INSIDE THE LAW

Fall 2013

CONTENTS

The Danger of "Browse Wrap" Agreements in the Commonwealth 2

Real Estate *Investor* or *Dealer*? 5

Trusts Are Still an Integral Part of Most Estate Plans 8

Firm News 11

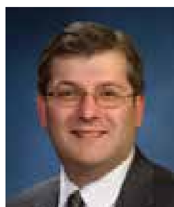
Fletcher Tilton PC
Attorneys at law

Worcester • Framingham • Cape Cod | www.fletchertilton.com

Find us on Facebook

THE DANGER OF "BROWSE WRAP" AGREEMENTS IN THE COMMONWEALTH

By Bobby Hazelton, Esq.
(508) 459-8040 | bhazelton@fletchertilton.com



In today's economy more and more goods and services are sold through the Internet. Your business may increasingly rely on e-commerce rather than face-to-face transactions. Having a low-cost method to resolve disputes with these remote, faceless customers is a business necessity. How do you make sure the other party agrees to your warranties, disclaimers and even dispute resolution procedures? One popular method, the browse wrap agreement, may not be a good choice for companies wanting to transact business with residents of Massachusetts.

Browse wrap agreements have become ubiquitous on e-commerce service websites. Visit any services website and you will see the small link on the bottom of the page that points you to the website's terms and conditions. Moving the terms of the agreement away from the point of sale is a very popular marketing technique. The fewer things customers have to do to purchase your products and services, the more likely they are to complete the purchase. If the customers have to stop to evaluate terms, they are more likely to abandon the transaction. How far away can you move the terms and conditions from the point of sale and still have them be binding on the transaction?

Decades ago, the software industry pioneered the first bold step in moving the terms away from the point of sale. Software involves the sale of a license to use intangible property rather than a tangible good or service. The license agreement is typically long and verbose. The software vendors began putting the software license inside the product packaging. Consumers objected to this practice, stating that they could not possibly have agreed to the terms because they were unable to read them when the software was purchased. Courts largely agreed with this position and allowed consumers a period of time after the purchase of software to consent to the terms or return the software for a refund of the purchase price. Despite this pro-consumer ruling, few consumers would avail themselves of this remedy. Most would continue to use the software. The "shrink wrap" license agreements proved to be effective for both marketing and risk prevention purposes.

How do you make sure the other party agrees to your warranties, disclaimers and even dispute resolution procedures?

One popular method, the browse wrap agreement, may not be a good choice for companies wanting to transact business with residents of Massachusetts.

When the software distribution model moved from physical media to Internet downloads, the industry reacted with the "click wrap" agreement. In a click wrap transaction, the purchaser of the software would be required to review a window or screen showing the terms and conditions of purchase, and then take some type of affirmative action, such as a click, to state whether they agreed to those terms and conditions. Many e-commerce companies selling goods followed this model. Most courts have upheld click wrap agreements, and they have become a fixture in e-commerce product sales.

The click wrap agreement wasn't an ideal solution for e-commerce service providers. These companies required longer-term relationships with customers. Service website transactions were not discrete, but continuous and spread over time. As the law progressed, the service website agreement also needed to progress. The need to constantly update terms led to the birth of the browse wrap agreement. With the browse wrap, the customers bound themselves to terms and conditions by performing some action other than clicking "I Accept." Most often the terms would be located on a separate web page with just a hyperlink pointing to the terms and conditions. Users would purportedly bind themselves to the terms just by using the website services. Would the terms of these browse wrap agreements be binding on the parties? If they are binding, could companies that sell goods use a similar type of agreement to avoid losing customers during the "click to assent" stage of a browse wrap agreement?

The answers to these questions will continue to evolve as lawsuits progress through the courts of each state; however, the Massachusetts Appeals Court's recent decision in *Ajemian v. Yahoo* makes pure browse wrap agreements inadvisable. In *Ajemian*, the estate and siblings of John Ajemian filed suit in Massachusetts probate court to compel Yahoo to turn over certain emails from the deceased Ajemain's email account. Yahoo asked the court to dismiss the suit because, inter alia, Yahoo's terms of service included clauses that (1) removed any right of survivorship to the account, (2) did not allow any third parties to bring actions for benefits they may receive from Ajemian's account, and (3) required all disputes to be resolved in California courts. The forum selection clause was in the Terms of Service on Yahoo's website at the time Ajemian opened the account, and the limitation on survivorship and third-party beneficiary clauses were added to the Terms of Service four years later. The appeals court denied Yahoo's request because it found that Yahoo failed to show that the terms were adequately communicated to Ajemian or accepted by Ajemian.

