

Tenants in financial trouble

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As the economic recession continues, and as businesses experience a troubling decline in revenues and net profit, commercial property owners are often burdened with tenants unable to fulfill their obligations pursuant to commercial real property leases relating to the premises on which the struggling businesses operate.

In such circumstances, negotiations are often initiated by either the landlord or tenant in order to rectify a difficult economic situation. Presumably, each of the landlord and the tenant is motivated to find terms and conditions pursuant to which the business can operate and continue to pay rent. A landlord and tenant might agree to modify the lease, sometimes reducing rent in exchange for a longer term. Other times, a landlord might agree to terminate a lease if, in fact, the landlord has other viable options for the property, whether it be the next tenant or a possible development. Even a financially troubled tenant might attempt to induce its landlord to modify the lease or terminate the lease with an upfront cash payment, particularly if the lease has personal guarantees going forward. The landlord should be aware that any such upfront payment received by the landlord to induce concessions pursuant to the lease, whether relating to a termination or otherwise, must be reported as taxable income in the year of receipt. IRS Regulations treat such payments as merely another form of rent relating to the property.

On the other hand, in some circumstances, the financial condition of the tenant may be so dire that the tenant is in default with no possibility of reaching any agreeable modifications with the landlord. In such circumstances, expenses incurred by the landlord in obtaining legal and physical possession of the leased premises, including legal fees, generally will be currently deductible by the landlord.

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