BANK VIOLATES TRUTH IN LENDING ACT

A husband and wife who operated a day care business out of their home decided to take out a new mortgage on the home. Over the 10 years that they had owned the business, they had taken corresponding deductions and depreciation on their tax returns to account for the business run from the home. As calculated for tax purposes, approximately 17% of the home was devoted to the day care business, even though during the hours when the day care business was open, about 52% of the home's square footage was devoted to that use.

The homeowners came to realize that their lender had dramatically increased their monthly payments and had sent the loan documents to them when it was too late by law for them to change their minds (more than three days after they signed the papers). They sued the bank under the federal Truth in Lending Act (TILA), asking that the loan transaction be rescinded. Among other things, TILA requires lenders to provide particular disclosures to borrowers of "high rate" loans when points and fees exceed 8% of the amount borrowed. The bank had not made these disclosures to the borrowers at least three days ahead of the transaction, as required by TILA.

The bank's response was two pronged. First, it argued that TILA did not even apply to the case because of an exemption in the law for extensions of credit primarily for business or commercial purposes. Second, the bank took the position that the points and fees that the homeowners were required to pay could not count toward the 8% threshold because the homeowners had folded those costs into the loan instead of paying them up front in cash. A federal trial court sided with the homeowners on both points, allowing their case to go to trial.

Regarding the bank's claim that the "business purposes" exception in TILA should apply, the key fact was that, properly calculated, only a small percentage of the home was devoted to the business, thus defeating any attempt to argue that the loan was primarily for business or commercial purposes. As for the fact that the points and fees were financed, not paid in cash, this method of payment was of no consequence for purposes of meeting the 8% threshold. The applicable statutory language says only that the points and fees must be "payable" by the consumer at or before closing. The borrowers did bear the costs of the points and fees at the time of closing, no matter whether they were being paid then, deducted from loan proceeds, or, as happened here, added to the amount to be financed over time.

Working in favor of the borrowers on both points was the fact that TILA is a remedial statute to be construed and applied so as to achieve its goals of assuring the meaningful disclosure of credit terms and avoiding the uninformed use of credit. ■

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HUTCHISON & STEFFEN
ATTORNEYS
A full-service, AV-rated law firm
Peccole Professional Park
10080 West Alta Drive, Suite 200
Las Vegas, Nevada 89145
702-385-2500 • Fax 702-385-2086
hutchlegal.com
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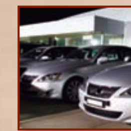
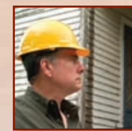

All In The Family– Father Wins Millions

Generation Skipping Trusts


Age Discrimination In Employment

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Legal Matters

Winter 2009

CONGRATULATIONS TO HUTCHISON & STEFFEN AS LEAD COUNSEL IN OBTAINING THE LARGEST JURY VERDICT IN 2008!*

Lawyers USA, a national legal publication, has released its annual Top Ten Jury Verdicts of 2008. The Hyatt v. Franchise Tax Board of California case in which Hutchison & Steffen served as lead counsel was ranked the largest U.S. jury verdict awarded to an individual plaintiff. The year's top verdict was awarded to the Firm's client, Gilbert D. Hyatt, a 70-year-old inventor who was hounded by California tax authorities for the past 15 years. Congratulations, Mark Hutchison, on leading the trial team and Firm staff to this historic victory. You may read about the entire list at: www.lawyersusaonline.com.

Lawyers USA compiles the Top Ten Jury Verdicts each year, applying certain ground rules. Verdicts must be to an individual plaintiff, which is defined as a single person, family or small group of individuals injured in a single incident who had their claims tried in one case before the same jury. They do not include business-against-business suits, class action or consolidated suits. ■

*As compiled by Lawyers USA.

FIRM INFORMATION

DID YOU KNOW:

Under our client resources links we offer more than **50 legal links** to useful Web sites ranging from Courts to Corporate and Securities to Legal Briefs, to name a few. Simply point your Internet browser to **www.hutchlegal.com/resources** and click on Legal Links.

ALL IN THE FAMILY

FATHER WINS $4 MILLION FROM DAUGHTER

A jury has returned a multimillion dollar judgment for the plaintiff in a case that is likely to make for strained relationships for one Michigan family. The winner, Richard, was the retired founder of a large automobile dealership. The loser was his daughter, Gail, to whom he had sold a controlling interest in the dealership. The jury agreed that Gail had made decisions that had hurt the dealership to such an extent as to cause the value of its stock to plummet, and eventually to put it into bankruptcy. The financial distress of the dealership had come to a head when it was discovered that the dealership had sold millions of dollars worth of vehicles that it had not paid for, a practice called "selling out of trust" in the automobile sales industry.

The main transgression by the second generation ownership was the use of funds derived from shares in the dealership to buy two new car dealerships, one of which was located just across the street from the original business. Even though the dealerships sold different brands of vehicles, the competitive disadvantage caused by the new competition was clear. Not only that, but a clause in the agreement between Richard and Gail had restricted Gail from acquiring competing dealerships.

While the bulk of the jury verdict was attributable to breach of the noncompete provision, there were additional amounts awarded for a monthly consulting fee that Gail was supposed to have paid her father after she took over the business, for interest due on a loan under a "shareholder oppression" claim, and, for good measure, for sanctions. ■

NEW NONPROFIT TAX FORMS

The Internal Revenue Service recently published new draft instructions for a revamped version of Form 990, used by nonprofit organizations. The new rules will go into effect when nonprofits file their 2008 tax returns.

