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FALL 2005 NEWSLETTER

CAREFUL! NEW RULE AFFECTS THE DISPOSAL OF CONSUMER CREDIT INFORMATION

In the Fair and Accurate Credit Transactions Act of 2003 (FACTA), Congress required the adoption of rules for the proper disposal of consumer report information and records. The legislation was prompted by the growing risk of consumer fraud and related problems, including identity theft, that arise from the improper disposal of consumer information for which there is no longer a business need or purpose. FACTA and the rule stemming from it are meant to make it tougher for dumpster divers and miners of computer data to profit from sloppy disposal methods.

The Federal Trade Commission's Disposal Rule went into effect June 1, 2005, but affected businesses will have six months from that time to come into compliance. After that, failure to comply could trigger a range of civil enforcement actions by the Government or affected consumers.

While there is room for interpretation of the Disposal Rule's meaning, and how it should be applied as circumstances change, the Rule's essential standard is all in one sentence:

Any person who maintains or otherwise possesses consumer information for a business purpose must properly dispose of such information by taking reasonable measures to protect against unauthorized access to or use of the information in connection with its disposal.

What Is Covered?

Consumer information covered by the Rule means any record about an individual, in any form, that is a consumer report or is derived from a consumer report. The definition includes a

compilation of such records. If the information does not in some fashion identify individuals, however, such as information in aggregate form, the Disposal Rule does not apply. The obvious ways in which individuals may be identified are names, Social Security numbers, driver's license numbers, telephone numbers, physical addresses, and e-mail addresses. But even pieces of information that, by themselves, do not identify someone can, in combination, be regarded as identifying information.

Who Is Covered?

The Rule was intentionally written broadly to apply essentially to any "person" maintaining or possessing consumer information other than an individual who has obtained his own consumer report. Some entities that commonly obtain consumer credit information include consumer reporting agencies, lenders, insurers, employers, landlords, government agencies, mortgage brokers, financial institutions, and automobile dealers. This is far from an exhaustive list. If an entity can obtain a consumer report for one or more of the business purposes mentioned in the Fair Credit Reporting Act, it is safe to assume that the entity and the information it obtained are subject to the Disposal Rule. Disposal and records management companies also fall under the Rule.

Reasonable Measures

The Rule uses the flexible term "reasonable measures" to describe the duty regarding disposal because perfect destruction of consumer information in every instance is unattainable. Variables that may be taken into account include the sensitivity of the information, the nature and size of the entity's operations, the costs and benefits of different disposal methods, and ongoing changes in technologies. It is also noteworthy that the concept of "disposal" also covers the sale, donation, or transfer of any medium on which consumer information is stored.

The Rule provides a nonexhaustive set of examples of "reasonable measures." To prevent the reading or reconstruction of records in paper form, policies should be adopted, and their implementation monitored, for the burning, pulverizing, or shredding of such papers. The same approach is advisable for policies on destruction or erasure of electronic media. Since simply deleting information stored on a computer is usually insufficient to safeguard the information, use of some low-tech methods of destruction on some high-tech methods of storing information may be in order. For example, the Federal Trade Commission has suggested, at least for small businesses, the nearly cost-free method of disposing of electronic media by smashing the material with a hammer.

A covered person's due diligence also should extend outside the office when disposal of information is contracted out to a provider of such a service. One of the "reasonable measures" mentioned in the Rule refers to taking steps to determine the competency and integrity of the disposal company, such as reviewing an independent audit of the company, getting references, requiring that the company be certified by a trade association, or reviewing and evaluating the disposal company's policies and procedures on information security.

GIFTING AS AN ESTATE PLANNING TOOL

The wisdom of making a will is well settled as sound legal advice, and rightly so. Less talked about, but equally advisable for many people, is the use of gifts during one's lifetime as a method for estate planning. Apart from the intangible benefits that flow from the fact that, as the saying goes, it is more blessed to give than to receive, gifting has favorable down-to-earth, dollars-and-cents ramifications.

