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LAW REPORT

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Like-Kind Exchanges of Real Estate

Today, the 1031 exchange, also known as the "like-kind exchange" or the "tax deferred exchange" is a staple transaction of the commercial real estate industry. When you sell investment property and have a gain, you generally have to pay a tax on the gain at the time of the sale. Internal Revenue Code Section1031 provides an exception and allows you to postpone paying a tax on the gain if you reinvest the proceeds in similar property as part of a qualifying like-kind exchange. According to *The New York Times,* this tax deferral "began more than 90 years ago as a small tax break intended to help family farmers who wanted to swap horses and land. Farmers who sold property, livestock, or equipment were allowed to avoid paying capital gains taxes, as long as they used the proceeds to replace or upgrade their assets. Over the years, however, as the rules were loosened, the practice of exchanging one asset for another … spread to everyone from commercial real estate developers to art collectors to major corporations."


J.J. Sherman

On January 1, 2013, the U.S. House of Representatives and the U.S. Senate passed a bill increasing the capital gains tax for top-bracket taxpayers to 20 percent. Given the capital gains tax increase, industry experts expect to see a rise in like-kind exchanges of commercial real estate in 2013. Dino Champagne of Asset Preservation, Inc., a qualified intermediary, remarks, "The general consensus is that there will continue to be a lot of activity this year. The good news is that the Medicare Surtax of 3.8 percent on net investment income which is effective January 1, 2013, also can be deferred."

Best Practices for Negotiating the Purchase Agreement for Replacement Property in Your Like-Kind Exchange

1. Ask the other party to cooperate with you to achieve your intended tax benefit. Negotiate a clause in your letter of intent and your purchase agreement requiring each party to cooperate with each other in the event either elects to undertake a tax deferred exchange. Generally, the other party will agree to cooperate so long as it doesn't suffer any costs, expenses, or liabilities for assisting the exchanging party to accomplish the tax deferred exchange. Also, the tax deferred exchange can't delay closing or otherwise reduce the exchanging party's liabilities or obligations under the purchase agreement. The party electing to undertake the exchange may be asked to indemnify the cooperating party from any liability, damages, and costs incurred as a result of cooperating in accomplishing a tax-deferred exchange.
2. Negotiate the right to assign the purchase agreement to your qualified intermediary. Add an express clause in your purchase agreement that permits the party electing to undertake a tax deferred exchange to assign its rights under the purchase agreement to its qualified intermediary in the exchange, without the prior approval or consent of the other party. Generally, the other party will agree to this so long as the assignment does not relieve the original party of its obligations under the purchase agreement or require it to indemnify the electing party's qualified intermediary.
3. Pay attention to closing dates. In order to reap the benefits of Section 1031, the exchanging party must identify the replacement property in writing on or before midnight of the 45th day from the date the relinquished property is transferred. Replacement property must be unambiguously identified by street address, legal description, or distinguishable name. Furthermore, the exchanging party must acquire ownership of all replacement property it intends to purchase, within a maximum of 180 days after the close of the sale of the first relinquished property or the due date (with extensions) of the income tax return for the tax year in which the relinquished property was sold, whichever is earlier. This means that an exchanging party must be ready, willing, and able to close on replacement property in a timely manner, and must do sufficient due diligence to determine that the seller will be ready, willing, and able to close on the sale of the replacement property in a timely manner. If a third-party matter may delay closing, keep in mind that you may lose the opportunity to defer payment of capital gains tax. ◆

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IN THIS ISSUE:

Balancing Social Media with HIPAA

Health care institutions and medical practices increasingly use social media to engage patients, but they must balance patient engagement with privacy rules. The Health Insurance Portability and Accountability Act (HIPAA) and its sister act, the Health Information Technology for Economic and Clinical Health Act (HITECH), require businesses to meet a minimum level of compliance relative to handling the personal health information of patients. HIPAA protects all individually identifiable health information, such as names, addresses, birth dates, and Social Security numbers, held or transmitted by a covered entity, its workforce, or its business associates, in any form or media, whether electronic, paper, or oral. For more information on the HIPAA privacy rule and HIPAA security rule, see http://www.hhs.gov/ocr/privacy/hipaa/understanding/coveredentities/index.html.

