

IGDB LEGAL UPDATE

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FALL 2010

UNCERTAINTY REGARDING TAX LAW CHANGES IN 2011 — WHAT TAXPAYERS SHOULD BE AWARE OF

By David N. Milner, Esq.

AS 2010 DRAWS TO A CLOSE, TAX PLANNERS AND THEIR CLIENTS ARE FACED WITH UNCERTAINTY — WILL THE SO-CALLED “BUSH ERA TAX CUTS” BE ALLOWED TO EXPIRE ON DECEMBER 31ST? IF THEY ARE ALLOWED TO EXPIRE, MOST TAXPAYERS WILL BE FACED WITH AN INCREASED TAX BURDEN BEGINNING IN 2011.

All told, there are some 70 federal tax provisions that are scheduled to expire. Principal among the changes that will take place if Congress does not act before the year end are:

- The current income tax rates of 10%, 15%, 25%, 28%, 33% and 35% will be replaced and increased to rates of 15%, 25%, 28%, 36% and 39.6%.
- The income tax rate at which most taxpayers pay income tax on long term capital gains will increase from 15% to 20%.

- Dividend income will be taxed at ordinary income tax rates.
- The gift tax rate will increase from the current 35% rate on cumulative taxable gifts which exceed \$1 million to a rate which will be determined using the unified transfer tax rate schedule.
- The estate tax rate will be determined using the same unified transfer rate schedule, with the result that cumulative taxable transfers made by a taxpayer, whether made as a gift during his or her lifetime (in excess of the

permitted annual exclusion) or which occur as a result of their death, which exceed \$1 million, will be taxed on a graduated rate schedule beginning at 41%, increasing to 50% for cumulative transfers made in excess of \$2.5 million. (Cumulative transfers of less than \$1 million, while technically taxed, are protected by the application of a unified credit). In addition, the estates of the very wealthy will again be subject to a 5% surcharge.

- The carryover basis rules permitting executors to increase the tax basis of property inherited by up to \$1.3 million will end. Taxpayers who inherit property from a decedent will be required to use the value of the property on the decedent's date of death (or on the alternative

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BANKRUPTCY — WHAT ARE YOUR RIGHTS WHEN SOMEONE WHO OWES YOU MONEY FILES FOR BANKRUPTCY

By Mark B. Brenner Esq.

THE FILING OF A BANKRUPTCY CASE AUTOMATICALLY STAYS (STOPS) MOST CREDITOR LAWSUITS AND OTHER COLLECTION EFFORTS AGAINST THE DEBTOR UNTIL THE CREDITOR OBTAINS PERMISSION OF THE BANKRUPTCY COURT TO PROCEED.

Notable examples of actions unaffected by the stay include the enforcement of criminal fines and penalties and the collection of child support and spousal maintenance.

Ignoring this automatic “stay” of collection efforts may result in an order of contempt and monetary damages against the party who violates the stay.

However, the automatic stay is not limitless and it does not grant the debtor the right to abuse the bankruptcy code or ignore creditors' rights. By disregarding the limits of the automatic stay and taking no action following the debtor's bankruptcy filing, a creditor often risks multiplying its losses.

The debtor has a continuing obligation to make full disclosure of his or her assets and liabilities during the bankruptcy proceeding. All the debtor's disclosures must be made “in good faith.” The debtor starts with a clean slate on the date of filing for bankruptcy. However, the debtor must pay rent for periods after the filing and must pay for goods and services “post-petition,” meaning after the bankruptcy filing.

A debtor's obligation to pay pre-petition rent arrears after bankruptcy filing largely depends on two factors. The first is whether the debtor

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PIERCING THE CORPORATE VEIL—NOT SO FAST

By Randy J. Heller, Esq.

IN THE MIDST OF THIS ECONOMIC DOWNTURN, THE CONSTRUCTION INDUSTRY HAS TAKEN IT ON THE CHIN. Even long-standing, venerable companies have fallen on hard times. Frequently, owners or general contractors become unable to pay their obligations. And when there is no payment bond, or the time to file a mechanic's lien has lapsed, many contractors have been confronted with the bleak prospect of having to walk away empty handed or sue a defunct corporation. While the trust fund provisions of the Lien Law can sometimes impose personal liability, those sections are often unavailable.

...a mere breach of contract cannot form the basis for piercing the corporate veil, but the occurrence of fraud...might meet the test.

At that point we are usually asked about the viability of "piercing the corporate veil"—that is, seeking to recover personally from the individuals who own the company, rather than the company itself. But this option is usually more difficult than is popularly believed.

The general rule is that a corporation exists independently of its owners, who are not personally liable for its obligations, and that the individuals may incorporate for the express purpose of limiting their personal liability. One seeking to pierce the corporate veil and to impose personal liability on the owners of

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continues to occupy the leased premises. The second is whether the debtor will assume or reject its lease and its corresponding obligations. Assuming the debtor seeks to keep its lease, the debtor must pay arrears arising pre-petition and pay his post-petition rent and additional rent when it comes due. If the debtor rejects its lease and vacates the leased premises, the debtor's obligations to pay rent under the lease will end and rent arrears will likely be subject to discharge upon completion of the bankruptcy case.

Bankruptcy strategies for both debtors and creditors often depend upon the type of bankruptcy the debtor chooses when filing his case. The following is a summary of the different types of bankruptcy proceedings.