In the interests of greater transparency and accountability, more information now must be divulged about the inner workings of the nonprofit. There are some detailed questions about such matters as compensation for officials, fund raising sources, and whether the organization has an ethics policy.

Whereas previously nonprofits with gross receipts of less than $25,000 were exempt from filing requirements, now all nonprofits must file some version of Form 990. ■

Actual resolution of legal issues depends upon many factors, including variations of fact and state laws. This newsletter is not intended to provide legal advice on specific subjects, but rather to provide insight into legal developments and issues. The reader should always consult with legal counsel before taking any action on matters covered by this newsletter. Nothing herein should be construed to create or offer the existence of an attorney-client relationship.

GENERATION SKIPPING TRUSTS

If you have heard of generation skipping trusts (GSTs) at all, you probably think of them as a way for wealthy families to shield their fortune from estate taxes. That is true as far as it goes, but GSTs can also have benefits for the less well off by protecting assets from ex-spouses and creditors and by serving as a place for appreciable assets to grow outside of taxable estates.

Although the phrase "generation skipping" sounds like an arrangement which leaves out children altogether in favor of the grandchildren, in fact what a GST "skips" is the taxation of assets put into children's estates by their parents. In a typical scenario, grandparents who are satisfied that their children are financially secure may decide to set up a GST in favor of all of their descendants as possible beneficiaries. Successive generations eventually receive the assets without the repeated imposition of estate taxes when each preceding generation dies. The assets are taxed only once, at the time of the initial transfer to the trust.

The first generation of children can be made to benefit as well. Although they technically won't own the assets in the trust, they can be given a right to distributions for their reasonable needs, meaning not only their support and maintenance, but also "comforts, conveniences, pleasures, and happiness." However, discretion over whether trust funds may be used for the benefit of the child must be exercised not by the child, but by a "disinterested trustee," that is, someone who is not a related or subordinated person as defined in the Internal Revenue Code.

There is a limit on the amount that can be transferred into a GST. Currently, the limit is $2 million for each person setting up the trust. In other words, a married couple could place up to $4 million in a GST. In 2009, the per person amount is set to rise to $3.5 million. Any amount that is transferred in excess of the limit is subject to gift or estate tax when the older generation passes along the assets, and an additional "generation skipping tax" is imposed when the children die and the property is transferred to the grandchildren. The potential estate tax benefits of a GST are easy to see when it is considered that each dollar over the limit is taxed at the highest estate tax rate, which currently is 45%.

If there are downsides to a GST for some people, they may be found in the fact that someone outside the family (the trustee) will become intimately involved in the family's money matters, and that it will be necessary to file an income tax return for the trust each year. Still, under the right circumstances and with proper planning under the guidance of a professional, these and any other drawbacks for a GST could pale next to the bottom line advantages realized as assets are passed from generation to generation without Uncle Sam taking his cut. ■

AGE DISCRIMINATION IN EMPLOYMENT

When the federal government required one of its defense contractors to reduce its workforce, the contractor first evaluated its employees based on the criteria of "performance," "flexibility," and "critical skills." After adding points to scores for years of service, the employer arrived at a list of 31 employees to be laid off. On their face, the criteria were age neutral, but all but one of the employees chosen to receive a pink slip were at least 40 years old, within the age group protected by the federal Age Discrimination in Employment Act (ADEA).

The laid off employees sued their former employer under the ADEA, alleging the disparate impact form of age discrimination. Disparate impact refers to the use of policies or criteria by an employer in making employment decisions that are not overtly based on age, but which, when applied, allegedly have a disproportionate impact on older individuals. (The other type of employment discrimination, known as "disparate treatment," asserts that the employer intentionally treated applicants or employees differently because of their age.)

The plaintiffs first established, using statistical experts, that such a skewed result against older workers under the layoff criteria would rarely happen by chance, and that the same factors that were most closely linked statistically to the older employees—flexibility and critical skills—were also the factors most influenced by the discretion of the contractor's supervisors.

The contractor countered that it was not liable because the ADEA provides that an employer action is not unlawful if differentiation among employees is based on "reasonable factors other than age" (RFOA). A jury returned a multimillion dollar verdict for the plaintiffs. Ultimately, the case reached the United States Supreme Court, which upheld the judgment for the plaintiffs.

The critical issue determined by the Supreme Court was whether the RFOA element needed to be proven by the plaintiffs or by the defendant employer. In other words, did the plaintiffs have to prove that there were no reasonable factors other than age underlying the employer's decision, or did it fall to the employer to present an "affirmative defense" and prove the existence of the other reasonable factors? Examining the language of the ADEA and taking note of a previous ruling where a similar provision in the law was in the nature of an affirmative defense, the Court ruled that RFOA is an affirmative defense that the employer must prove and, in this case, had not.

The Court's opinion anticipated criticism, which, in fact, was forthcoming, that its decision could open the floodgates for similar claims and make it too easy for plaintiffs to prevail. It pointed out that, even before the RFOA affirmative defense comes into play, the plaintiff in an ADEA disparate impact case must isolate and identify specific performance practices by the employer that are responsible for statistical disparities disfavoring older workers. As the Court put it, "[t]his is not a trivial burden."

However, concerns about tilting the scales too far against employers should be directed at Congress, according to the Court, since it created the RFOA concept and made it a defense to be proven by employers. ■