Train Your Workforce. One of the best ways to prevent a HIPAA violation from social media misuse is to train your workforce and business associates. This means working with leadership, nurses, physicians, clinical staff, support staff, volunteers, fundraising, marketing, and public relations on an ongoing basis. Here are some examples that might occur in the workplace and can be used for training purposes:

Example 1: Nurses at a hospital use Facebook to provide shift change updates to their coworkers. For them, this is a convenient tool. They don't have to hold an in-person conversation at a shift change. Instead, the nurses "friend" each other through Facebook and quickly read what each other wrote on their pages. They don't use patient names, just sufficient information so that the incoming nurses can be ready for their shift.

This is a HIPAA violation. It does not matter that the patients' names were omitted. There is a reasonable basis to believe the information posted on the nurses' Facebook pages can be used to identify the individual patients, since the nurses posted sufficient information so that the incoming nurses could be prepared for their shift. Facebook is not a "secure site" for HIPAA purposes. If the nurses want to communicate online, then they should use the hospital's secure network.

Example 2: An intern writes on Facebook about an unusual patient case he witnesses at the hospital while working a day shift. No patient names are used. He simply wants to share the experience after returning home from work.

This is a HIPAA violation. It does not matter that the patient's name was omitted. If the case was that unusual, there is a reasonable basis to believe the information posted can be used to identify the individual. A clear breach of HIPAA privacy rules has taken place. While HIPAA does allow use and disclosure of de-identified health information, simply omitting someone's name does not make that health information de-identified.

Example 3: Medical staff in a hospital ward throw a retirement party for a senior doctor, and a nurse takes out her smartphone and snaps a group picture at the party. The nurse posts the picture on Facebook to share with Facebook friends. Another nurse tweets the picture using the nurse's Twitter account. In the background of the photo, unintentionally, there's a whiteboard with names of patients, their room numbers, and their medical conditions.

This is a violation of the hospital's obligation under HIPAA to maintain the confidentiality and the integrity of protected health information. Many violations of patient confidentiality — especially in social media — occur unintentionally, but they are still HIPAA violations. To counter this potential risk, many hospitals and medical offices now post signage prohibiting the use of cameras on smartphones.

Example 4: A marketing firm hired by a busy OB/GYN practice in town decides it would be great to post pictures of babies delivered by the practice on the OB/GYN's Facebook page as a means of attracting "mothers-to-be" to the practice. Each post to the Facebook page includes a tasteful photo of a newborn, together with the baby's name, date of birth, and birth weight, wishing the baby a happy birthday!

Here, the baby's photo, name, date of birth, and birth weight are individually identifiable information. Unless the baby's parent or guardian has signed a consent permitting its posting online, this is likely a violation of the medical practice's obligation under HIPAA to maintain the confidentiality and integrity of protected health information. In this instance, because it has access to protected health information, the marketing firm hired by the medical practice might be considered a business associate and the OB/GYN could be responsible for its actions under HIPAA.

Educate your workforce and business associates early and often to prevent a HIPAA violation from social media misuse. ◆

Supplier Diversity Announcement

As a 100 percent woman-owned business certified by the Women's Business Enterprise National Council (WBENC), we are proud to serve as a diversity supplier and help our clients achieve their commitment to diversity. We recognize that businesses gather strength from difference.

Law Offices of J.J. Sherman, P.C. is on the Minority and Women-Owned Law Firm Outside Counsel List of the FDIC.

Spotlight on the Retail Lease

Relocation Clauses

Have you planned for a potential relocation of your store? If you're a retail tenant negotiating a lease at a shopping center, expect the landlord to reserve the right to relocate your store to a comparable space in the shopping center and be sure to insist on basic protections. After all, a tenant signs a lease relying on a specific location (and the expected pedestrian traffic at that location). Ask for pre-approval of the relocation space, and require the landlord to pay all relocation costs as well as the costs of remodeling the relocation space so that it is substantially the same as the existing space. Tenants also ask for up to 90 days' notice of relocation, and if the parties cannot agree on a relocation space, tenants reserve the right to terminate their lease. Additionally, if your build-out is significant, ask the landlord to pay the unamortized cost of your construction if the landlord exercises its relocation right and you end up terminating the lease instead of relocating your store. ◆

Instagram Pushes the Privacy Envelope

Social media sites generally reserve the right to alter their Terms of Use at any time. If the alterations constitute a material change to the Terms of Use, companies generally agree to notify their users via email according to the preference expressed on the users' accounts. What constitutes a "material change" is determined by the company's discretion, acting in good faith and using common sense and reasonable judgment.

