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KMK Newsletter

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GOOD TRANSITION - SUCCESSFUL COMMUNITY

By Benny L. Kass, Esq.

Question: I am serving on the Board of Directors of my community association and this is a critical time for us. We are a new community facing a transition from developer control. What steps – legal and practical – should we take so that this process will be successful?

Answer: In the past few years, there has been an explosion of new community associations – especially condominiums. These associations are as small as 4 units, and often larger than 200 units. But the process of transition is important regardless of your size.

Many new community association owners are first time buyers. They have never owned any real estate and have no business experience whatsoever. These associations are big businesses, with budgets in the millions of dollars. Unless owners get involved, learn the process, and hire competent professionals, your association may be headed for disaster – both financially as well as emotionally.

Service on a community association Board of Directors is a thankless job. The hours are long and there is no pay. But if you want to make sure that your investment (your home) will not be

(Continued on page 6)

WHEN THE MARKET SLUMPS, SUDDENLY GOD IS TO BLAME: THE IMPLICATIONS OF FORCE MAJEURE CLAUSES IN PRE-CONSTRUCTION CONTRACTS

By: Sarah K. Gentry, Esq.

An old proverb provides – “Men plan, God laughs.” In the world of real property law the meaning of this phrase is somewhat diluted by lawyers attempting to plan for unplanned or unforeseeable events. In what are often called “force majeure” or “Act of God” clauses, lawyers contemplate excusing performance based on conditions which are outside of the duty-bound parties’ control. But, what is meant by these force majeure clauses and to what extent can something be deemed an “Act of God”?

Analyzing force majeure clauses in the context of pre-construction contracts helps shed light on the meaning and interpretation of such.

(Continued on page 4)

In this issue...

Good Transition – Successful Community . . . 1
Implications of Force Majeure Clauses. 1
Charitable Gifts That Give Back 2
5% Vacancy Conversion Exemption. 3

CHARITABLE GIFTS THAT GIVE BACK

By: Laurie P.O'Reilly, Esq.

Most of us have the desire to contribute to favorite charities and good causes. The common way of doing this is to make cash donations in amounts we are able to afford. Whether or not the gift is made with tax benefits in mind, there are favorable tax consequences to making such gifts: the donor receives a charitable deduction, generally in the full amount of the donation. Larger donations may be limited to a certain percentage of adjusted gross income, usually fifty percent, but any portion not deductible in the year of the gift can be carried forward and deducted in the succeeding five years. Gifts to authorized charities are also free of federal gift tax, which is beneficial to those persons whose lifetime gifts to non-charities are in excess of the $1,000,000, which is the current amount exempt from gift tax. (This does not include gifts up to the amount of the annual exclusion, currently $12,000, which are already free from gift tax.)

Another way to realize charitable giving wishes while enjoying tax benefits-- especially when making a substantial gift--is to set up a charitable remainder trust ("CRT"). These trusts are established by an individual ("Donor") who transfers property into trust for the eventual benefit of a named charity or charities. A trustee manages the trust assets and pays the Donor or other persons the Donor chooses income from the trust. When the trust terminates the assets remaining in the trust are paid to the charitable beneficiary or beneficiaries. (More than one charity can be named as beneficiary of the same trust.)

The trust can be set up for a term of years or for the lifetime of the Donor. The payments to the Donor or other income beneficiaries are made based on the value of the trust property. Payments to the Donor are subject to income tax, but the Donor receives a charitable deduction based on the projected value of the interest the charity will receive at the end of the trust term. The value is determined by using a formula that takes into account the ages of the donor and income beneficiaries, the expected payout of the trust and the applicable federal interest rate. The older the income beneficiaries, the greater the income tax deduction. Tax benefits are greatest if appreciated assets, such as low basis real property or stocks, are contributed to the trust, since the charitable trust will not pay income tax on the sale of the assets as the Donor would have had to do if he or she had sold the property. However, cash or cash equivalents may also be contributed.

