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TABLE OF CONTENTS

Article 9 Sales: Another Opportunity For Your Business in the Downturn

By: Donald R. Geiter, CIPP/US

Last year, in our "Summer 2009: Business and Litigation Update," we reported on Fiat's purchase of bankrupt automotive manufacturer, Chrysler, in a so-called "363 Sale" (in reference to the applicable section of the United States Bankruptcy Code, Section 363). In that article, we walked prospective buyers through some the basic requirements of a 363 Sale. While a 363 Sale affords a relatively quick avenue for a prospective buyer to purchase assets of a distressed company free and clear of liens and encumbrances, there is an alternative, known as an "Article 9 Sale" (in reference to Article 9 of the Uniform Commercial Code, which governs the rights of secured parties).

A secured creditor (often a bank or some other financial institution) may arrange an Article 9 Sale in cooperation with a prospective buyer. The simplicity, speed and relative lack of expense involved are the major advantages of an Article 9 Sale over a 363 Sale. The catalyst for an Article 9 Sale is the distressed company's default on its loan with the secured creditor. Once the secured party has taken default action required by its credit agreements with the distressed company, the secured party may proceed to a sale of assets representing its collateral. Often this decision is made with the cooperation of the prospective buyer.

The basic requirements for an Article 9 Sale are few:
1) timely notice to "interested parties" (which includes the distressed company, any guarantors, and any other junior secured parties), and
2) the sale is concluded in a "commercially reasonable" manner.

Typically, the secured creditor or an auctioneer conducts the sale, in the form of a private or public sale. Unlike a 363 Sale, neither the sale nor its terms need to be approved or confirmed by court action. Also, an Article 9 Sale does not require the distressed company to file for bankruptcy. Instead, the Uniform Commercial Code simply mandates that all aspects of the sale (i.e., the method/manner of sale, time, place and other terms) must be "commercially reasonable."

If timely notice is not provided to interested parties or if it can be demonstrated that any aspect of the sale led to a reduction in the value of the assets sold, the sale may be challenged by any interested party and possibly subject the buyer to entanglement in a lawsuit. Therefore, as a prospective buyer in an Article 9 Sale, it is important to confirm that the sale is completed in strict compliance with the requirement of the Uniform Commercial Code. To confirm this, you and your counsel should obtain and review the following:

• the security agreement that creates the security interest, the financing statement filings which perfected the security interest and the documentation evidencing the debt;

• evidence that the secured party was entitled to enforce the security interest;

• written notice of default from the secured party to the distressed company (and proof of receipt);

• a UCC lien search against the distressed company;

• "notification of disposition" sent by the secured party to the distressed company and each interested party;

• if the assets were purchased at auction sale, documentation from the auctioneer that the sale took place on a given date under the auctioneer's standard procedures and that the buyer made the highest bid for the collateral;

• a copy of any waiver of notice and other rights by the distressed company in connection with the sale of the assets; and

• information regarding the value of the assets, including any recent appraisal of the assets.

A smooth Article 9 Sale is largely dependent on the cooperation of all parties involved, including the distressed company. A distressed company with a complex debt structure may increase the risk of challenge to the Article 9 Sale and impact the most important benefits of an Article 9 Sale -- simplicity, speed and expense Further, certain assets not covered by the secured party's lien or under the Uniform Commercial Code (for example, real estate) may require a separate agreement or judicial action to transfer all assets necessary for the buyer to conduct the distressed company's business. Nevertheless, properly planned and structured, prospective buyers should consider an Article 9 Sale as a viable acquisition strategy. However, you should seek the advise of experienced counsel to guide you through the process. If your business is interested in learning more about Article 9 Sales or needs assistance in structuring an Article 9 Sale, please contact Don Geiter.

Back To Top

Technology Licensing: A Cost Effective Way for Small and Mid-Size Businesses to Commercialize Technology and G

By: Andrew L. Ney

What is *technology licensing*?

Simply put, technology licensing is the buying and selling of technology in a well-defined and effective manner. One party has knowledge concerning a specific technology or the legal rights to a specific technology and another party wishes to acquire such knowledge or legal rights.

