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# LEGAL NOTES

INFORMATION FOR OUR BUSINESS AND CORPORATE CLIENTS

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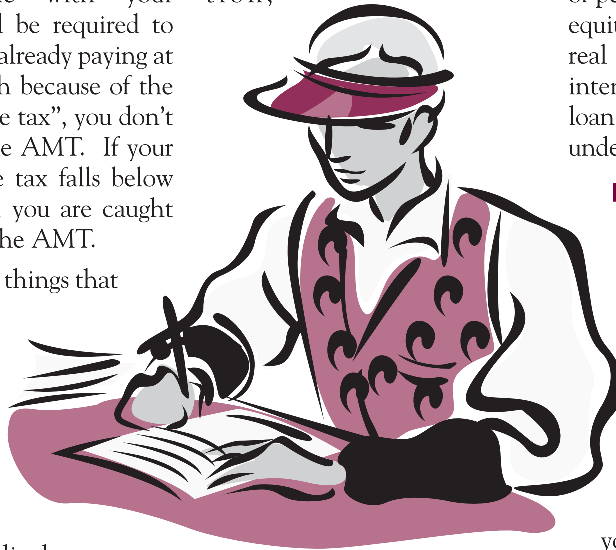
# BEWARE OF THE ALTERNATIVE MINIMUM TAX TRAP

The Alternative Minimum Tax ("AMT") is an extra tax some people have to pay on top of their regular income tax. The original idea behind this tax was to prevent people with very high incomes from using special tax benefits to pay little or no tax. Now however, the AMT affects more people each year, including some people who don't have a very high income and some people who don't have lots of special tax benefits.

The name Alternative Minimum Tax comes from the way the tax works. The AMT provides an alternative set of rules for calculating your income tax. In theory, these rules determine the minimum amount of tax that someone with your income should be required to pay. If you are already paying at least that much because of the "regular income tax", you don't have to pay the AMT. If your regular income tax falls below this minimum, you are caught in the trap of the AMT.

The top four things that cause people to be subject to the AMT are: state and local taxes, interest on second mortgages, medical expenses, and long-term capital gains.



### STATE AND LOCAL TAXES

If you itemize your deductions on Schedule A, there is a good chance you claim a deduction for state and local taxes, including property tax and state income tax. For 2005, you can claim a deduction for sales tax if you don't claim a deduction for state or local income tax. These deductions are not allowed under the AMT. If you live in a place where state and local taxes are high, you're more likely to be subject to the AMT. In addition, given the red hot real estate market and some people's desire to purchase second homes, the doubling up of state and local property taxes makes it much more likely that a lot of people who have invested in real estate will be subject to the AMT.

### INTEREST ON SECOND MORTGAGES

The AMT allows a deduction for interest on mortgage borrowings used to buy, build or improve your home. If you borrowed against your home for some other purposes, the interest deduction is not allowed under the AMT. Again, a lot of people have taken out home equity loans to purchase other real estate. In that case, the interest on the home equity loan would not be a deduction under the AMT.

### MEDICAL EXPENSES

The AMT allows a medical expense deduction, but it is much more limited than the deduction under the regular income tax. If you claim an itemized deduction for medical expenses, part or all of it will be disallowed when you calculate your AMT.

### LONG-TERM CAPITAL GAINS

Long-term capital gains receive the same preferential rate under the AMT as they do under the regular income tax. In theory, capital gains should not cause you to pay AMT. In practice, it is possible to be stuck in the AMT trap because of a large capital gain. The reasons have to do with the fact

*(continued on page 4)*

# WHEN CAN AN EMPLOYER USE OFF-DUTY CONDUCT AS A BASIS FOR FIRING AN EMPLOYEE?

When an employee leaves his job, he expects to be left alone. The employee believes that, as long as he is fulfilling his job responsibilities, he is off of his employer's moral, social and political clock. Therefore, he believes that he can smoke, drink, cohabitate, associate with others and engage in any other legal activities that he chooses without intervention by his employer. The employer, on the other hand, may object to and/or have concerns about the employee's off-duty conduct — such as drinking — and feel the need to discipline him for this activity.

## EMPLOYEE'S RIGHT TO PRIVACY VS. LEGITIMATE BUSINESS CONCERNS

To address these competing interests, courts and arbitrators have begun issuing guidelines for determining under what circumstances an employer can discipline an employee for his off-duty conduct.

Typically, courts and arbitrators will uphold an adverse employment decision based on the off-duty conduct of an employee when the employer proves that the conduct has negatively or adversely impacted its business, its reputation or good will, or the employee's work performance. However, some states have enacted laws setting forth specific rights to privacy, in addition to the rights afforded their citizens by common law. So, what constitutes an adverse impact on business and/or the employee's work performance sufficient to sustain disciplinary action will vary from state to state. In most instances the employee's right to privacy still takes a back seat to the employer's legitimate business concerns.