Gifts reduce the size of the donor's estate that will be subject to court administration, thereby cutting probate costs and potential estate tax liability. Less obvious, but equally advantageous, is the way that gifts can provide savings on income taxes. This occurs when income-producing property is given by an individual in a high income tax bracket to someone in a lower tax bracket.

Gifts do not trigger income tax liability for the recipient. However, the original cost, or basis, of the gift remains for the recipient what it was for the donor. As a result, if the recipient later sells the property, he generally will owe capital gains tax on the difference between the donor's basis and the sales price.

As for the gift tax, the starting point to consider is that the federal Government levies the tax on transfers of real or personal property made during the giver's lifetime where something of similar value is not received in return. For tax purposes, the dollar value of a gift is the fair market value of the property when it is given, less the fair market value of anything received in return. The donor is liable for any gift tax that is due, but if the donor does not pay the tax the donee becomes personally liable.

An annual exclusion of up to \$11,000 is available for transfers to other persons without payment of the federal gift tax. Rather than pay the gift tax on gifts over \$11,000, the donor can choose to exempt as much as \$1 million in gifts above this exclusion over his lifetime. The donor does not need to file a federal gift tax return for gift amounts less than \$11,000. Because the exclusion amount is per donee, any one donor actually can make gifts in a large total amount, without incurring a gift tax, by giving to many different recipients. For a married couple, the annual exclusion is \$22,000 per donee.

There is an unlimited marital deduction provision in the federal gift tax law, so that no gift tax is due, and no return need be filed, for gifts between spouses in any amount. Also excluded from the gift tax are amounts paid by a donor to a qualified educational institution for another's tuition, or to a health-care provider for someone's medical services. Gifts to qualified charitable, religious, and educational entities, government agencies, and many organizations with tax-free status are not subject to the gift tax.

This article merely introduces the subject of the gifting of property. Estate planning techniques and tax laws are complex. You should always consult with a qualified professional to assist you in such matters.

SAFEGUARDS FOR ELECTRONIC BANKING

In banking as in so many other areas, the trend is clear: We continue to move steadily away from traditional paper transactions toward high-tech means of conducting our business. It

will not happen overnight, though, and even the most technophobic among us should be assured that there are some federal laws and regulations in place that will make the transition easier and more secure.

Electronic Fund Transfer Act

The methods for electronic fund transfers (EFTs) are already commonplace for many bank customers. They include ATMs, debit or check cards, preauthorized deposits and withdrawals, and telephone transfers. The federal Electronic Fund Transfer Act answers some basic questions about using EFT services. The Act is especially important when things go wrong, providing rules for the correction of errors and dealing with loss or theft.

Financial institutions must provide documentation of EFTs in two forms: terminal receipts and periodic statements. Among other pieces of information, both documents must include the type of transfer, the amount and date of the transaction, and the location of the terminal. For preauthorized transfers that occur at regular intervals, the institution must provide a notice that the transfer occurred as scheduled.

As with credit cards, financial institutions must investigate and promptly correct any EFT errors reported by the consumer, but there are some differences in the details. For errors like unauthorized or incorrect EFTs, or omission of an EFT from a statement, a consumer should contact the institution as soon as possible, and no later than 60 days after receiving the statement showing the error. As a general rule, the institution must promptly investigate and resolve the matter within 45 days. If more than 10 days pass, it must make the correction, subject to the results of the investigation. Such a recredit is made final if the institution finds an error; if it does not, it must explain the outcome of its investigation in writing to the consumer.

Loss Limits

If your credit card is lost or stolen, your loss is limited to \$50 per card. That is also the general rule for an EFT card or code, but with the important caveat that procrastination in reporting a lost or stolen EFT card or code can be much more expensive. The exposure limit jumps to \$500 for a consumer who does not report the loss or theft within two days of learning of it. Not only that, but failure to report an unauthorized transfer within the 60-day period for doing so creates unlimited exposure to losses from transfers made after the 60-day period.

