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NEWSLETTER
SPRING 2008

So you want to buy a ranch?

"The best way to make a small fortune ranching is to start with a large fortune." – Devens Gust

Editor's Note:

In his nearly 40 years of law practice, Devens Gust established himself as one of Arizona's most respected lawyers. In 1988, Devens retired from active practice and became a full-time cattle rancher in Mule Creek, NM. Before he left Gust Rosenfeld he and his wife, Betty, operated the 4 Drag Ranch on Eagle Creek in Arizona, and he wrote this article for the firm's July 1985 newsletter. Both Mr. and Mrs. Gust are now deceased. We hope you enjoy the article.

The desire to own a piece of land—any land, but preferably land in Arizona—is almost universal. The desire to own an Arizona ranch is even stronger in many of us.

Every now and then some starry-eyed client walks into my office with color photographs of an old ranch house under a cottonwood tree, a map, a brochure and a purchase contract and asks me to tell him if everything is OK for him to buy the ranch.

SEE **RANCH** ON PAGE 6

Building Green – What's A LEED?

Because buildings require prodigious amounts of energy—some estimate up to 76 percent of the energy expended in the United States each year—there is now significant effort to implement more environmentally friendly and sustainable building design and construction. These practices are often described as "building green."

One standard for measuring the *greenness* of buildings is LEED certification. LEED—Leadership in Energy and Environmental Design—is a voluntary building certification program started in 2000 by the U.S. Green Building Council, a non-profit organization.

SEE **BUILDING GREEN** ON PAGE 2

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NEW FACES

Christopher Ingle


CHRISTOPHER INGLE

Chris practices in the areas of litigation, contracts, commercial transactions, intellectual property, employment law and public law. Chris graduated *magna cum laude* in 2001 from Arizona State University and earned his J.D. in 2007 from the University of Arizona, James E. Rogers College of Law.

Mingyi Kang


MINGYI KANG

Mingyi practices in commercial real estate transactions. He represents institutional clients, corporations, partnerships, municipalities and individuals. He received his B.S., *cum laude*, from the LaSierra University School of Business in accounting, finance and risk management in 2000 and graduated *cum laude* from Arizona State University's Sandra Day O'Connor College of Law in 2007. He is a licensed Certified Public Accountant in the State of California and has four years experience in public accounting firms.

Sarah C. Smith


SARAH C. SMITH

Sarah practices in public finance, including bonds, leasing and other types of financing for state agencies, counties, cities, towns, community colleges, school districts, several types of improvement districts, community facilities districts and governmental agencies. She also practices municipal law, including drafting multi-agency agreements, ordinances, resolutions, policies, deeds, leases and contracts for governmental agencies. Sarah graduated *cum laude* in 2003 from Harvard University, Extension School, and earned her J.D., *cum laude,* in 2007 from Suffolk University Law School.

ET·Y·MOL·O·GY COR·NER

Ride 'm Buckaroo

You may know that the word "cowboy" comes from the Spanish "vaquero," meaning someone who tends cattle from horseback. Some, though, also believe that "vaquero" and its Anglicized version "buckaroo" may have been derived from the Arabic "bakara" or "bakhara" meaning "heifer" or "young cow," perhaps dating to the Muslim invasion of Spain in the 8th century.

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BUILDING GREEN

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LEED certification is available for various types of commercial buildings, including both new construction and existing buildings. The LEED matrix rating system evaluates buildings based on certain categories such as sustainability, water efficiency, energy and atmosphere systems (e.g., lighting and HVAC systems), materials and resources, and indoor environmental quality.

There is a hierarchy of LEED certification starting with the basic *Certified*, then moving up the scale to *Silver*, *Gold,* and at the top for environmental responsibility, *Platinum*. Achieving LEED certification is tangible recognition of a reduction in the carbon footprint of a development and imparts obvious value and status to a project.

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Foreclosure "Income"?

According to a recent newspaper article, Arizona bankruptcy filings in the month of January 2008 increased 63 percent over the number of bankruptcy filings in January 2007. Arizona home foreclosures in 2007 grew 150 percent over foreclosures reported for the previous year.