There are very specific rules that must be followed to set up a CRT and the Internal Revenue Service has provided detailed guidelines that set forth the requirements. Although there are several different types of CRT's, two common ones are the Charitable Remainder Unitrust ("CRUT") and the Charitable Remainder Annuity Trust ("CRAT") with the biggest difference between the two being that the Donor receives variable income from the CRUT and fixed income from the CRAT. A CRUT is appropriate where the trust assets are expected to increase in value and the Donor desires more income over time. A CRAT is better where the Donor wants a fixed income stream regardless of the appreciation or depreciation of the trust assets.

An example of how a CRAT works is as follow:

Jane is age 70 and has recently retired. She has considerable savings which include some stocks she has held for many years that she bought for $20,000 but are now worth $100,000. Her retirement income is sufficient to allow her to maintain a comfortable lifestyle, but she would like to have some additional income to finance her travel plans. She has been considering for some time making a substantial gift to her beloved high school alma mater and would like to use her stocks to make the gift. Rather than sell the stocks and pay capital gains tax on the proceeds or give the stocks outright to her alma mater, she decides to set up a Charitable Remainder Annuity Trust. By doing so she can make a gift to her favorite charity while enjoying some supplemental income. In addition, she will

(Continued on page 7)

5% VACANCY EXEMPTION: DEAD OR ALIVE?

By: Gilles A. E. Stucker, Jr., Esq.

Historically, housing accommodations that are vacant when converted into condominiums or cooperatives are not subject to a 5% conversion fee assessed by the District.

The Washington Post recently published consecutive front page articles related to the plight of tenants in relation to the conversion of apartments into condominiums and cooperatives. As reported, landlords have forced tenants out of their homes in order to avoid the 5% conversion fee by obtaining a vacancy exemption. Unfortunately, unscrupulous landlords see the vacancy exemption as an incentive to push tenants out, while the original intent was to provide an incentive for land owners and developers to improve abandoned and distressed properties in the District.

The D.C. Council has considered the vacancy exemption over the past year, starting with the Fiscal Year 2007 Budget Support Act of 2006 ("Support Act"), which became law on March 2, 2007. Title II, Subtitle M of the Support Act amended D.C. Code §§ 42-3402.04 and 42-3402.10, details the 5% conversion fee that is normally owed to the District when an owner converts a housing accommodation into a condominium or cooperative. Changes to the conversion process under the Support Act include:

1. Vacant buildings are subject to the 5% conversion fee even if the owner has a vacancy exemption.

2. The 5% conversion fee is reduced when the owner sells a unit, provides a lease, or provides an option to lease for at least five years, to current or qualifying tenant-purchasers.

3. A lien is recorded on the housing accommodation in the amount of the declared conversion fee when the housing accommodation is registered as a condominium or cooperative.

4. The full amount of the conversion fee is due within two years regardless of whether all the units are sold.

5. Requests for vacancy exemptions will be investigated, and the Mayor will photographically document at least 25% of the total number of randomly selected units in the housing accommodation.

6. The vacancy exemption will expire 90 days after certification. Under old law, the vacancy exemption expired 180 days after certification.

On July 17, 2007, the Vacancy Conversion Fee Exemption Reinstatement Temporary Amendment Act of 2007 ("Temporary Act") became effective and temporarily repealed Title II, Subtitle M of Support Act. The Conversion Fee Clarification Emergency Amendment Act of 2008 ("Emergency Act") continued the repeal of Title II, Subtitle M of the Support Act. The Emergency Act is set to naturally expire on May 22, 2008. Therefore, Title II, Subtitle M of the Support Act is not in effect as of the writing of this article.

The Washington Post also reported that Council members Cheh and Graham are looking to amend the 5% vacancy exemption, and may act on such matters as early as April 1, 2008.

Certainly, there are many issues that need to be considered and addressed, including grandfathering issues. For example, many developers work on a timeline of one or more years from purchase to sell out. Many have already filed applications for vacancy exemptions or hold vacancy exemptions and are in the middle of construction and/or selling units. Further, if any new law requires a "5% lien", how will this lien attach to on-going projects?

It will be interesting to see how the Council handles these issues in the coming weeks considering the competing interests. The vacancy exemption has been in place for years to provide an incentive for developers to clean up and develop vacant buildings. However, as the result of a few unscrupulous landlords, the Council is moving to substantially limit the vacancy exemption.

SEE UPDATE INSERT

UPDATE: 5% VACANCY EXEMPTION: DEAD OR ALIVE?