Either party can initiate the technology buying/selling process. If a deal is made, the party selling the knowledge or legal rights is known as the "licensor" and is "licensing-out" the technology, and the party buying the knowledge or legal rights is known as the "licensee" and is "licensing-in" the technology. A technology licensing arrangement is very similar to a real estate lease by which the landlord (i.e., the licensor) gives the tenant (i.e., the licensee) the legal right to occupy the premises in return for rental payments by the tenant to the landlord or a real estate sale by which the seller transfers to the buyer ownership of the real estate in return for the price paid by the buyer to the seller. Thus, the term "licensing" includes both outright sales of technology or rentals of the technology. Because licensing (or renting) of technology was the more common form of such transactions early on, the word "licensing" has stuck in characterizing these business arrangements. Many individuals involved with such business deals refer to this business activity as *technology transfer*.

In everyday usage, the word "technology" refers to a body of knowledge that deals with applied science. Simply put, technology is the business of putting science to work.

The word "technology" takes on an additional meaning when used in connection with the word "licensing." The form in which the technology exists and the legal status of the technology are as important as the particulars of the technology. Is the technology documented or only in someone's head? Can the technology be communicated? Is the technology widely known and, therefore, available from many sources? Is the technology covered by a patent or the subject of a trade secret and, therefore, available from only one source? The answers to these questions bear upon not only the pricing and other terms of the prospective license but also on whether the deal should be done at all.

Why be interested in *technology licensing*?

A licensor often is prompted to license-out to derive income in the same way that a landlord rents real estate. This is the purpose of individuals, academia, research institutions and manufacturers that possess by-product technologies that are not applicable to their established product lines or services. At times, manufacturers license-out because they cannot, alone, fully satisfy the demands of their markets with their products or services (e.g., foreign markets, inadequate capacity). Rather than letting these markets remain unexploited, manufacturers license-out to others, even to competitors, and receive income from the licensees. Also, the technology of a manufacturer can serve as the contribution to a joint venture with another party. Certain customers, notably car and plane manufacturers, impose multiple-sourcing requirements on suppliers before the supplier's product is designed into the customer's products.

Manufacturers often are prompted to license-in to diversify or to expand a product line. The licensing-in option, of course, must be compared with the alternatives of a business acquisition or a sales agreement or internal development, any one of which can produce the desired diversification or product-line expansion, to determine which approach is best. Manufacturers also acquire rights to technologies that improve their methods of manufacture.

What is the *technology licensing* process?

Things get started when one party, be it the prospective seller of the technology or the prospective buyer of the technology, decides that technology licensing is the way to proceed to achieve a desired business objective. The party starting the process must determine why another party, not yet identified, would be interested in a technology license. Understanding how the other party will benefit from a technology license serves three purposes. First, it impacts on the decision to go forward or to drop the matter. Second, it provides the basis for presenting and selling the opportunity to the other party. Third, it is likely to identify the other party or parties.

After the merits of the prospective deal have been developed and the other party has been identified, the "selling of the deal" experience begins by presenting the details of the opportunity to the other party. If there is mutual interest, the parties negotiate the terms of the deal, a contract is drafted and signed, and, hopefully, the parties live happily ever after.

Responses to two myths about *technology licensing*

"Technology licensing is useful only when dealing with high-tech." While most of the notoriety today about advances in technology is concerned with high-tech and there is very significant licensing of high-tech developments, there is significant ongoing research and development in technical fields that are considered medium-tech and low-tech and significant technology licensing of low-tech and medium-tech developments.

"Technology licensing is a sophisticated form of doing business that is best conducted by large companies with super-sophisticated managements and systems." If you have read this far, you already appreciate that technology licensing is very similar to many other business deals. Although there are many differences between implementing a technology license and implementing some of the other more common business deals, a businessperson who has succeeded in doing these other more common deals in his or her successful management of a business should not be fearful of being interested in technology licensing as a cost effective way to commercial technology and grow.

Back To Top

Does a Tax Appeal Make Sense For Your Business?

By: Daniel M. Frey

In today's economic environment, your property, whether residential, commercial or industrial, may be over-valued for tax purposes, which means that you may be paying more than your fair share of real estate taxes. Because property values have dropped throughout Pennsylvania, now is an excellent time to re-examine your property tax assessment and possibly realize some significant savings in real estate taxes.

>Your property's assessed value is different from its appraised value. The appraised value determines the fair market value of the property. The assessed value is the figure, determined by your county's Assessment Office, which is used to determine your real estate taxes. While your property's appraised value may change every year, your property's assessed value remains fixed until:1) the county conducts a county-wide reassessment;
2) you make significant improvements to the property; or
3) you appeal your assessment.

