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2011 is Shaping Up to Be a Great Year

by Chris Sackett, Managing Member

"What doesn't kill you makes you stronger."[1] We've all heard it many times, and if it's true, most of us have never been so strong after surviving the recent economic downturn. Although we're not out of the woods yet, most economic indicators are positive as we move into 2011. At BrownWinick we're excited to be part of your business and legal team as you take advantage of the opportunities and tackle the challenges that are sure to make this year more exciting, and likely more rewarding, than the past couple of years. As your company executes its business strategy, please keep us in mind and let us know how we can help you succeed. Whether you need assistance in government relations and programs, mergers and acquisitions, taxes, raising capital, start-up or spin-off businesses, intellectual property, litigation, a workout transaction, or some other area, BrownWinick is uniquely qualified and positioned to contribute to your success in 2011.

2011 marks the 60th year since the founding of BrownWinick. We're proud of our history and look forward to our future. Part of that future is dependent upon identifying top legal talent. As part of that process, we've recently made Rachel Rowley a partner in our litigation area. We've also hired Bridget Shapansky to practice in the business/transactional area and Matt McKinney to practice in the litigation area. BrownWinick is fortunate to have such wonderful young attorneys at our firm, and we're confident you will enjoy working with them. ■

Avoiding Liability For Bankruptcy Preference Claims

by Bradley R. Kruse

We Just Received A Preference Claim, Now What?

Receiving a demand letter or lawsuit for the return of preferential payments to a bankrupt debtor is typically a frustrating situation for creditors. To creditors that have not had much previous experience dealing with bankruptcy preferences, being hit with a preference claim can seem especially confusing and unfair. The conversation with the attorney usually begins something like this, with the creditor in an agitated tone:

> "The debtor owed us $150,000 at the time they filed bankruptcy almost two years ago and the information we have so far is that we are only going to receive pennies on the dollar from the debtor. Now, after all this time, someone representing the bankruptcy trustee says we have to give back the few payments we did receive from the debtor. How can this be?! These payments total almost $100,000 on top of what we are owed!"

As frustrating as this situation may seem at first, if creditors understand preferences, as well as their rights and defenses, creditors can often greatly reduce their preference liability if not eliminate it entirely.

Bankruptcy Preferences Explained

The Bankruptcy Code contains provisions allowing a bankruptcy trustee (which includes a debtor-in-possession in a Chapter 11 case) to recover any payments the debtor made within 90 days before filing for bankruptcy to a creditor on account of antecedent debt, provided the debtor was insolvent and such payments enabled the creditor to receive more than the creditor would have received if the case were a Chapter 7 liquidation.

The purpose of these provisions is to prevent a debtor from paying some creditors and not others during the time period leading up to the debtor's bankruptcy. The theory is that debtors experience a period of financial difficulty prior to filing for bankruptcy, and that especially in the 90-day period prior to the bankruptcy, debtors, who already have limited funds, are often tempted or pressured to pay certain creditors with their limited funds. The result is that some creditors are "preferred" over others. The goal of the Bankruptcy Code is to prevent or limit such preferential treatment by allowing the trustee to recover any preferential payments and subsequently distribute the proceeds to unsecured creditors on an equal or "pro rata" basis.

In order to promote these goals of equal distribution to creditors and to allow the trustee adequate time to investigate and evaluate potential preference claims, the Bankruptcy Code allows the trustee to file a preference action up to two years following the filing of the debtor's bankruptcy. Most trustees usually send creditors a demand letter notifying the creditors of the specific payments at issue and requesting repayment by a specific date. However, if the two-year time limit for filing suit is fast approaching, some trustees will simply file suit first without sending a demand letter.