After the March KMK Newsletter went to print, the following were introduced by the DC Council: (1) the Vacancy Exemption Repeal Emergency Declaration Resolution of 2008 ("2008 Resolution"), (2) the Vacancy Exemption Repeal Emergency Amendment Act of 2008 ("2008 Emergency Act"), and the Vacancy Exemption Repeal Temporary Amendment Act of 2008 ("2008 Temporary Act"). A copy of the 2008 Resolution is attached hereto.

The 2008 Emergency Act and 2008 Temporary Act state that the Mayor shall not require a conversion fee for a condominium unit, or the proportionate share value of a cooperative residence, that:

(1) Is sold to a low-income household;
(2) Is sold to the head of household; provided, that the head of household has resided in the unit, for at least one year;
(3) Is sold to an elderly or disabled tenant; provided that the elderly or disabled tenant has resided in the unit, for at least one year and is either 62 years of age or older or has a disability; or
(4) Is not sold, but leased, to those persons set forth in subparagraphs (1), (2), or (3) of this paragraph, provided that such person shall be a low-income household. A lease under this section shall not require monthly payments greater than 30% of gross household income.

Further, the 2008 Emergency Act and 2008 Temporary Act state that:

(1) the conversion fee shall be paid in full into an escrow account at the time of settlement on the sale of the unit or cooperative share, or lease of the unit or cooperative share.
(2) The conversion fee shall be submitted to the Mayor within 30 business days of settlement.
(3) The Mayor may impose civil fines, penalties, and fees for failure to submit the conversion fee to the Mayor, or any infraction of the provisions of this subsection, or any rules or regulations issued under the authority of this subsection.
(4) The Conversion Fee Clarification Emergency Amendment Act of 2008, enacted February 22, 2008, and the Conversion Fee Clarification Temporary Amendment Act of 2008, enacted March 19, 2008, are repealed.
(5) Applications filed on or before March 31, 2008 shall be considered under the law in effect on that date. Applications filed on or after April 1, 2008 shall be considered under the provisions of this 2008 Emergency Act and 2008 Temporary Act.

The 2008 Emergency Act and 2008 Temporary Act radically change when the 5% conversion fee is due. The across-the-board exemption from the 5% conversion fee is no longer available if an application for a vacancy exemption was not filed by March 31, 2008. However, the exemption from the 5% conversion fee is now available on a per unit basis. These changes in the law may place requirements on settlement companies to collect and forward the conversion fee, as well as allow the District to impose fines, penalties and fees for nonpayment thereof.

Any incentive to kick out tenants has been abolished under the 2008 Emergency Act and 2008 Temporary Act, and now there may be an incentive to maintain tenants through the conversion process. These tenants will be protected by both the landlord and tenant laws and the Tenant Opportunity to Purchase Act if the landlord attempts to illegally kick them out.

Councilmember Mary Cheh

Councilmember Jim Graham

Councilmember Marion Barry

Councilmember Kwame Brown

A PROPOSED RESOLUTION

IN THE COUNCIL OF THE DISTRICT OF COLUMBIA

To declare the existence of an emergency with respect to the need to eliminate the vacancy exception to payment of a condo conversion fee; to not require payment of the condo conversion fee when a unit is sold to a low-income household, or existing tenants, including the elderly or disabled; or leased to the same who are low-income; and to impose penalties for non-payment or submission of the condo conversion fee within 30 days of settlement.

BE IT RESOLVED, BY THE COUNCIL OF THE DISTRICT OF COLUMBIA, That this resolution may be cited as the "Vacancy Exemption Repeal Emergency Declaration Resolution of 2008".

Sec. 2. (a) The "Rental Housing Conversion and Sale Act of 1980" established a "Conversion fee" with the intention of creating a special fund dedicated to helping those low-income tenant who were displaced by the conversion of buildings. The uses of the fund were later expanded to include the District of Columbia Home Purchase Assistance Program, and other programs. Currently, the conversion fee is 5% of the sales price for each condominium unit, or proportionate value of the cooperative residence, within the housing accommodation.