Often, the updated terms proposed by social media companies "push the envelope," especially when it comes to the privacy of their users. Take Instagram, for instance. In December 2012, Instagram, the photo-sharing service which Facebook bought in 2012 for $1 billion, announced new Terms of Use that would have allowed its marketing partners to use members' photos — including those of children — in advertising campaigns without their knowledge or any compensation. The proposed clause in the new user agreement reads: "Some or all of the Service may be supported by advertising revenue. To help us deliver interesting paid or sponsored content or promotions, you agree that a business or other entity may pay us to display your username, likeness, photo (along with any associated metadata) and/or actions you take, in connection with paid or sponsored content or promotions, without any compensation to you."

This proposed clause challenged state privacy laws as well as state right of publicity laws. The right of publicity allows an individual to control the use of his/her name and likeness in a commercial setting. It seeks to ensure that a person is compensated for the commercial value of his/her name or likeness. Invasion of privacy claims seek to remedy damages suffered by an individual as a result of unwanted publicity.

Instagram users — ranging from professional photographers who use the app to showcase their works to celebrity users such as supermodel Bar Refaeli, funnyman Jonah Hill, and Kim Kardashian, the most followed person on Instagram — instantly criticized the updated Terms of Use and threatened to quit the service, resulting in a reversal of Instagram's decision. The head of Instagram wrote in late December 2012, "Because of the feedback we have heard from you, we are reverting this advertising section to the original version that has been in effect since we launched the service in October 2010."

Instagram's new Privacy Policy and Terms of Use (absent the advertising section) went into effect in January 2013 and apply to photographs uploaded by users after January 19, 2013 and January 16, 2013, respectively. They permit the sharing of user information back and forth between affiliates (including Facebook) as well as the sharing of user information with third-party advertising partners and third-party organizations that help Instagram provide the Instagram service to users. *The New York Times* reports, "Instagram contends that this change will help Instagram 'function more easily as part of Facebook by being able to share info between the two groups.' The potentially lucrative move will let advertisers in Facebook's ad network use data and information that users have shared on Instagram, like details about favorite places, bands, restaurants, or hobbies, to be better target ads at those users."

The Instagram debacle serves as an important reminder to users of social media sites to read Terms of Use and Privacy Policies and to check their privacy settings on a regular basis. ◆

FIRM NEWS

WEBINAR ON SOCIAL MEDIA!
On December 6, 2012, J.J. Sherman presented an interactive Webinar on Social Media for Health Care Institutions and Medical Practices hosted by Medical Office Today. The recording of the Webinar is available at www.medicalofficetoday.com.

FIRM EXPANSION!
We are working actively with clients doing business in California and are expanding our practice into the Washington, D.C. market in order to cater to clients doing business on the East Coast.

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Copyright Update

In January 2013, the Ninth Circuit Court of Appeals decided that a lower court incorrectly denied DC Comics' contention that it made a deal in 2001 with the estate of Superman creator, Jerome Siegel. As a result of this ruling, the Siegel estate likely will not be able to recapture its copyrights in the flying superhero. This decision follows a related ruling in October 2012 denying the estate of Superman's other creator, Joseph Shuster, the ability to recapture its portion of the Superman copyrights.

The termination right under 17 U.S.C. § 304(d), which the Siegel estate tried to exploit, applies only to a grant of a copyright made prior to January 1, 1978. Since the Ninth Circuit determined that the estate of Jerome Siegel did, in fact, make an enforceable contract with DC Comics in 2001, the lower court on remand likely will consider the 2001 agreement the parties' operative agreement, superseding all prior grants of the Superman copyright, and as a post-1978 grant, it would not be subject to termination under 17 U.S.C. § 304(d). In October 2012, a federal judge denied Joseph Shuster's heirs the opportunity to recapture their copyright in Superman, because a 1992 agreement with Shuster's heirs was deemed to have superseded all prior copyright grants.

The estates of Superman co-creators Siegel and Shuster have spent years trying to exercise the termination provisions of the 1976 Copyright Act with the goal of recapturing the very lucrative copyrights in Superman. *The Hollywood Reporter* reports, "Superman was first created in comic form in the 1930s when the artists were struggling financially. Famously, they handed over rights for little compensation and have been in and out of courts and negotiating tables for more than 70 years."

This decision and the companion Shuster decision mark a major victory for Warner Brothers, the owner of DC Comics, and they arrive just in time. Warner Brothers plans to release the big-budget *Man of Steel* starring Henry Cavill, Russell Crowe, and Amy Adams this summer of 2013. ◆