Thus, if your property's assessment is too high (either because it was originally assessed too high or because of a decrease in your property's value), you are paying more than necessary in real estate taxes every year that the assessment remains the same. County-wide reassessments usually occur only once or twice a decade, although in some counties, a county-wide reassessment has not occurred in over 20 years. So it is wise to reexamine your assessment every few years to make sure you are not paying too much in taxes. For example, currently in York County, a property's assessed value should be approximately 78.5% of the fair market value. So, if you own a commercial property assessed at $1 million, your property is being taxed as though its value is approximately $1,272,264.60.

You are entitled to appeal your property tax assessment every year if you believe the assessment is higher than it should be. The costs involved in an appeal are often far less than the total savings you will realize if your appeal is successful (especially for larger commercial or industrial properties). In today's economy, when many property values have declined, considering a tax assessment appeal will make sense for many property owners. In most cases, the only costs involved in an appeal are an appraisal of your property and legal fees.

Several steps are involved in determining whether an appeal is appropriate:1. Estimate the value of your property (or consult a recent appraisal).
2. Multiply the estimated fair market value of your property by the common level ratio[1]

For example, for a property located in York County with a current fair market value of $1,000,000, you would multiply $1,000,000 by .785 (the York County common level ratio) to determine that the assessed value for 2010 should be $785,000. If this amount is significantly lower than your current property tax assessment, you may want to consider challenging that assessment. If you are unsure what the current assessed value is for your property, you can check your most recent property tax bill or consult with your County's Assessment Office.

Any reduction in the assessed value of the property will likely result in tax savings for you, not just in the current year but in future years as well, as this assessed value will remain in place until the property is reassessed. To estimate how much in annual savings you could realize, multiply your local millage rates by the difference between your current property tax assessment and what you determine the assessment should be. For example, if the combined millage rates in your municipality (school, county and municipal millage rates) are 25 mills (or 2.5%), you would save $2,500 per year for every $100,000 that you reduce your property's assessment. Millage rates for your county are available on your county's Assessment Office website.

If you are interested in exploring whether or not a tax assessment appeal makes sense for your business, our firm has a team of attorneys experienced in handling tax assessment appeals throughout Central Pennsylvania. We will review the analysis with you to determine whether or not pursuing an appeal would be appropriate in your situation.

[1] The common level ratio is a percentage, determined every year by the state, which accounts for the difference between the Assessed Value in a county and the current fair market values in the county. This number varies from county to county and can be found by going to http://www.steb.state.pa.us/commonmain.asp.

Back To Top

Charitable Boards: Serious Inquiries Only

By: Kimberly J. Decker

Being a member of the board of directors or trustees of a non-profit organization can be a very rewarding way to serve the community and aid a good cause. Too often, however, well-meaning people enthusiastically jump onto the board of a non-profit without really understanding their responsibilities to the organization as well as the responsibilities of the organization to the public. Board service on a non-profit is every bit as serious as board service on a for-profit corporation. In addition, the IRS has been taking careful note of the corporate governance developments in the for-profit world and they are, not surprisingly, filtering down to the non-profit world. Non-profit corporate governance practices are under the microscope, and it is more important than ever that a non-profit board member understand the ramifications of how a non-profit is organized and makes decisions.

In 2008 the IRS revised its Form 990, adding a whole host of new questions about corporate governance, including director independence, handling of conflicts of interest, code of ethics and executive compensation. The Form 990 addresses many of these topics by simply asking whether corporate governance policies exist for various topics or not. On the face of it, such a question seems innocuous enough - but the Form 990 is a publicly available document, and a non-profit answering that it does not have various corporate governance policies in place may be viewed as lacking professional management, financial integrity or accountability.

Director Independence: Form 990 requires an organization to indicate how many members of its governing body are "independent". Directors are independent according to the IRS definition if they are not compensated as an officer or employee of the organization or a related entity, receive total compensation or other payments of $10,000 or less from the organization, and neither the board member nor any family member was involved in an "interested person" transaction with the corporation.

While the IRS does not require a certain proportion of a non-profit's board members to be independent, it does recommend that a majority of directors be independent when possible. Generally speaking, its a best practice to have at least a majority of independent directors when possible. It is also a best practice to document board and committee meetings in a timely manner and to determine whether directors are independent annually through use of an annual disclosure requirement for directors to disclose events and compensation that could affect independence.

Conflicts of Interest: Form 990 asks whether a written conflict of interest policy exists. A corporation may not answer yes to this question unless the policy addresses, at a minimum, all of the following four areas: how conflicts are defined, to whom the policy applies, the method for facilitating disclosure of information that may help identify conflicts and the procedures to be followed to manage conflicts. If such a policy exists, the corporation must disclose whether, in fact, officers, directors, trustees and key employees must disclose annually any interest they have that could give rise to conflicts. Also, the corporation must state whether it regularly and consistently monitors and enforces compliance with the policy and how it does so.

