated at least to its design standard, and to The American Society of Heating, Refrigeration and Air Conditioning Engineers (ASHRAE) Standard 62, if possible.

Pre-Occupancy Inspection

Once the site has been selected, tenants should have the right to demand an inspection of the leased premises for mold before taking occupancy. Any inspection should be conducted by a certified industrial hygienist (CIH) with experience in conducting mold inspections. Which party bears responsibility for paying for the inspection and the scope of the inspection should be agreed upon in advance. A mold inspection clause should also address the parties' respective rights and responsibilities in the event that the inspection detects a mold problem. If the landlord insists that the lease requires the tenant to move into the premises provided that the landlord remediates (cleans up) the mold, then the tenant should insist on an abatement of rent for any portion of the premises which are rendered untenable during the remediation.

For mold problems in existence before the tenant moved in, the landlord should be responsible for the cost of the remediation as well as any costs and expenses incurred by the tenant as a result of the remediation, including, without limitation, costs attributable to a delayed commencement date. Depending upon the sensitivities of the tenant, the tenant may desire the right to terminate the lease if mold is detected during the pre-occupancy inspection.

Read the Fine Print

A tenant's mold claims against its landlord may be limited by terms and provisions of the lease which make the tenant responsible for mold and mold-causing conditions within the leased premises. In addition, the lease may impose certain duties upon the tenant with respect to mold detection, reporting to the landlord and remediation of the problem. Moreover, landlords may require tenants to release and indemnify the landlord for certain claims or losses relating to mold and to maintain a separate insurance policy or endorsement covering mold claims.

By considering mold issues in the site selection process and in lease negotiations, tenants can seek to protect themselves from potential mold claims by their employees, customers, guests, and even the landlord. In addition, if the lease is silent on mold issues, the parties risk having a court determine which party is ultimately responsible for any physical damage to the property and any bodily injury to persons caused by the mold problem.



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Beware of Owner Purchases of Equipment or Materials

Contractors are often asked to bid on jobs where materials or equipment are purchased directly by the owner. Purchase of materials by owners presents problems for both owners and contractors.

The following issues arise when an owner/customer provides equipment or materials:

1. Contractor Control

The contractor will not have control over the exact equipment that will be selected or deal with any contingencies which may arise during installation of the equipment.

For example, what if the equipment provided does not work in the space provided? In a typical situation, a contractor can go back to its supplier (presumably with whom it has a long term relationship) and return the equipment. An owner may not have that option.

2. Installation of Equipment/Materials

a. **Installation Cost** - If the owner is supplying the materials/equipment, is the contractor still being paid for installation? This issue needs to be addressed in the contract between the owner and contractor.

b. **Extras** - The contractor should assist the owner in selecting the proper equipment, including providing specifications (see 3(a) below). Nevertheless, it is still possible that additional equipment, adaptors, or other hook-ups will be required in order to complete the installation. The contractor may also incur the additional costs of unpacking or moving equipment or materials (see 3(e) below). Normally these "extras" would be built into the contractor's bid. The owner and the contractor will need to discuss who will pay for these costs.

3. Time/Coordination

When an owner supplies equipment, the contractor must coordinate with either the owner (whose availability may be limited) or the owner's chosen suppliers. Coordination issues include:

a. **Purchase of Proper Equipment** - The contractor must provide clear specifications of equipment to the owners. Normally, the contractor will have a good idea of the equipment to be installed, but it can also discuss the installation with its suppliers to deter-

mine which materials or equipment are best suited to that installation. Moreover, a contractor, as a frequent purchaser from suppliers, will have leverage to address problems if they occur. In contrast, the owner may lack the contractor's expertise or leverage to avoid or solve problems;

b. **Construction Schedules** - Construction schedules often vary. The contractor will need to coordinate with the owner (and in turn the owner's supplier) to make sure the equipment or materials are delivered to the site on time and at the proper location. If the construction schedules change, the contractor will need to coordinate with the owner and/or the owner's supplier and shipper to insure that proper delivery occurs.

c. **Shipping Charges** - Payment of shipping charges will need to be addressed. Who will be responsible for shipping and when will those costs be paid, are questions the contractor and owner need to resolve.

d. **Written Instructions** - The contractor will need to obtain from the owner or its supplier copies of all written materials, including instructions, associated with the materials or equipment provided.

e. **Proper Packaging** - The materials or equipment to be installed need to be properly packaged and unloaded. Cranes or lifting devices also may need to be scheduled.

4. Local Building Codes

The contractor is most familiar with the requirements of the local building codes. If the equipment ultimately supplied by the owner does not meet building code requirements, the contractor will either inadvertently install non-conforming materials, or be forced to cancel or postpone the installation because of improper equipment or material. This could lead to conflict with the owner, because the owner could assert that the contractor did not provide proper specifications. Once again, the owner and contractor need to address this issue in the contract before a problem occurs.