Under these financial conditions, it's no surprise that creditors are being forced to write off bad debts. An article in the Spring 2006 edition of our newsletter discussed the federal tax consequences of such write offs.

As a follow-up, this article will address some of the exceptions to the general IRS reporting requirements.

To recap, if a creditor cancels a debt of $600 or more in any of seven "identifiable events," a creditor must file a Form 1099-C with the IRS and furnish a copy of the Form 1099-C to the debtor. These "identifiable events" involve situations in which the creditor is either unable to enforce the debt or has voluntarily relinquished the right to enforce the debt. The debtor is generally required to recognize as income the full amount discharged.

However, the following general exceptions to these rules apply:

Bankruptcy – A creditor is not required to report a debt cancelled in bankruptcy unless the creditor knows that the debt was incurred by the debtor for business or investment purposes.

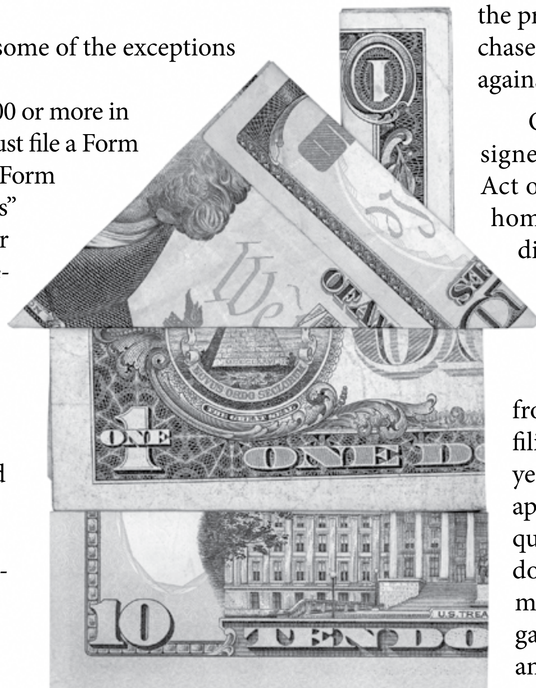
Interest – A creditor is not required to report the discharge of interest.

Nonprincipal Amounts – Discharged penalties, fines, fees and administrative costs need not be reported. In the case of a lending transaction (where a lender loans money, or makes advances to a borrower), the lender is required to report only the principal discharged.

Related Parties – A creditor is not required to report the discharge of a debt when the creditor acquires the debt of a related debtor, becomes related to the debtor, or transfers the debt to another debtor related to the debtor.

Release of Debtor – A creditor is not required to report the release of a debtor from a debt obligation when other debtors remain liable for the full unpaid balance of the debt.

Guaranty or Surety – A creditor is not required to report the release of a guarantor or surety.



Nonrecourse Debt – A creditor is not required to report the cancellation of nonrecourse debt (i.e., debt in which the creditor only has recourse to the property securing the debt and does not have recourse to the other assets of the debtor). A mortgage that is a purchase money mortgage under Arizona Revised Statutes § 33-729(A) might constitute a nonrecourse loan for purposes of filing and furnishing a Form 1099-C. This is because if the property sold is insufficient to satisfy the purchase money mortgage, the lender has no recourse against the debtor's other assets.

On December 20, 2007, President Bush signed the Mortgage Forgiveness Debt Relief Act of 2007. In general, this law applies to homeowners who otherwise would recognize discharge of indebtedness income in connection with a mortgage restructuring or debt forgiven in connection with a foreclosure.

Homeowners are permitted to exclude from income $2,000,000 ($1,000,000 if married filing separately) of debt forgiven in calendar years 2007, 2008 or 2009. This exclusion only applies to debt associated with a homeowner's qualified personal residence. However, the law does not change a lender's reporting requirements. A lender who discharges a home mortgage is still required to report on Form 1099-C any discharged debt even though the taxpayer may not be required to recognize such income.

This article is a general discussion of the general exceptions to the IRS reporting rules and specific exceptions may apply to your unique circumstances.

If you are unsure whether you have an obligation to issue a Form 1099-C, we recommend that you consult with us or a tax professional.

