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THE NEW YORK PROMPT PAYMENT ACT AND CONSTRUCTION PROGRESS PAYMENTS

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The New York Prompt Payment Act (General Business Law Art. 35E) governs payment procedures and remedies for most private non-residential construction contracts in excess of $150,000. These include contracts entered into between owners and contractors, contractors and subcontractors and subcontractors and their subcontractors. The Act does not apply to public construction projects or most residential projects.

The Act can be very onerous if not properly understood. The Act can override portions of construction contracts that address payment, suspension of work and dispute resolution. Thus, language in affected construction contracts can be misleading if inconsistent with the Act.

The Act recognizes the legitimate need to withhold payment for disputed work as long as the reasons for withholding are timely specified in writing. This requires the withholding party to stay on top of what is going on, a task that is not always easy during an ongoing construction project.

The following is a brief summary of the Act's more significant features.

CERTAIN CONTRACT CLAUSES ARE DEEMED VOID

The following clauses, when contained in construction contracts covered by the Act, are deemed void and will not be enforced:

- Attempts to impose laws of a state other than New York to the contract.
- Attempts to require that litigation, arbitration or other dispute resolution take place in another state.
- Denial of the right to suspend work because of another party's failure to timely make undisputed payments.
- Denial of a suspending party's right to timely remove its materials, tools and equipment if another party fails to timely make undisputed payments.
- Denial of an aggrieved party's right to pursue an expedited arbitration proceeding through the American Arbitration Association to receive undisputed payments.

DETAILED PAYMENT PROCEDURES IMPOSED

The Act sets forth detailed procedures regarding the timing of and steps to be taken in submitting, reviewing, approving, disputing and/or paying construction progress payments. These procedures supersede any language to the contrary in an affected contract. They must be understood and adhered to. They require a monthly payment cycle and a timely written statement of the reasons for withholding a disputed payment.

TWELVE PERCENT INTEREST OWED ON LATE PAYMENTS

The Act requires payment of 1% per month interest on all payments that are not paid when due, a rate that is nearly double current market rates. As with all of the items listed above, this requirement cannot be changed by agreement. It appears that the higher interest rate should be limited only to undisputed payments not timely made.

MANDATORY DISCLOSURE OF PAYMENT SCHEDULES

A contractor or subcontractor must disclose in writing to its subcontractor, at the time the contract is entered into, the dates the higher tier party is scheduled to receive progress payments from the owner or contractor, as the case may be. Failing that, payments will be due to the subcontractor even if they have not been received from the owner or contractor.

The Act permits payments to be withheld where there is a reasonable basis for doing so, and the reasons that may justify withholding payment are broadly defined. A key feature of the Act, however, is the requirement that the withholding party must timely provide a written statement describing the items in the invoice that are not approved and the reasons justifying the withholding. Failure to timely provide such a writing may trigger the imposition of the 12% interest rate, allow the party seeking payment to suspend work, or result in commencement of an expedited arbitration proceeding.

If you are involved in a private non-residential project in excess of $150,000 you will need to understand the intricacies of the Prompt Payment Act. It is important for anyone involved in administering an affected construction contract to understand and comply with its requirements.

If you have any questions about the Prompt Payment Act, please contact **Jim Hughes** at **jhughes@hancocklaw.com**.

FEDERAL GIFT AND ESTATE TAX LAW UPDATE

MARION HANCOCK FISH

Occasionally, there is good news in the law, positive changes that provide real opportunity. The recently enacted federal gift and estate tax laws are a prime example. These new tax rules present a great opportunity to pass on substantial wealth at minimal tax costs. For family business owners, the time may be ripe to devise a plan.

The American Taxpayer Relief Act of 2012 (ATRA), enacted in January 2013, made permanent new higher exemption amounts for federal gift and estate tax - the tax on what you give away during life and on the wealth that remains in your estate at death.

To give you some historical perspective, here are the current transfer tax exemption amounts and those that were in effect during the last few decades.

FEDERAL ESTATE AND GIFTS TAX EXEMPTIONS

1990	2000	2010	2013
$600,000	$675,000	$5,000,000	$5,250,000

These federal gift and estate tax exemption amounts are now indexed for inflation and will be adjusted in January of each year.

For family business owners thinking about transition to the next generation and beyond, these historically high tax exemptions mean that Mom and Pop can give up to $10,500,000 in business wealth without incurring federal gift tax.

Assume that Mom and Pop still retain 100% of their family business but are ready to turn over the reins to the next generation. In the simplest of situations, it might make sense for Mom and Pop to make outright gifts of the business stock to their children. They will first need to have the business valued by a qualified expert to determine the value of the stock gift. The gift is then reported to the Internal Revenue Service on a Form 709 gift tax return, which is due by April 15 of the following year. The business valuation report must be filed with the return to comply with IRS requirements.

One further note on business valuation: you may find that the business wealth as valued for gift tax purposes is substantially less than the company book value, due to factors such as lack of marketability and control. These discounts in value allow you to make the gifts while using less of your gift tax credits, sometimes described as leveraging your gift tax credits.

Your gift planning will really pay off if the business thrives after the gift, since the increased value in the business post-gift will have passed transfer tax free, saving tax costs of nearly 50¢ of every $1 in appreciation.

Even if the value of the business is not large enough to cause concern about the federal estate tax, New York estate tax cannot be overlooked. The New York estate tax exemption amount is currently $1,000,000, but its gift tax was eliminated altogether in 2000. This next table shows some of New York's estate tax history:

NEW YORK ESTATE TAX EXEMPTION

1990	2000	2010	2013
Increased from $115,000 to $300,000	$675,000	$1,000,000	Remains $1,000,000

While it seems very unlikely that the New York estate tax will change, the fact that New York has no gift tax does create planning opportunities to avoid the New York estate tax.

For example, assume that Mom and Pop's business has been valued at $5,000,000. If they still owned the business at their deaths, the estate tax bill to New York would be about $400,000, hardly chump change in anyone's book. By giving the business during life, most if not all New York estate tax is avoided, depending on the size of the taxable estate at the death of the second of them to pass away.

There is more to consider besides transfer tax for a family planning a business transition. Other planning concerns include:

- funding retirement income
- developing business leadership
- providing inheritance for family not in the business
- diversifying wealth in non-business assets

With these favorable tax credits, the gift and estate tax aspects of many family-owned business transitions may not require the sophisticated treatment needed in the past to minimize tax costs. Instead, valuable time, attention and expertise can be brought to bear on other important strategies to successfully transition from Mom and Pop to their sons and daughters, and to grandchildren.

If you have any questions about these gift and estate tax rules, please contact **Marion Hancock Fish** at **mfish@hancocklaw.com**.