A Chapter 7 bankruptcy is a liquidation proceeding. Typically, though not always, the debtor is an individual who seeks to discharge his pre-petition "general unsecured obligations," such as credit card debt, and retain all of his post-petition income. If the debtor is an individual with primarily consumer obligations, meaning obligations incurred for a personal, family or household purpose, and the debtor's income exceeds the median income for his family unit's size in the state of his residence, the debtor must pass a "means test" established by Congress before he can file a Chapter 7

case "in good faith." If the debtor fails the means test, his Chapter 7 case can be dismissed (unless a bankruptcy court finds that there are special circumstances to allow the filing to continue) or converted to a Chapter 13 case, sometimes referred to as a wage earner's or a debt adjustment proceeding.

Essentially, a debtor who wishes to continue in residence and retain the benefits of his lease must pay pre-petition rent arrears and post-petition rent as it comes due.

Because a debtor cannot assume a lease or continue to occupy the leased premises unless he cures his pre-petition lease defaults, most individual Chapter 7 debtors try to stay current with their landlord. Since a debtor cannot keep his lease and not pay arrears, the debtor's incentive to pay the landlord is comparatively high. If the debtor owes rent on the date of filing, the landlord is a secured creditor to the extent it holds a security deposit. Essentially, a debtor who wishes to continue in residence and retain the benefits of his lease must pay pre-petition rent arrears and post-petition rent as it comes due.

A Chapter 13 bankruptcy is a debt adjustment plan for individuals with regular income who

owe not more than \$1,081,400 in secured debt and not more than \$360,475.00 in general unsecured debt. In Chapter 13, a debtor adopts a plan to pay off past debts gradually from future income and may take up to 5 years to pay arrears owed to a landlord, so long as the debtor pays future rent when due.

A Chapter 11 bankruptcy, typically filed by businesses, provides for the adoption of a reorganization plan to allow the debtor to reorganize its affairs and pay off some, but usually not all, of its creditors. Occasionally, individuals file a Chapter 11 bankruptcy if they exceed the debt limitations applicable to Chapter 13.

Because a bankruptcy case must conform to the provisions of the bankruptcy code and extensive case law that interprets it, a bankruptcy filing does not conclude the debtor's responsibility to his creditors. Interested parties should make the effort to compile complete and accurate records of the debtor's obligations and seek the assistance of experienced counsel to protect their rights.

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TAX LAW CHANGES (CONTINUED)

valuation date if the executor elects to use such date for purposes of valuing the assets owned by the decedent for federal estate tax purposes) as their basis for determining gain or loss or computing depreciation, regardless of what the decedent's tax basis may have been.

- The American Opportunity Tax Credit, which allows qualifying individuals who attend college to claim a tax credit of up to \$2,500 for the cost of tuition and related expenses, will end.
- The dollar limit on expenses qualifying for the dependent care credit will be reduced from \$3,000 to \$2,400, and the applicable credit percentage will be reduced from 35% to 30%.
- The Nonbusiness Energy Property Credit, which allows individuals to claim a non-refundable credit on qualified energy efficiency improvements made to a taxpayer's principal residence, will end.
- The exclusion from gross income for individuals on account of services rendered as a member of a qualified volunteer emergency response organization will be eliminated.

CONGRESS HAS RECENTLY ADDRESSED CERTAIN PROVISIONS THAT OTHERWISE WOULD HAVE BEEN ELIMINATED.

- The exclusion of gain resulting from the sale of qualified small business stock held for more than five years acquired between February 18, 2009 and December 31, 2010 was scheduled to be reduced from 75% to 50%. Under the Small Business Jobs Act of 2010, taxpayers

will be able to exclude 100% of the gains realized on qualified small business stock acquired after the date of the enactment of the act, September 27, 2010, and before January 1, 2011. Whether this provision actually serves to benefit many taxpayers remains to be seen.

- In 2010 and 2011, taxpayers will be able to claim a current deduction under Section 179 of the Internal Revenue Code for up to \$500,000 of qualifying property. This amount had been \$250,000 for 2010 and was scheduled to be reduced to \$25,000 beginning in 2011. The definition of qualifying property has also been modified to include qualified real property such as leasehold improvements subject to a \$250,000 limitation.

CONGRESS HAS ENACTED OTHER LEGISLATION WHICH TAXPAYERS MUST BE AWARE OF.

- Buried in the 2,409 page Health Care bill is a requirement that all businesses send a Form 1099 to every company or individual from which they purchased more than \$600 of goods and services.

Cautionary Note — Congress and the Administration are currently attempting to reach a compromise which may result in some or all of the Bush Era Tax Cuts being extended, albeit for a limited period of time.

Congress and the Administration are currently attempting to reach a compromise which may result in some or all of the Bush Era Tax Cuts being extended, albeit for a limited period of time.

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Construction, Suretyship and Litigation

PIERCING THE CORPORATE VEIL (CONTINUED)

the corporation must first demonstrate that the owners “exercised complete domination over it in the transaction at issue.”

But demonstrating “domination” by the owners is not enough. A creditor must demonstrate other factors as well.

Among those factors is whether the owner has “failed to adhere to corporate formalities;

inadequate capitalization; commingling of assets; and the use of corporate funds for personal use.” It must be shown that the owner “abused the privilege of doing business in the corporate form.” A creditor must show that the owners engaged in a level of bad faith reflected in the commission of torts or predatory acts. For example, a mere breach of contract cannot form the basis for piercing the corporate veil, but

the occurrence of fraud (such as by stripping the assets of the corporation so as to render it judgment-proof) might meet the test.

To pierce the corporate veil, court decisions state that a creditor has “a heavy burden” to prove its right to such relief. Can it be done? Yes, in the right situation. But it is not the panacea which it is commonly believed to be.

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