When reaching its decision, the appeals court was careful to reaffirm that it does recognize forum selection clauses in click wrap agreements. More specifically, the appeals court searched for two distinct characteristics to decide whether the agreement was accepted. First, was the agreement shown to Ajemian. Second, did Ajemian take an affirmative action such as clicking "I Accept."

Because of *Ajemian*, a company considering moving from a click wrap agreement model to a browse wrap agreement model should reconsider its decision. If you already have a viable means to conduct your transactions, you would not want to move to a model that is less likely to result in an enforceable agreement. If you already have a browse wrap model and you are able to transition to a click wrap model, you may find it advisable to make the switch. If you have a service-based e-commerce business that doesn't lend itself to discrete transactions, you may still want to implement certain aspects of a click wrap model on certain of your transactions. For instance, you may want to have all account sign-ups subject to a click wrap rather than a browse wrap agreement. If you have content that requires disclaimers or specific types of agreements, you may want to prominently display the disclaimers in conjunction with the material and even require a click wrap screen prior to allowing access to the content. The key will always be to prove that you provided notice and that the other party agreed to the terms.

Fletcher Tilton can review your e-commerce websites and provide recommendations on how to include and integrate click wrap terms and conditions. **FT**

REAL ESTATE INVESTOR OR DEALER? CONVERTING ORDINARY INCOME TO CAPITAL GAIN

By Cory J. Bilodeau
(508) 459-8007 | cbilodeau@fletchertilton.com

As the real estate market continues to improve and values increase, it may be time for real estate owners to revisit a tax planning strategy. Real estate developers should consider locking in capital gains treatment by selling real estate they hold for investment to a related development corporation. The gain on the sale to a development corporation will be taxed as capital gain and the subsequent gain on the sale of the developed real estate as ordinary income. The development corporation handles all post-sale development of the real estate, including grading; installing roads, sewers, and other utilities; and construction of homes.

The character of gain resulting from the sale of real estate depends on the classification of the seller as an *investor* or *dealer*. For investors, the gain is capital, and for dealers, the gain is ordinary income. Investors generally purchase and hold real estate for its appreciation over a period of time. A dealer sells real estate to customers in the ordinary course of its trade or business. Dealers typically include real estate developers, subdividers, and home builders. The primary factor in characterizing a taxpayer as a dealer is whether the real estate is sold in the "ordinary course of a trade or business." The term "capital asset" expressly excludes property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business (inventory). The intent of the seller and the purpose for which the seller purchased the property are the determining factors. Other requirements, including that the real estate be sold to customers and the property be "held primarily for sale," are relevant but not necessarily dispositive in characterizing gain.

The courts have developed a framework for determining whether a real estate sale should be considered a sale of a capital asset or inventory. The framework focuses on answering the following three principal questions:

- Is the taxpayer engaged in a trade or business, and if so, what business?
- Is the taxpayer holding the property primarily for sale in that business?
- Are the sales contemplated by the taxpayer "ordinary" in the course of that business?

In attempting to define whether a taxpayer is engaged in a trade or business and what type of trade or business, courts consider the following factors to be relevant, with no single factor or combination of factors controlling:

1. The Nature and Purpose of the Acquisition of the Property and the Duration of Ownership

The nature and purpose of the acquisition is reflected in the taxpayer's motivation in holding the property prior to the sale. The course of conduct over a period of time, and not a specific moment in time, is relevant. A taxpayer should contemporaneously document its motivation for the real estate acquisition and any subsequent change of purpose.

Not all courts have identified the length of the holding period as a factor. However, courts that have considered it have generally indicated that holding an asset for a long time evidences an investment purpose. The distinction between capital and ordinary gains lay between profits arising from the everyday operating of a business on the one hand and the realization of appreciation in value over a substantial period of time on the other. The lengthy retention of property is indicative of an intention to hold such property for investment purposes.

2. The Extent and Nature of Efforts to Sell the Property

Solicitation and marketing efforts may indicate that the purpose of holding property is not for investment. The relevant question is whether any solicitation and marketing efforts are undertaken, rather than who performed such activities (e.g., the taxpayer, real estate agent, or real estate broker). Solicitation and advertising efforts suggest that the taxpayer is looking for customers and is no longer willing to hold the real estate for future appreciation.