Best practices in this area include:

- requiring annual disclosure by board members of potential conflicts;
- prior independent board member review and approval of all related party transactions; and
- establishing and enforcing a written policy on conflicts of interest.

Code of Conduct: The IRS "encourages" non-profit corporations to adopt and regularly evaluate a code of ethics. Such a code should define acceptable behavior and the organization's expectations for conduct. Form 990 requires a corporation to state whether a written whistleblower policy exists that encourages reporting, specifies that the organization will protect whistleblowers and identifies those individuals to whom information can be reported.

Having a code of conduct is, obviously, a best practice. In addition, the code should be in writing and prohibit retaliation against whistleblowers as well as preventing document destruction in the face of an investigation. Another best practice is to designate a board committee or other group comprised of independent persons to receive whistleblower reports.

Executive Compensation: Comprehensive disclosure is required regarding the compensation paid to:

- all current officers and directors and trustees who are voting members of the board;
- current "key employees" (i.e., persons paid over $150,000 in compensation, organization-wide control or influence similar to an officer, director or trustee or had authority over at least 10% of the organization's activities or was within the group of the organization's top 20 highest paid employees);
- the five most highly compensated employees other than officers, directors or trustees with compensation over $100,000;
- former officers, key employees and highest compensated employees with compensation over $100,000; and
- former directors and trustees with compensation over $10,000.

In addition, Form 990 requires a company to disclose its process for determining the compensation for its chief executive officer. Form 990 also requires a company to disclose whether or not its compensation determination process takes into account the IRS' "reasonable compensation" factors. Compensation is rebuttably presumed to be reasonable where:

- it is reviewed and approved by independent persons;
- the decision makers use data regarding comparable compensation paid to executive in similar positions; and
- the deliberations and decisions regarding executive compensation are documented contemporaneously (i.e., minutes are taken).

Best practices in the executive compensation area include forming a compensation committee made up entirely of independent directors or trustees with an established charter that details the committee's authority, purpose and the company's compensation philosophy. Another best practice includes complying with the IRS' rebuttable presumption of reasonableness. The company's chief executive officer should never be present during deliberations regarding his or her compensation, although the CEO may provide input on other executive officers' compensation. Finally, best practices also include giving the committee authority to hire outside consultants, as needed.

One size does not fit all in the non-profit corporate governance arena, and neither do the best practices described above. Best practices are not practices required by law - they reflect the current thinking about the best possible set of procedures, all things being equal. However, each non-profit organization needs to tailor its corporate governance based on factors like its size, industry, resources, business sophistication, nature of its tax exempt status and other unique characteristics of its mission and sponsorship.

Back To Top

Federal Estate Tax: Here Today, Gone Tomorrow

By: Randy R. Moyer

By now, you may have heard or read that the federal estate tax laws have changed dramatically in 2010. In fact, as of January 1, 2010, there is no federal estate and generation-skipping transfer taxes. But don't get too excited because the repeal of these taxes is not permanent. Here today, gone tomorrow.

These changes were part of the 2001 Tax Act. In previous years, the 2001 Act gradually increased the amount that could be excluded from estate tax and generation-skipping transfer tax. By 2009, these exclusion amounts reached

$3.5 million. At the same time, the top tax bracket for estates and generation-skipping transfers was reduced from 55 percent to 45 percent. The federal gift tax remains, but the top marginal tax rate has been reduced to 35 percent for transfers made in 2010.

The 2001 Act is set to expire at the end of this year. As a result, unless Congress acts in 2010, pre-2001 law will govern the federal estate and generation-skipping transfer taxes beginning in 2011, resulting in the reinstatement of both taxes with an exclusion amount of only $1 million and a top tax rate of 55 percent. The federal gift tax rate also will return to 55 percent.

Most legal and financial professionals were surprised and disappointed that Congress failed to act before the end of 2009 to resolve the uncertainty surrounding the estate and generation-skipping transfer taxes. Some believe that Congress may soon act to reinstate the taxes retroactively to January 1, 2010. Others believe that tax legislation resolving these issues will be enacted only after the fall elections and will not involve retroactive reinstatement for 2010.