Proceed with Caution

The federal Government provides some EFT protection for old hands and novices alike, but the best approach is to combine that protection with your own safe practices. Keep a low profile for thieves and scam artists by protecting your personal information, such as bank account numbers, passwords, and Social Security numbers. Never respond with such information to unsolicited telephone calls or e-mails. Verify the legitimacy of a website address before providing personal information on the site. It is a good idea to have virus protection and a “firewall” on your computer to keep hackers out. Finally, keep good banking records and review each bank statement promptly so that you can report anything suspicious you see in time for it to do you the most good.

RETIREMENT GUIDE FOR SMALL BUSINESSES

The Internal Revenue Service has created a free CD-ROM that is designed to help small businesses establish and maintain retirement plans for employees. Sections on setting up contributions, investments, and distributions have information not only from the IRS, but also from the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, and the Social Security Administration. Some of the contents of the CD-ROM include:

- * Rules for traditional and Roth IRAs, as well as other retirement plans;
- * Investing your IRA;
- * Publications and forms;
- * Retirement calculator;
- * Video clips on retirement planning;
- * Frequently asked questions;
- * Research material on IRAs; and
- * Links to more retirement information on government websites.

You can order the CD-ROM online at www.irs.gov/retirement or call toll-free 800-829-3676 and request Publication 4395.

PROTECT YOUR HOME WITH TITLE INSURANCE

When someone buys a home, in addition to the land, bricks, and wood, the buyer receives the legal title to the property. If the title is defective, it could interfere with enjoyment of the property and result in financial loss. When title insurance is purchased by a property owner, the insurer guarantees that the owner has clear title to the property, free of claims or encumbrances.

Title insurance begins with a search of land records tracing the property's "chain of title" back in time through previous owners. A title search should reveal any legal documents that do not clearly pass title, such as where incorrect names or notary acknowledgments appear, as well as outstanding mortgages, judgments, or tax liens. Even a thorough search by an experienced title examiner cannot be absolutely certain to detect every problem, however. Title insurance protects against the unseen hazards that may not surface until long after property is purchased. Some of the risks against which title insurance gives protection include: a forged deed that transfers no title to the property; previously undisclosed heirs with claims against the property; and a legal document executed under an invalid or expired power of attorney.

A title insurance policy protects the insured party, such as the home buyer or the buyer's mortgage lender, against losses suffered if the title is found to be defective, even after a search of land records suggests no problems. Lenders' title insurance decreases and eventually is discontinued as the loan is paid off. Owners' title insurance, issued in the amount of the purchase price, lasts as long as the insured has an interest in the property.

As with any other insurance policy, the fine print in a title insurance policy must be examined with care. Typically, there are exclusions or exceptions from coverage. For example, the effects of governmental laws, ordinances, and regulations are generally excluded. You also should be aware of two other common policy provisions. The first is a standard arbitration

clause, requiring binding arbitration to resolve any dispute under a specified dollar limit. The second provision, a “co-insurance” clause, states that the owner must obtain increased coverage if the insured property is improved in order to furnish the same level of protection.

Title insurance protection takes various forms. The insurer will negotiate with third parties about their claims against the insured property, pay for defending against an attack on the title, and pay claims if necessary. Title insurance also helps to make sure that a dream home will not become a legal nightmare for the home buyer.

TASTER’S CHOICE MODEL WINS BIG

A two-hour photo shoot paying \$250 has turned into a jury verdict of over \$15 million for the model, but it took almost 20 years and some good luck for it to happen. Russell had his photo taken for use on labels by a major coffee maker. He did not think much more about it until many years later, when he saw the photo of himself savoring a cup of coffee.

According to the modeling agreement, which Russell had kept in his records, he was supposed to be paid additional sums if the photo was actually used in marketing. The company had never paid more money to Russell, even though his photo had ended up on countless jars of coffee around the world for a six-year period. Nor did the company get his permission for the use of his image.

The jury award was based not just on the company’s obligations under the agreement, but also on a percentage of the profits derived from the use of the image. Russell was able to show that his face, appearing as it did in all kinds of advertising, not just the jars of coffee, helped to sell a lot of coffee. As a result, the company’s misappropriation of his image carried a very big price tag.

QUOTABLE

“Supposing is good, but finding out is better.”

Mark Twain