5. Warranty Claims

Often, one of the advantages touted by having owners supply materials, is that the owner will be responsible for enforcing warranties. However, a defense often asserted by manufacturers is that the product was improperly handled or installed. Because the contractor was not involved in the shipping, and the owner was not involved in the installation, a conflict can arise. The result is parties pointing at each other. The simpler situation is when the contractor installs the

product and is responsible for enforcing the warranty.

6. Insurance

The contractor needs to work with the owner to make sure that insurance has been clearly defined. That is, who is insuring the materials in transit to the site and who is responsible for insurance at the site, prior to installation.

7. Liability for Payment

There have been lawsuits where an owner has purchased materials or equipment directly from a supplier and then the supplier has not been paid. The supplier then sues both the contractor and the owner, because the supplier was under the impression that the materials (while ordered by the owner) were still being underwritten by the contractor's credit. While it is unlikely the contractor will be liable to the supplier, bad feelings may develop between the contractor and the supplier.

As the list above indicates, there are costs and risks associated when an owner purchases materials or equipment directly. At the very least, the parties should be made aware of the increased costs to the contractor, and understand when the contractor's price is adjusted.



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*Pictured (back row): Left to Right: J. Patrick Brinkman, Richard C. Salmen, Elizabeth H. Kiernat, Daniel R. Kelly, Honnen S. Weiss, Kareen R. Ecklund, James A. Blomquist, Stephen E. Yoch, Randy J. Sparling, David B. Eide.
Pictured (front row): Left to Right: Karen R. Kees (Legal Assistant), Russell J. Sudeith Jr., David M. Cremons, Timothy J. Hassett, Mark S. Radke, Catherine L. Sjoberg.
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Welcome Our New Attorneys!

Felhaber, Larson, Fenlon and Vogt, P.A. is pleased to announce that Janet C. Ampe, H. Le Phan and Catherine L. Sjoberg have joined our firm. Please join us in welcoming them to Felhaber.

Janet C. Ampe

Ms. Ampe graduated with a B.A., summa cum laude, from the University of Minnesota Carlson School of Management, in 1989. She received her J.D., summa cum laude, from the William Mitchell School of Law in 2002, graduating in the Top 2 percent of her class. Ms. Ampe will focus her practice on labor and employment issues.



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H. Le Phan

Ms. Phan graduated with a Bachelor of Arts, summa cum laude, in 1993, and earned her Juris Doctor from William Mitchell College of Law in 1997. Ms. Phan practices in the areas of labor & employment litigation, commercial litigation, and business immigration.



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Catherine L. Sjoberg

Ms. Sjoberg graduated from the University of St Thomas in 1993 with her B.A. cum laude in Business Administration. She received her J.D. from the University of Denver College of Law in 1999, graduating in the Top 10 percent of her class. Ms. Sjoberg has several years of commercial real estate and corporate law experience, the focus of her practice.



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Join Us For A Complimentary Client Seminar

Consider attending one of our upcoming seminars, with timely discussions on a variety of legal topics. The seminar presenters include Felhaber attorneys who have expertise in the seminar subject matter. The following seminars have been scheduled for 2003. Please contact Karen Dyck, Marketing Director, at kdyck@felhaber.com if you would like to receive a seminar invitation. Please state your name and address with the name of the seminar you would like to attend. You may also log on to www.felhaber.com, which will offer on-line registration approximately three weeks ahead of the seminar date.

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A Professional Association – Attorneys at Law

2003 SEMINAR DATES:

- Workers Compensation - April 10
- Association Management - April 24
- Multi-Employer Benefit Seminar - May 21
- Estate Planner - May 29
- Builder/Developer - Sept./Oct.
- Labor & Employment Law - October 10
- Health Law Seminar - To be determined

Tax Implications On Home Sales ■ Continued from page 1

Under the regulations the benefits of Section 121 exclusion may be obtained even if the title is held by a trust. Each unmarried taxpayer owning an interest in the residence may exclude up to \$250,000.

Especially noteworthy is that the proposed regulations allow partial benefits of Section 121 even if the taxpayer does not satisfy the full two year requirement regarding ownership and use if the sale is due to unforeseen circumstances such as a change in place of employment or a change in health.

If you own multiple homes then your “principal” residence is determined by factors such as:

1. Place of employment
2. Principal abode of family members
3. Address listed on tax returns, driver license, car registration and voter registration
4. Mailing address for bills
5. Location of church or clubs of which taxpayer is a member



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Real Estate Report is an update on legal developments. It is not intended to be legal advice and should not be relied on without consulting counsel.

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