3. The Number, Extent, Continuity, and Substantiality of Sales

Although there is no bright line test with respect to frequency, number, or continuity of sales, court decisions provide some guidance. In one case, 244 lot sales in a single year and average lot sales of 15 per year during a five-year period constituted a trade or business. In another, the sale of 63 properties over more than 20 years was not a trade or business. The substantiality of income derived from sales, as well as its proportion to the taxpayer's total income, is a factor in deciding whether a taxpayer is engaged in a real estate trade or business.

4. The Extent of Subdividing, Developing, and Advertising to Increase Sales

Taxpayers with an investment strategy are usually waiting for the value of their property to appreciate on its own over a period of time; they do not seek to increase the property's value through improvements. By contrast, extensive

The character of gain resulting from the sale of real estate depends on the classification of the seller as an *investor* or *dealer*.

development and improvement activities more likely indicate that the owner is selling property in its real estate business. Subdividing property into residential lots, grading and surfacing the streets, and installing drainage facilities and utilities indicate dealer status. Steps to enhance the marketability of the property later sold, where those activities are "purely legal" (subdividing) does not change the character of the property from investment to dealer.

One issue that arises is whether a taxpayer who is a real estate dealer can hold real estate for investment, notwithstanding that the taxpayer is a dealer with respect to certain real estate holdings. Courts' decisions have firmly established that a dealer may also hold real estate for investment. The fact that a taxpayer is a real estate dealer does not automatically taint its other real estate holdings. The critical question is the taxpayer's intent at the time of the sale. Actions prior to the sale are indicative of a taxpayer's intent at the time of the sale but not necessarily conclusive. The taxpayer's purpose and intent may change over time. As discussed above, certain actions the taxpayer takes, such as advertising, physical improvements to the property, and sales of individual lots, tend to indicate that the real estate is held primarily for sale. Real estate held for a long period of time that appreciates in value and with minimal improvements made indicates that the real estate is held for investment.

Because of this, a taxpayer who is a dealer should hold its investment properties in separate entities apart from its dealer properties. The formation documents for the entity should state that it is being formed for real estate investment purposes. The purpose for which a specific real estate interest was acquired should be memorialized in the company's records. The name of the entity should avoid the word "developer" or "development" but may include "investments" or "investor." The taxpayer's real estate holdings should be properly identified on its books and records and in tax returns (e.g., inventory, investment property, rental property).

There are significant tax and non-tax complexities in structuring this capital gains tax planning strategy. However, certain formal steps can be taken to support an investment purpose and intent and to preserve capital gain treatment. **FT**

TRUSTS ARE STILL AN INTEGRAL PART OF MOST ESTATE PLANS

By Dennis F. Gorman, Esq., CPA, MST
(508) 459-8037 | dgorman@fletchertilton.com

The importance of estate planning to reduce federal estate taxes has been significantly diminished due to recent tax law changes; however, trusts remain an integral part of most families' estate plans. Here are some of the more important reasons why you should consider employing one or more trusts in your estate plan.

Revocable Credit Shelter Trusts

Revocable Credit Shelter Trusts are principally used to minimize federal and Massachusetts estate taxes. While the federal exemption has been increased to $5,250,000 per person, the Massachusetts threshold remains at $1,000,000. Thus, where a family's assets, including investments, real estate holdings, life insurance proceeds, and retirement accounts, exceed $1,000,000, these trusts should be considered to minimize Massachusetts estate taxes. For families with more significant assets, they minimize federal estate taxes as well.

Family "Safety Net" Trusts

For couples with combined taxable assets of less than $1,000,000 and with children, reciprocal wills are often employed together with a Revocable Family Trust. The latter trust receives assets upon the death of the surviving spouse (or a single parent) and holds the assets for the benefit of the children until they reach certain ages, at which point remainder distributions are made. This is not a tax savings trust but rather a trust to hold assets for the benefit of younger children. By leaving children's inheritances in trust, you often avoid unnecessary complications, for example, guardianships or dissipation of assets by immature beneficiaries or through divorce, etc.

Irrevocable Life Insurance Trusts

Irrevocable Life Insurance Trusts ("ILITs") are employed to own life insurance policies with significant face values. ILITs, if properly structured, will remove the life insurance from both spouses' taxable estates. In considering whether to employ an ILIT, one has to consider the overall taxable estates of the family, federal exemptions, and the anticipated Massachusetts tax bite. These trusts do

require immediate, ongoing annual maintenance to deal with the payment of annual life insurance premiums.