(b) The fee exemption for vacant buildings first appeared in the "Rental Housing Conversion and Sale Act of 1980 Reenactment and Amendment Act of 1995". Discussion on the amendment at the time focused on the intent to relieve owners of vacant buildings of the cumbersome task of "sending in" a single tenant to a vacant building to hold a conversion vote. Seemingly "inadvertently", the amendment also exempted vacant buildings from the conversion fee.

(c) This law created a perverse incentive to empty buildings through any means possible, including eviction through neglect, coercion, threat and illegal actions. As a recent Washington Post investigation confirmed, "landlords emptied more than 200 buildings in the past four years, with many quickly converted to condominiums."

(d) Subtitle M of Title II of the Fiscal Year 2007 Budget Support Act of 2006, the Vacancy Conversion Fee Clarification Amendment Act of 2006, clarified the circumstances for collection of a condominium and cooperative conversion fee, including circumstances under which the fee may be reduced; eliminated the vacancy exemption to payment of condominium and cooperative conversion fees; and limited the duration of vacancy exemptions properly granted for tenant elections.

(e) The Council enacted this legislation to remove the incentive to certain unscrupulous developers to empty buildings of their occupants, through coercion or other means, to avail themselves of the 5% conversion fee payment exemption for vacant properties.

(f) Since enactment of the Fiscal Year 2007 Budget Support Emergency Act of 2006, several developers across the District, including developers that produce affordable housing, reported various unintended consequences and unresolved issues surrounding the repeal of the conversion fee payment exemption for vacant buildings.

(g) The Council passed two cycles of emergency and temporary legislation to postpone the effective date of the Budget Support Act revisions to this law until those ambiguities could be clarified. This emergency legislation repeals the most recent cycle of emergency legislation and clarifies those ambiguities with regard to payment of fees while eliminating the vacancy exemption for conversion fees.

Sec. 3. The Council of the District of Columbia determines that the circumstances enumerated in section 2 constitute emergency circumstances making it necessary that the Vacancy Exemption Repeal Emergency Amendment Act of 2008 be adopted after a single reading.

Sec. 4. This resolution shall take effect immediately.

(*Continued from page 1)*

WHEN THE MARKET SLUMPS, SUDDENLY GOD IS TO BLAME

For example, a purchaser signs a pre-construction contract in the District of Columbia for a new condominium unit. Per most contracts, the seller is required to deliver (i.e. complete settlement) the contracted for property within twenty-four (24) months. In the event of non-delivery within the twenty-four (24) month period, and so long as the purchaser has not signed an addendum extending the permitted delivery time, the purchaser has the choice of terminating the contract and receiving their earnest money deposit plus interest. These terms are usually found in a "delay" provision in the contract. However, the period for delay is usually extended, and excused, by the force majeure clause of the contract. In sum, the delay and force majeure clause read together excuses the seller from performing within the twenty-four (24) month period, and in turn stays the purchasers right to contract rescission, for any period of delay outside of the sellers control.

Not surprisingly, when the market is strong, sellers are generally happy to relinquish deposits and rescind contracts in the event of delayed performance – the seller is likely to realize a greater profit than the two (2) year prior contracted for amount. However, when the market is in a slump, as we are currently experiencing, sellers often cite to force majeure clauses in order to retain the likely above market sales price. In today's market, the meaning of these force majeure clauses is particularly relevant.

Simply stated, "a force majeure provision in a contract may specifically provide for impossibility of performance due to an act of God." 1 Am.Jur.2d Act of God § 13. But, what is an act of God excusable delay: a thunderstorm, or, a tornado; rainfall or a flood? Courts are reluctant to provide a hard and fast definition for "force majeure" or "act of God." It is important to note that although often used synonymously, "force majeure" and "act of God" are sometimes treated as slightly different. "Act of God" generally connotes an entirely natural event, whereas "force majeure" allows for human interaction in the chain of causation. *Id*.

In D.C. the courts have found the "force majeure" label alone unhelpful for purposes of analysis and hold that the Court "still must 'look to the language that the parties specifically bargained for in the contract to determine the parties' intent concerning whether the event complained of excuses performance.'" *Nat'l Ass'n of Postmasters of the U.S. v. Hyatt Regency Washington*, 894 A.2d 471, 475 (D.C. App., 2006) (citing *Perlman v. Pioneer Ltd. P'ship*, 918 F.2d 1244, 1248 n.5 (5th Cir., 1990)). Therefore, the laundry-list of events typically provided for in a force majeure clause is of utmost importance.