Defenses to Preference Claims

The explanation of the policy goals behind recovering preference payments may be of hollow comfort to a creditor facing a claim from a

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1 Friedrich Nietzsche

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bankruptcy trustee that a six-figure amount be returned to the debtor's bankruptcy estate. However, all is not lost. The Bankruptcy Code provides a number of defenses to preference actions. Creditors can often use one or more of these defenses to negate a preference claim in its entirety or to negotiate a settlement for a much lower dollar amount. Three of the more common defenses are: 1) Contemporaneous Exchange; 2) New Value; and 3) Ordinary Course. It is important for creditors faced with a preference demand or suit to seek guidance from legal counsel in order to maximize the effectiveness of these defenses.

Pursuant to the Contemporaneous Exchange Defense, a creditor may avoid liability for any asserted preferential payment if such payment was intended by the debtor and the creditor to be a contemporaneous exchange for new goods or services and was, in fact, a substantially contemporaneous exchange. An example of this would be a COD payment.

Under the New Value Defense, a creditor may avoid preference liability to the extent that the creditor gave new value to the debtor after the transfer in question, such as by furnishing additional products or services on credit. Specifically, subject to some limitations set forth in the Bankruptcy Code, creditors can effectively offset additional credit that was provided to the debtor after any of the preference payments in question. Some districts require that the amount of new value remain unpaid, while other districts do not impose such a requirement.

The Ordinary Course Defense allows creditors to avoid liability for any preferential payments that were made in the ordinary course of business dealings between the creditor and the debtor or that were made according to ordinary business terms. An example of the latter is payments paid in accordance with the terms of the invoice. For example, if the preference payment in question was made within 25 days of the invoice and the term of the invoice was net 30 days, the creditor may assert that payments were made according to ordinary business terms.

The Ordinary Course Defense is also based on the concept that if the debtor and creditor established a regular course of dealing regarding the timing and amount of payments, even if that course of dealing is not in accordance with the terms of the invoices, a valid defense may still be asserted. This is one of a creditor's most powerful defenses, though it is typically very fact intensive. Essentially what the creditor seeks to do is to compose a snapshot of the payment history during the 90-day preference period and compare that with the payment history between the parties prior to the preference period. If the creditor can show that the payment history and course of dealings between the creditor and the debtor were similar for both periods, the creditor has an excellent chance of successfully asserting an Ordinary Course Defense. Some of the more important comparisons to be made between these periods include, range of payments, average time for payments,[1] average amount of each payment, average number of invoices paid by each payment, and the correspondence between the parties. Again, the more similar these comparisons are between the preference period and the pre-preference period, the stronger the defense will be. If the course of dealing shows more pressure being put on the debtor by the creditor in the 90-day period, the defense is weakened.

Minimizing Preference Risk

Though easier said than done, the best way to avoid preference exposure is to not let a customer get behind in payments very far in the first place. However, once that happens, creditors can try to minimize their exposure to preferences by switching to COD terms if it believes the customer is in financial distress. Creditors will often refuse to ship additional product or perform additional services until the customer pays up on outstanding invoices. Though this may prompt a significant payment from the customer, it most likely will nullify use of the ordinary course defense with respect to such payments should the customer file for bankruptcy within 90 days of the payments. Whether to exert such pressure is a calculation each creditor must make based on the specific circumstances.

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1 Creditors will typically want to calculate this based on number of days from invoice or delivery rather than on number of days late.

A Christmas Present From Congress

by Ronni F. Begleiter

Although much of the media attention has focused on the extension of the Bush income tax cuts, Congress has given those subject to estate tax a generous Christmas present. For those dying in 2010, 2011 and 2012, the estate tax threshold has been raised to $5 million. For most people, that will both eliminate federal estate tax and allow a full step-up in the tax basis of the decedent's assets.

In 2011 and 2012 you will be able to make lifetime gifts of up to $5 million per person. That increase allows a couple to give away up to $10 million without paying taxes on their gifts. Even if you have previously maxed out your lifetime gifting ability, you can now make an additional $4 million of tax-free gifts. Those gifts can even be made to grandchildren and future generations without causing any generation skipping transfer tax. This presents an excellent opportunity to help manage your children's estate tax liability as well as your own.