## DIFFERENT STATE STANDARDS

In Pennsylvania and other jurisdictions, for example, courts and arbitrators have expanded the adverse impact business standard and upheld terminations of employees for off-duty conduct where the employer establishes that it fired the offender out of concern for the safety of the offender's coworkers, or because the offender's coworkers refused to work with him for reasons related to the off-duty conduct.

Also, in these jurisdictions, courts and arbitrators have relaxed the requirement that the offensive off-duty conduct has an adverse impact on the employee's work performance. Decision-makers in these jurisdictions uphold disciplinary actions as long as the conduct is closely related to or bears a strong relationship to the employee's job responsibilities. Consistent with this standard, the termination of a security officer who committed a theft off-duty, may be or could be upheld because his duties are directly related to preventing theft and apprehending thieves. Similarly, the discipline of a truck driver for driving under the influence of alcohol, off-duty, may be or could be upheld because there is a strong relationship between the offense and his job responsibilities. Likewise, the termination of a truck driver for a theft committed off duty would not constitute just cause for the employee's termination as it bears no connection to his employer, his duties or his co-workers.

## PROVING LEGITIMATE BUSINESS CONCERNS

Over the past few decades, several states have enacted legislation designed to provide increased protections of the privacy rights for their citizens in the employment arena. However, the case law suggests that, in many instances, a legitimate compelling business concern of the employer will outweigh the employee's privacy concerns.

Therefore, in Pennsylvania and other states, under some circumstances, if the employer can prove that the off-duty conduct of an employee has an adverse effect on its business, the employer may be permitted to discipline the employee for the offensive conduct. However, because courts and arbitrators are reluctant to trample on the privacy rights of employees, they will hold the employer to a strict standard. The employer will be required to prove that the offensive conduct had a *negative effect* on a *legitimate and compelling* business concern.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# CHECK YOUR HURRICANE INSURANCE COVERAGE NOW

The hurricanes in Florida, Mississippi and Louisiana caused massive property destruction. Many of those who suffered substantial damage were uninsured. Others were insured only to find out that their policies did not cover the losses they suffered. Much to their surprise, many insureds discovered their insurance policies for commercial or residential properties did not cover them for losses due to hurricanes. Although they believed that they purchased insurance policies with hurricane coverage, they later learned that the hurricane coverage was limited by a flood exclusion which insurers normally include when insuring shore properties.

The typical hurricane coverage will define a hurricane as a storm named by the National Hurricane Center and having a catastrophe code assigned to it by the insurance company either before or after the storm causes damage to the insured's property. Certainly the recent storms which battered Florida, Mississippi and Louisiana fall within the scope of that coverage.

However, the hurricane coverage typically contains a flood exclusion, which will exclude coverage for losses caused by floodwater, surface water, waves, tidal water, or the overflow of a body of water from any source, including hurricanes. Under this exclusion, floods which are caused by rising floodwaters would typically be excluded.

The effect of the flood exclusion might appear to weaken the hurricane coverage. Not surprisingly many people, after receiving the news that they had no hurricane coverage, might question the reason to purchase hurricane insurance if damage due to rising floodwaters, for example, is excluded. Insurers respond that the exclusion is consistent with the other terms of the policy as the typical insurer does not want to assume the underwriting risk of insuring a flood loss, regardless of the source, for any shoreline property.

The exclusion does not eliminate all coverage for hurricane losses. Instead it limits the covered losses to those caused by wind-driven rain. Since hurricanes generate significant wind speed, many hurricane losses would be covered.

The interaction of hurricane coverage and the flood exclusion can be explained as follows: Water losses that occur from below (surface water, floodwater, etc.) are not covered, while water losses that occur from above (wind) are covered.

If you find yourself in this situation, you also must read the other sections of your policy that apply to water losses.

Now is a good time to check your policy to determine if you have hurricane coverage. The coverage will be listed on the declaration sheet of your policy. If hurricane coverage is listed, do not assume that you are covered for any loss caused by a hurricane. Make certain that you read the actual hurricane endorsement to find if it contains a flood exclusion. If it does, then you should consider buying flood insurance, particularly if your property is located near a flood plan or the shoreline. Knowing now the actual extent of your coverage can greatly help you immensely should you suffer damage from a hurricane.