The typical force majeure clause may provide the following – "reasons beyond the control of the seller shall include, without limitation, impossibility of performance, acts of God, fire, earthquake, flood, explosion, condemnation or acts of governmental agencies asserting jurisdiction, and any other legally supportable justification." Here, in order for a delay to be excusable it must be one as expressly contemplated above – i.e. it must be within the bargained for intent of the parties.

This may seem like a simple and unambiguous way to resolve what is meant by force majeure or act of God delays, but once a seller provides the basis for delays it is often unclear whether such delays were in fact bargained for. For example, in consideration of the above clause, should the seller be excused from performance based on delays in having the utility company remove a telephone pole? Or, does a period of greater rainfall than usual constitute a flood for purposes of an excusable delay? Of course the seller would answer yes to both of these questions, but is that truly the bargained for intent?

Although the Courts are reluctant to provide a black letter definition it seems that a common theme is found when finding a delay valid – the unexpected.

(*Continued on page 5)*

(*Continued from page 4)*

WHEN THE MARKET SLUMPS, SUDDENLY GOD IS TO BLAME

Of course, what is in fact unexpected depends on what the parties bargained for and the location of development. While a hurricane may be unexpected on a mountaintop development, such an occurrence may not constitute an unexpected and excusable delay in a beach front community.

Another important aspect of force majeure clauses is the "catch-all" phrase – e.g. "any other legally supportable justification." The catch-all phrase is an attempt to include anything a lawyer could not contemplate – i.e. the sellers' lawyers attempt to decrease the chances of God laughing at their stake. However, the District has specifically found that "'[w]here general words follow specific words in a[n] . . . enumeration, the general words are constructed to embrace only objects similar in nature to those objects enumerated by the preceding specific words.'" *Id*. at 476 (citing *Edwards v. United States*, 583 A.2d 661, 664 (D.C. 1990). Therefore, the catch-all phrase is limited by the bargained for intent as indicated by the enumerated list. Despite the attempt to neatly wrap everything up with a catch-all phrase, a list of excusable delays, although an attempt to expand excuses, may in fact limit the sellers' excusable delays. A seller cannot only provide for natural weather occurrences in the force majeure clause, and then claim excusable delay based on government permitting.

What should a buyer do with the knowledge of the meaning of a force majeure delay? After all, the buyer is often a single consumer entering into a contract of adhesion with a major developer, which means there is little opportunity to negotiate terms. Although the buyer may not be able to negotiate the terms of the force majeure clause, it is important for the buyer to be aware that in the event of seller delay, simply affixing the force majeure label as justification for the delay will not suffice. Buyers should carefully read the bargained for delays, and compare such with the seller's provided justifications to determine whether such delays were in fact bargained for, and in the event that the seller does not provide justification for delay, the buyer can demand the return of the buyers good faith deposit. As much as lawyers attempt to play God and foresee the unforeseeable, the force majeure label alone will not excuse seller delay.

(Continued from page 1)

GOOD TRANSITION – SUCCESSFUL COMMUNITY

wasted, you may want to seriously consider putting your "hat" in the election ballot and consider running for a board of director position.

Although many owners do not understand this, when the very first home in a complex is sold, the association is already in existence. The developer usually selects the first board of directors, which controls the association until turnover of control is accomplished. In general, the laws in the surrounding jurisdictions require that control be turned over to the owners within so many years after the first sale, or when a certain percent of the homes have been sold, whichever comes first. The turnover requirement should also be spelled out in your association's governing documents.

Transition between developer control and owner control of an association is perhaps the most important aspect of any community association. If done properly, your association will be off to a good start; if done poorly, it may take a long time to get back on track. And, unfortunately, some associations never succeed.

Many developers do not understand the importance of working with owners so that they can property and effectively manage their own association. It is not acceptable for a developer merely to announce one day that a meeting will be held, at which time the owners will elect a new board of directors. Owners are new to the complex and do not know one another. They are reluctant to vote someone into office without knowing who that person is or what that person stands for.