Not surprisingly, this Congressional gift is not permanent. Instead, it is like a gift card with a two-year expiration date. Like its predecessor, the new law will "sunset" and will expire on January 1, 2013 unless Congress passes new legislation to extend it. After the last ten years of estate tax drama, it seems unlikely that Congress will agree on an extension with only two years to do so. Even if there is agreement, the extension may not be as taxpayer-friendly as the law now in effect. Therefore, those who are interested in making significant gifts should do so during the next two years.

While this increase in the federal estate tax threshold will save many families from paying estate tax, it will also rewrite many people's wills. It is common for wealthy people to divide their estates into two portions. One portion is equal to the federal estate tax threshold prevailing at the time of death. That portion passes to a trust with various family members as beneficiaries. The rest of the decedent's assets then pass to his or her surviving spouse, either outright or in trust. With a new estate tax threshold of $5 million, that formula will pass the first $5 million of a person's wealth to the trust, leaving far less to pass to the surviving spouse.

If you and your spouse are not comfortable with that result, you should review your will with your BrownWinick attorney. Similarly, if your will makes provision for a bequest to your grandchildren and makes that bequest equal to your generation skipping transfer tax exemption, the new law will pass more of your wealth to your grandchildren and leave less of

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your wealth for your children to share. Again, this suggests that you should review your current will and make sure you are comfortable with how your wealth will pass.

Before you dismiss this as a non-issue, remember that the $5 million federal estate tax threshold used to be only $600,000. If your will has not been updated in the last ten years, you may have a will that does more tax planning than you now need.

Unfortunately, death is still certain but taxes are not. While your BrownWinick attorney cannot tell you what the estate tax rules will be at the time of your death, he or she can explain what the current law means for you and your estate.

Ronni F. Begleiter is a member of the firm representing clients in the area of pensions and employee benefits and estate planning matters. Ronni can be reached at (515) 242-2463 or begleiter@brownwinick.com.

Tax Extensions and Incentives – For a Limited Time Only

by Bridget C. Shapansky

Congress left taxpayers on the edge of their seats up until nearly the end of the year. With the Bush tax cuts set to expire at the end of 2010, taxpayer friendly legislation was needed or comparatively unfavorable provisions would go into effect. With the rapidly increasing national debt, many feared Congressional inaction. At what seemed to be the eleventh hour, Congress, generously and somewhat unexpectedly, passed favorable legislation to benefit taxpayers retroactively and into 2011.

Major tax breaks and incentives were provided to businesses, the most significant of which were the increase in the Section 179 deduction limitation and the enhanced bonus depreciation deduction. The Section 179 deduction allows a deduction for the purchase of machinery, equipment and software subject to certain limitations. Through 2011, a taxpayer may immediately expense up to $500,000 of property placed in service during the year. The fifty percent bonus depreciation deduction, which enables businesses to more rapidly deduct capital expenses for certain property, was extended for property placed in service before September 8, 2010. The bonus depreciation deduction was further increased to 100 percent for property placed in service after September 8, 2010 through December 31, 2011. The Section 179 limitations and bonus depreciation provisions are very generous as they doubled the amounts previously allowed and permit the total write off of expenses incurred for certain property.

In addition, owners of qualified small business stock can exclude up to 75 percent of the gain generated from the sale of stock acquired during 2010, prior to September 27, 2010, and 100 percent of the gain generated from the sale of stock acquired after September 27, 2010 through the end of 2011. A taxpayer is eligible for the gain exclusion only if the stock is held for five years or more. Further, the gain exclusion is not included in the calculation of Alternative Minimum Tax ("AMT").