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Recent developments in municipal bond insurance

One of the byproducts of the subprime mortgage meltdown has been the downgrade of most of the major municipal bond insurers by the national rating agencies. In an effort to reduce interest expense, many municipalities, school districts and other political subdivisions contract with bond insurance companies to guarantee the timely payment of principal and interest associated with the political subdivision's bonds. The credit enhancement provided by bond insurance companies allows bonds to be priced and traded at the rating assigned to the particular bond insurance company by one of the three major rating agencies. Prior to the recent problems, this would have generally provided a "AAA" rating for the bonds.

However, many of the major bond insurance companies expanded their product lines and wrote policies insuring loan portfolios consisting of subprime mortgages. When these loans started defaulting, the rating agencies lowered the ratings for several of the bond insurance companies and for the bonds insured by those companies.

Because insured bonds trade based upon the credit enhanced rating on the bonds, the effect of such a downgrade is to lower the price investors are willing to pay for the bonds in the secondary market and to decrease the market for the bonds since they no longer qualify to be held by money market funds. If the bonds were issued with a fixed rate, this has no immediate impact on the political subdivision.

If the bonds were issued with a variable rate, however, the interest rate on the bonds will likely increase, resulting in additional interest expense to the political subdivision.

The long-term impact may be that political subdivisions will question the value of bond insurance if it cannot provide and maintain a "AAA" rating on the bonds. The few remaining "AAA" rated insurers have increased their premiums dramatically in light of the reduced competition and increased demand. Issuing bonds without "AAA" bond insurance will lead to increased interest expense on future bonds.

The recent turmoil has also led to a securities law issue. Under Securities and Exchange Commission ("SEC") Rule 15c2-12, most political subdivisions are obligated to disclose any change in rating on their own bonds. The rating agencies have all posted on their websites the actions they have taken with respect to each insured bond issue. It does not appear that the rating agencies will send any notice of such action directly to each issuer. Each issuer may need to identify for itself what actions have been taken to downgrade that issuer's insured bonds and provide disclosure of such action at www.DisclosureUSA.org.

Please contact any Gust Rosenfeld public finance attorney if you have any questions regarding these recent developments.

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PERSONAL NOTES

The firm elected **Mark Collins, Lindsay Jones**, **Brandon Kavanagh, Shiela Schmidt,** and **Frank Tomkins** to join the membership.

Fourteen of the firm's attorneys were selected for the 2008 *Ranking Arizona* Best of the Best Awards by *Arizona Business Magazine*. Congratulations to **Mike Bate**, tax law; **Tom Chauncey**, corporate law; **Steve Guttell**, alternative dispute resolution; **Tom Halter**, banking law; **Rob Haws**, labor and employment law; **Rick Hood**, international trade and finance law; **Sean O'Brien**, bankruptcy; **Dick Segal**, commercial litigation; **Chris McNichol**, construction and real estate law; **Christina Noyes**, franchise law; **Jim Kaucher**, health care law; **John Hay**, information technology law; **John Hay**, intellectual property law; and **Dick Whitney**, trusts and estates.

Tim Barton spoke on the subject of title insurance at the Colorado Bar Association National Conference in Vail, Colorado, in early January.

Martin Jones is a member of the board of directors of the South Mountain Laveen Chamber of Commerce.

Mingyi Kang taught the ASU College of Law volunteer Income Tax Assistance ("VITA") training for the non-resident alien taxation section in early February. ASU VITA is helping international students, exchange scholars and people in the local community prepare their tax returns for free.

Scott Malm recently spoke at the National Business Institute seminar on Boundary Law. In the last two months, the Arizona Court of Appeals ruled in his client's favor in two cases relating to real estate disputes. Scott was also part of a team that traveled to and built homes for low-income people in Mexico.

Craig McCarthy has been elected to the Board of Directors for the Ahwatukee Foothills YMCA. He also serves on the Finance committee for the Board.

Andrew McGuire gave a presentation on development impact fees before the Government Finance Officers Association in February.

Sarah Smith volunteered for the State Bar of Arizona's Young Lawyers Division's Wills for Heroes Program in January. The program is aimed at helping prepare free wills, living wills and healthcare power of attorneys for the Phoenix Fire Department.