Qualified Personal Residence Trusts

Qualified Personal Residence Trusts ("QPRTs") are used to transfer a residence of significant value to the children where the asset would otherwise be subject to significant estate tax. With a QPRT, the parents retain the right to control the property for a stated number of years, after which the remainder interest vests in the children. The transferring parents use some of their federal gift tax exemption when funding the QPRT, and the asset is ultimately removed from their taxable estate at a discounted value. QPRTs were more prevalent when the federal estate tax exemptions were lower; however, for some families, they may still be viable.

Medicaid Trusts

Where senior individuals wish to protect their home from a potential nursing home lien, Medicaid Trusts are often employed. The individuals transfer their residence to the Medicaid Trust while reserving a life estate in the deed. This means that the individuals retain the exclusive right to use the property, rent it, etc. They also have the obligation to continue paying the real estate taxes, insurance, and other maintenance cost of the property. Five years after the deed transfer to the trust, the property is not subject to a nursing home lien by Medicaid. Since the remainder interest in the residence is held by a trust, rather than by the children in their own individual names, the home is not subject to the claims of their creditors, divorcing spouses, etc.

Qualified Personal Residence Trusts ("QPRTs") are used to transfer a residence of significant value to the children where the asset would otherwise be subject to significant estate tax.

Furthermore, should the residence be sold during either parent's lifetime, any gain would be eligible for the "principal residence exclusion" for income tax purposes. Finally, should there be a need to sell the home during either parent's lifetime, the proceeds are split between the life tenants (the parents) and the remainderman (the trust), and both parties can reinvest the proceeds in a replacement residence without triggering a new five-year lookback period.

These trusts are widely popular today.

Special Needs Trust

Where a child is receiving governmental benefits, Special Needs Trusts ("SNTs") are frequently employed. The disabled child's own assets may be placed in an SNT to safeguard his or her eligibility. Alternatively, the parents may wish to leave the disabled child's inheritance in an SNT so as to safeguard his or her eligibility after the parents have passed. SNTs augment rather than supplant governmental benefits. They are often used in connection with tort-based settlements where the child receives a recovery from a lawsuit.

Overall Comment on Trusts

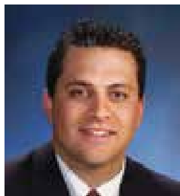
An increasingly important consideration today regarding all trusts is the issue of having your children's inheritances held in trust for some period of time to protect the inheritance from the claims of their creditors, divorcing spouses, etc. The longer the assets are held in trust, the longer they are protected. Immediate distributions upon the death of the parents cause the assets to be subject to the claims of the above third parties. Either professional trustees may be employed, or the children themselves, if they are capable. Furthermore, some beneficiaries need lifetime oversight of their trust funds due to diminished capacity, a lack of financial acumen, or a tendency to overspend. Trusts are often used to address these concerns.

Should you care to discuss any questions or any of the points raised in this article, feel free to contact any of the attorneys in the Fletcher Tilton Estate and Trust Administration Departments. **FT**

Where a child is receiving governmental benefits, Special Needs Trusts ("SNTs") are frequently employed.

FIRM **NEWS**

Todd Brodeur Gets WBJs "40 Under Forty" Award



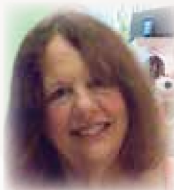
Every year the Worcester Business Journal puts out a list, "40 Under Forty," recognizing the top young leaders in Central Massachusetts for their career accomplishments and community service. This year, we're pleased to announce, that our own Todd Brodeur was on that list! The awards ceremony was held at Mechanics Hall in Worcester in late September.

To read the entire article, log onto: http://www.wbjournal.com/article/20130902/PRINTEDITION/308309997/1002

Upcoming Seminar & Events

For information or to register for any of our seminars, visit our website, today, under the Seminars & Events tab at the top of the page.

In Memoriam



Patricia Horning

Fletcher Tilton has recently lost a dear friend and co-worker. Patricia (Pat) Horning, an employee here for 44 years, passed away suddenly on Tuesday, October 15. As the Real Estate Paralegal Manager, Pat served clients with a cheerful smile and positive attitude. Knowledgeable and always willing to assist those around her, everyone enjoyed working with Pat. We extend our most sincere condolences to her family during this difficult time.

She will truly be missed.