Congress also provided new businesses with the opportunity to generally deduct up to $10,000 of start-up expenses, which is double the previous 2009 limitation. Also, general business credits generated in 2010 can now be carried back five years, instead of only one year, and forward twenty-five years, instead of only twenty years. Moreover, all general business credits are allowed to offset AMT. In addition, cell phones are no longer a luxury, as Congress no longer classifies them as "Listed Property." As a result, cell phones can now be deducted in a manner similar to other business property, without the burdensome recordkeeping requirements.

The recent legislation retroactively extended a variety of 2009 business incentives through 2011, including the research and development credit, a 15-year depreciation life (as opposed to 39 years under the prior law) for qualified improvements, an employer wage credit for activated military reservists and the work opportunity tax credit.

The tax breaks and incentives enacted to benefit individual taxpayers were also quite generous. Individual income tax rates were set to increase in 2011, with the highest income tax rate topping 39.6 percent and the preferential capital gain and qualified dividend rates set to expire. Congress, however, retained the current 2010 tax rates through 2012, resulting in a top income tax rate of 35 percent and preferential capital gain and qualified dividend rates of 15 percent.

In addition, the much anticipated AMT patch was finally enacted for the 2010 and 2011 tax years. For 2010, the amount of income exempt from AMT is $72,450 if married filing joint, and $47,450 if filing single. For 2011, the amount of income exempt from AMT is $74,450 if married filing joint, and $48,450 if filing single. These exemption amounts are significant, as the 2010 exemption amounts under the old law were $45,000 for married filing joint taxpayers and $33,750 for single taxpayers.

The new legislation also retroactively extended to 2010 and into 2011 the following: the election to itemize state and local sales tax in lieu of state income tax, the $2,500 American opportunity tax credit for higher education expenses, the $1,000 child tax credit, the $250 educator expense, the ability to deduct mortgage insurance premiums as home mortgage interest, the above the line deduction for higher education expenses and the ability to make a tax free charitable contribution of up to $100,000 from an IRA. Individuals may also be able to take advantage of the extended energy credits for the purchase of energy efficient appliances and improvements to the home. In addition, the new legislation allows self-employed individuals a deduction for health insurance payments for purposes of calculating self-employment tax.

Based upon the recently enacted legislation and looking forward to 2011, tax planning opportunities exist for certain business taxpayers. Through 2011, businesses should continue to invest in business property, equipment and machinery. The benefit provided by the Section 179 deduction will be significantly reduced in 2012 and bonus depreciation will revert back to 50 percent. This immediate deduction is a valuable means to reduce taxable income and a tax benefit that may not be seen again for a while.

Also, an S-corporation previously converted from a C-corporation may wish to sell appreciated property without being subject to the built-in-gains tax. During 2011, the amount of time required for a converted S-corporation to hold property without being subject to the built-in-gains tax on disposition is reduced to five years. If the S-corporation disposes of property owned for five or more years from the time of its S election through 2010 or earlier, then gain on the sale will not be subject to the additional built-in-gains tax. Further, the gain exclusion is not included in the calculation of AMT.

With respect to individuals, one thing is certain - individuals should have more cash in hand during 2011. Between maintaining the reduced tax rates and the extension of the preferential capital gain and qualified

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dividend rates, individuals will pay less tax than originally expected. In addition, employees and self-employed individuals share of the Social Security tax will be reduced from 6.2 percent to 4.2 percent, for a total rate reduction of 2 percent. The employer's portion of Social Security tax will remain at 6.2 percent. The self-employment tax will be effectively reduced from 15.3 percent to 13.3 percent.

As you can see, there are a variety of tax breaks and incentives for both businesses and individuals to take advantage of during the 2010 and 2011 tax years. As the saying goes, "All good things must come to an end," so do not delay in pursuing those provisions from which you will benefit. If you would like additional information on how these provisions impact your specific income tax situation, please contact your BrownWinick attorney.

Bridget C. Shapansky is an attorney at BrownWinick and represents clients in domestic and international business transactions, taxation and estate planning. Bridget can be reached at (515) 242-2438 or shapansky@brownwinick.com.