(*Continued on page 6)*

(Continued from page 5)

GOOD TRANSITION – SUCCESSFUL COMMUNITY

You can take the lead and arrange for a meeting of the owners. Have it in the social hall, a nearby church or school, or even in someone's home. Once you learn who is interested in taking an active role in the association, contact the developer and ask for a preliminary meeting for the purpose of asking your questions and raising any of your concerns. You and your group should try to pin the developer down as to when control will be turned over. You should also discuss the level of cooperation which the developer will give you during transition. Find out whether the developer intends to be helpful, or will just "wash his hands" and walk away. Some developers will even front some seed money so that the "rump" association will be able to hire an attorney and other professionals to assist them at the earliest possible time.

At some point in time, the developer will schedule a meeting of owners. The purpose of the meeting will be to elect a new board of directors. Your Bylaws most likely require that a formal notice must be sent to all owners advising them of the meeting and the pending election. This will give owners the opportunity to campaign for seats on the board. In my opinion, a community association is a mini-democracy. We have political campaigns for government officials; we should also have campaigns for directors of community associations.

Once the owners are in control, there are four mandatory steps that must be taken by the new Board:

1. **Select a management company**: The new board must decide whether to retain the existing management company -- which had been selected by, and may be too loyal to, the developer -- or select a totally independent management company. The association may decide to forego hiring such a company and become "self-managed", but I personally do not recommend this. An association containing a large number of homes needs formal and professional management.

2. **Audit the books**: An independent auditor or a certified public accountant must examine the association's books. It is important for members of the new board to satisfy themselves (and the owners they represent) that during the time the developer was in control of the association, all moneys collected and all expenses paid have been properly accounted for. Keep in mind that while the developer is in control of the association, the developer also has access to the association funds. Often, this access is unlimited. You want to make sure that funds which should have been paid by the developer are not inadvertently (or purposely) paid out of association proceeds.

Developers handle the question of payment of fees for the homes they still own in different ways, but the developer must be held accountable for all its legitimate obligations. Additionally, in many instances the developer, while serving as a board member, may have allowed many owners to become seriously delinquent in paying their association fees. The new board must establish a comprehensive collection policy that will be applied uniformly. I am a strong believer in a "zero tolerance" policy when it comes to delinquencies.

3. **Retain Legal Counsel**: The association should retain a lawyer knowledgeable about community association laws. The lawyer will have to handle a wide variety of issues, ranging from developer problems -- such as warranty and other transition issues -- to assisting the association in its day-to-day activities. A community association is not only a mini-democracy, it is also a business, and must function in that capacity as well. Your association has many owners; your annual budget repairs. This is known as a "reserve analysis study". The professional engineer determines the useful life of the major components in the complex (eg. the roof, elevator, and other common areas), and the projected cost to replace at the end of its life.

(Continued on page 7)

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GOOD TRANSITION – SUCCESSFUL COMMUNITY

On an annual basis, sufficient funds should be placed in reserve, so that when the component wears out, there will be enough money in reserve to pay for its replacement. Otherwise, each owner may be faced with a large special assessment. In the words of a TV commercial: "pay now or pay later".

Turnover of developer control is the most important aspect in determining the future success of a community association. It is not often understood by developers. Indeed, some developers do not want to encourage active participation by the new board for fear that this new board will be too conscientious in auditing the developer's activities.

Good dialogue among unit owners, the developer and board goes a long way toward creating a successful association. It's hard work to be on a Board of Directors, but your home is your investment and you certainly want to protect it as best you can.

(Continued from page 2)

CHARITABLE GIFTS THAT GIVE BACK

receive a charitable deduction to offset her income. After consulting with her accountant who was able to estimate the income tax benefits to her, she decides to contribute all of her stocks to the trust and selects a 7% fixed payout for her lifetime. As a result, she will receive $7,000 per year for the rest of her life from the trust income or principal, if income for any year is insufficient. (The payout must be between 5% and 50%, but can not be so large as to result in a remainder interest that is less than 10% of the value of the contributed property.) In addition she receives a charitable deduction in the amount of approximately $44,000 that she can use during the current tax year and the next five years until it is used up.

There are many variations on how charitable gift giving can be accomplished and can be tailored to the gift giver's individual wishes and needs. Charitable remainder trusts are one way to give a gift and receive a benefit in return.

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