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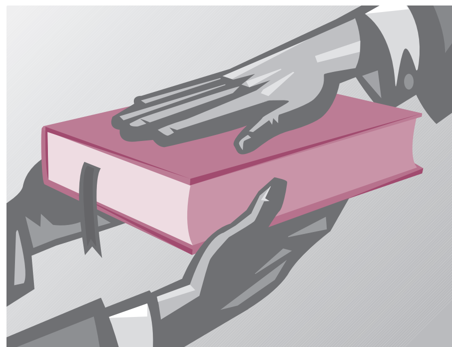
# COMMERCE COURT STREAMLINES LITIGATION PROCESS

Philadelphia is among a select number of states that have specialized business courts which exclusively hear business and commercial cases. Known as the Commerce Court, this business court has reshaped the environment for businesses that find themselves in Philadelphia-based litigation. Instead of a case ping-ponging its way from judge to judge on the way to trial, the Commerce Court provides one judge per case, from beginning to end, just as parties would find in federal court.

Unlike federal court, however, these judges are not also hearing drug cases, racketeering cases, civil rights actions, etc. along with the business and commercial disputes that find their way into federal courts. While all of these cases are important, they do not permit for the kind of specialization found in the Commerce Court. Rather, the three Commerce Court judges focus on business and commercial disputes, developing an expertise in those areas of the law, and in how to handle the parties and procedures in such cases.

Now entering its seventh year, the Commerce Court has handled thousands of cases, and issued over 650 Legal Opinions published on its web site (http://courts.phila.gov/commonpleas/trial/civil/commerce-program.html).



This body of law, and the judges' expertise, increase the information available to guide lawyers and litigants, and the consistency and predictability of what might occur if the matter is actually litigated. So parties who want to litigate will receive not just their day in Court, but a meaningful day in Court from a knowledgeable judge. These parties also have a greater ability to assess litigation risk and to more fully determine whether or not it makes sense to settle.

The Commerce Court also provides over 100 volunteer mediators, known as Judges *Pro Tem*. These mediators are distinguished members of the Philadelphia Bar, with extensive business litigation experience in a variety of practice areas. This pool of exceptional talent provides yet another reason why business litigants in Philadelphia can take greater control of their own destiny, and can have greater confidence that the outcomes they reach are rational and not random.

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# RECENT FIRM ACCOMPLISHMENTS

## FIRM OBTAINS FAVORABLE SETTLEMENT DEFENDING A STATE FAIR OPERATOR

Firm partner Michael S. Saltzman and associate Krista F. Fiore recently defended a state fair operator in a personal injury lawsuit resulting from an alleged trip and fall on the fair grounds. The plaintiff alleged that she tripped and fell in a pothole at the fair, and alleged that the distractions from the fair prevented her from seeing the pothole.

The defendants argued that the pothole was open and obvious and had the plaintiff been paying attention to where she was walking, she could have easily avoided it. Saltzman and Fiore also argued that the actual fair grounds were owned and controlled by co-defendants.

As a result of the alleged injury, the plaintiff, 60 years old at the time of the fall, claimed that she was permanently and totally disabled and no longer able to work as an assistant manager of a convenience store. She further alleged that she suffered brain injuries, a broken elbow, cervical spine herniations and radiculopathy, which her experts said would require a cervical fusion in the near future, as well as continued future medical care.

The plaintiff alleged that her past and future medical bills, wage loss, and lost earning capacity amounted to $3,000,000. Her settlement demand was $3,000,000.

After pre-trial mediation, and the defense of the deposition of one of plaintiff's five medical experts, the case successfully settled for $360,000 with the settlement being shared on a 50/50 basis with another defendant.

This was clearly a cost-saving settlement for our client, the fair operator.

## BEWARE OF THE ALTERNATIVE MINIMUM TAX TRAP

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that large capital gains reduce or eliminate the AMT exemption amount by forcing up what is considered your taxable income. The AMT exemption amount is designed to protect low income taxpayers from having to pay the AMT and is phased out for higher income taxpayers.

If you are caught in the AMT trap, your income tax could increase, sometimes significantly, with the AMT having a flat tax of 26% or 28%, depending on your level of income. There is little that can be done to eliminate the trap of the Alternative Minimum Tax, but in some cases it can be reduced.

One of the things most people can do to minimize the effect of the AMT, though, is to make whatever adjustments they can to their adjusted gross income as that number is reflected on their income tax return. These are the adjustments that are found on lines 23 through 35 on the first page of the Form 1040. Practically, what this means for most people, is that they should contribute to their self-employed, SEP, simple or qualified plan, should contribute the maximum amount possible to their 401(k), and should take any other expenses or deductions to their gross income that are reflected on those particular lines, including moving expenses, self-employed health insurance, student loan interest, tuition and fees, health savings account deduction, and the like. Most of these expenses must be incurred within the calendar year for the return that is being filed, but with regard to contributions to many individual retirement accounts, SEP, simple or other qualified plans, you are generally allowed to contribute to the plan up to April 15th of the year following the calendar year in question.

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