Our Firm Continues to Grow to Serve Your Needs

In our continuing effort to provide clients with the best possible legal services, BrownWinick continues to grow by hiring and promoting outstanding attorneys.

Bridget C. Shapansky joined our firm as an associate in December. Bridget received her B.A. in Accounting from the College of St. Benedict/St. John's University, St. Joseph, Minnesota in 2001; her J.D., with a business law concentration, in 2004 from Gonzaga University School of Law in Spokane, Washington. In 2005, Bridget graduated, *with honors*, from Northwestern University School of Law, Chicago, Illinois, with a Masters of Law in Taxation.

Bridget will provide legal services primarily in the areas of domestic and international business transactions, taxation, non-profit organizations and estate planning.

Prior to joining BrownWinick, Bridget was most recently employed as Associate Corporate Counsel at Kirke Financial Service. Prior to serving as Associate Corporate Counsel, she worked in the international corporate and federal tax areas at KPMG, LLP and was in private practice focusing primarily on tax and business law.

Matthew H. McKinney joined our firm as an associate in December. Matthew graduated from the University of Iowa in 2004, receiving his B.A. in Political Science and the University of Iowa Business School's Certificate in Entrepreneurship. Matthew received his J.D., *cum laude*, from Creighton University School of Law, while also earning certificates of concentration in litigation and criminal law and procedure.

Matthew focuses his practice primarily in the areas of commercial and civil litigation, which includes but is not limited to: complex-litigation, intra-corporate disputes and derivative actions. Matthew's diverse range of business litigation experience has included an array business tort and related claims. You can learn more about Matthew's legal practice by reviewing his blog at **http://corporatedispute.com**.

Prior to joining BrownWinick, Matthew worked with Tiffany & Bosco, P.A., in Phoenix, Arizona as an associate attorney and is also a former prosecutor, serving the State of Iowa as an Assistant Polk County Attorney.

Rachel T. Rowley was named a member at BrownWinick as of January 1, 2011. Rachel joined BrownWinick as an associate in November of 2007. Her practice focuses primarily in the litigation area.

RED FLAGS RULE UPDATE

The Exemption of Service Providers

by Rebecca Brommel

On December 18, 2010, President Obama signed legislation intended to exempt lawyers, health care providers, accountants and other service providers from having to comply with the Red Flags Rule. For those still covered by the Rule, the Federal Trade Commission began enforcement of the Rule on January 1, 2011.

The Red Flags Rule, which is aimed at detecting and combating identity theft, originally contained a broad definition of the term "creditors." This broad definition swept service professionals under the requirements of the Rule, even though these professionals generally do not offer or maintain accounts that pose a reasonable risk of identity theft.

The "Red Flag Program Clarification Act of 2010" or Public Law 111-319 contains a more narrow definition of the term "creditor." Upon the signing of the Red Flag Program Clarification Act, creditors are defined as organizations that, in their regular course of business, do one or more of the following: (1) utilize consumer reports in connection with a credit transaction; (2) furnish information to consumer reporting agencies in connection with a credit transaction; or (3) advance funds to or on behalf of a person, where the person has an obligation to repay, or the funds are repayable from specific property pledged. If you do not fit into one of these categories, you no longer need to develop a Red Flags Rule compliance program.

Rebecca A. Brommel is a member of BrownWinick who practices in the areas of business and commercial litigation, healthcare litigation and administrative law. Please contact Becki at (515) 242-2452 or brommel@brownwinick.com or your BrownWinick attorney if you need assistance in determining whether you are subject to the Rule and/or how to comply with the Rule.

NOTE: *The Legal Monitor* will be transitioning to e-mail distribution of the newsletter in 2011. We are hoping to have this project completed by the May edition. If you would like to make sure you are on the e-mail list, please e-mail DJB@brownwinick.com with your e-mail address with "Newsletter" in the subject line.