Melanie McBride joined the Phoenix Rotary 100. In addition, she also judged the ABA mock mediation competition at Phoenix School of Law in February; led a local high school field trip to the old courthouse to view a criminal trial; and also participated as a Recorder for the Arizona Town Hall in October.

TOP 10 estate and business planning mistakes (and opportunities)

MISTAKE #1

Forgetting to name successor agents, proxies, executors, and trustees in estate planning documents.

MISTAKE #2

Neglecting to properly structure a business venture to protect personal assets from business creditors.

MISTAKE #3

A married couple not taking advantage of both estate tax exemption amounts ($2 million in 2008) that are available to them, due to inadequate wills and assets owned the wrong way.

MISTAKE #4

For businesses owned by more than one individual, neglecting to have an owners' agreement and a binding buy-sell arrangement (with funding).

MISTAKE #5

Having inadequate beneficiary designations for retirement plans and IRAs that do not coordinate with the rest of the estate plan (a.k.a. "having all your ducks in a row").

MISTAKE #6

Neglecting to hold regular shareholder/member/partner and board of director meetings for a business entity, failing to prepare written minutes based on each meeting to include in the entity's records, and ignoring other formalities to assure that the entity is respected for all purposes.

MISTAKE #7

Failing to properly plan for family business succession.

MISTAKE #8

Failing to consider the income tax ramifications of each personal, investment, or business decision; and failing to take advantage of all available deductions, credits, and opportunities.

MISTAKE #9

Failing to incorporate trusts adequately for asset protection purposes (i.e., inability, disability, creditors, and predators of beneficiaries) in the estate plan.

MISTAKE #10

Failing to consider the options available to finance long-term care needs.

Source: RIA Practice Alert, 4/17/2008, Volume 54, No. 16.
Author: Martin S. Finn, CPA, LL.M., partner in the law firm of Lavelle & Finn, LLP in Latham, New York.

If you have questions about this article, please contact **Richard Whitney**, **Michael Bate** or **Abbie Shindler** at Gust Rosenfeld for more information.

RANCH

FROM PAGE 1

Usually, I can avoid the unpleasant task of telling him everything is all wrong because he has already signed the papers and is committed. If he hasn't signed, I have to explain the economics of cow-calf operations and show him why he won't ever be able to pay for that ranch.

There's hardly a cow ranch in Arizona today that will produce enough income to cover operating expenses for an absentee owner. I represent a few honest-to-God, old-time Arizona cowmen who live on and work their own ranches, and who are stingy enough to pay expenses, buy their own groceries and get by. The typical Arizona ranch, however, can't pay expenses, accomplish needed maintenance and pay the costs of a resident foreman or manager.

I have not heard of any ranch selling in the last several years at a price at which it would even begin to pay for itself. The buyer has to dig into his savings to make the payments.

Just about every ranch I have heard of that has changed hands in recent years has been bought by someone other than a cowman: doctors, lawyers, contractors, car dealers, business executives, and land owners trading out of high-priced development land.

Which brings us to taxes.

Undeniably there are tax benefits for ranch owners. After all, a business that doesn't produce enough income to pay operating expenses, that has an expensive cow herd and other assets that can be depreciated fairly rapidly, and that has many miles of barbed wire fences and corrals which would be extremely costly to duplicate at current labor costs, does produce a lot of write-offs. Add to this the interest paid on ranch or cattle loans at present rates and you've got a lot of deductions.

With these potential benefits come a host of grim specters. Just for starters, there are the many faceted attacks on public land users (and almost all Arizona ranches consist principally of public lands). This could mean increased grazing fees, loss of or reduced permit value, pressure from other public land users and vandalism. Second is the possible stringent enforcement by the IRS of the "hobby loss" rules, which have not yet been a serious hazard. Third is the reduction of much of the tax benefit through recapture at the time of sale. And fourth is the declining consumption of the product—beef—and the unexpected, new strong competition from foreign sources.

So, you see why I discourage my starry-eyed clients from signing these papers for the purchase of a ranch. But the romance and thrill of owning an Arizona ranch is so strong they will pass up a 12 percent, risk-free return on U.S. government bonds in order to buy a ranch and watch their large fortune become a small fortune.

By the way, if any of you happen to know where I can find a good Arizona ranch to buy, please give me a call.

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