In addition to the repeal of the federal estate tax, tax law changes in 2010 introduce the concept of "carryover basis" for capital assets owned at death. In the past, assets owned by a person at death received an income tax basis equal to date of death value so that unrealized capital gains accrued during lifetime were eliminated - commonly referred to as a "step-up" in basis. In 2010, the deceased person's basis in his or her capital assets and any unrealized gains will carry over to the heirs. The personal representative for the person's estate may, however, allocate a basis increase of up to $1.3 million for assets passing to non-spouse heirs. Assets passing to a spouse may receive a basis increase of up to $3 million. These 2010 carryover basis rules require the personal representative of the estate to ascertain the deceased person's basis (typically the purchase price) in the estate's capital assets. If basis is unknown, the IRS presumes the basis is zero.

In the meantime, it is important to consider how all of these changes may affect your current estate plan. The majority of tax-oriented wills and trusts for married couples minimize taxes with a formula that uses the estate and generation-skipping transfer tax in effect at death. These formulas work fine when there are estate and generation-skipping transfer tax exclusions in place, but may not work when the exclusions no longer exist. In other words, because the language used in tax formula clauses derives its meaning from tax laws that are not in effect, it is uncertain how that language will be interpreted. For example, the following unintended results could occur without court intervention:

• Disinheritance of Spouse. Although most estate plans allow the surviving spouse to benefit from all of the deceased spouse's assets, some estate plans may leave the entire tax exempt amount to or in trust for children or other beneficiaries with the balance passing to the surviving spouse. Since there is no federal estate tax in 2010, all property passes exempt from tax, which could result in the entire estate bypassing the surviving spouse.

• Disinheritance of Grandchildren.Gifts to grandchildren under a will or trust may be based on a formula that references the generation skipping transfer tax exemption, which currently does not exist. Depending upon the interpretation of that language, the grandchildren might be left nothing or, they might inherit everything.

While it is important to consider the impact of the tax law changes, the need to make revisions to your estate planning documents may be rendered unnecessary by Congressional action this year or Congressional inaction in 2011. Here today, gone tomorrow, or is it gone today and here tomorrow?

Back To Top

Tax Credit Under New Health Care Law Available to Small Businesses Beginning on 2010

By: Mark A. Smith

To encourage small employers to offer, or continue offering, health care coverage to their employees, the recently enacted Patient Protection and Affordable Care Act (PPACA) creates a new federal tax credit that will help such employers cover part of the employer cost of the coverage. Even though tax-exempt employers generally have no federal tax liability against which to claim a tax credit, special rules under PPACA nevertheless make this new tax credit available to small, tax-exempt employers that are described in one of the Internal Revenue Code Section 501(c) exempt organization categories. **This tax credit is available beginning in 2010, so small tax-exempt employers can begin to benefit almost immediately if they qualify for the credit.**

What tax-exempt businesses are potentially eligible for a credit?
To be potentially eligible for a credit, the business must
(1) have fewer than 25 full time equivalent (FTE) employees for the year;
(2) have average annual wages that are less than $50,000 per full time equivalent employee; and
(3) pay all or part of the health care plan premiums for employees under a "qualifying arrangement." A qualifying arrangement, in general terms, is one where the employer pays a uniform percentage of the health care premium cost and that uniform percentage is at least 50%.

What is the maximum credit available to a small tax-exempt employer?
The maximum annual credit available for years 2010 through 2013 is 25% of the employer's premium expenses, which is the credit level that can be claimed by an employer with 10 or fewer FTE employees and average annual FTE wages of $25,000. As the number of FTE employees ranges from 10 to 25, or the FTE annual wages range from $25,000 to $50,000, the size of the available credit reduces proportionately. In no event, however, can the dollar amount of the credit be more than the total amount of the withheld income taxes and Medicare taxes the tax-exempt employer is required to deposit with the U.S. Treasury for the year.

How does the tax-exempt employer actually claim a credit, i.e., how does it get access to credit dollars it is entitled to receive?
The IRS has not as yet published guidance on how a tax-exempt entity is to claim and receive its credit amount. The fact that the law treats the amount of the employer's withheld income taxes and Medicare taxes as a cap on the available credit suggests the mechanism for claiming the credit may be one that allows the tax-exempt employer to hold back from those payroll deposits any credit amount it is entitled to receive. But at this point that is conjecture, and any small, tax-exempt employer that determines it is eligible for a credit must await specific IRS guidance concerning the process for receiving, or offsetting, the credit amount.

Is there as yet any published IRS guidance giving more details or examples to help a small tax-exempt employer determine its eligibility for, and the potential amount of, this tax credit?
The IRS has posted on its website 22 Frequently Asked Questions about the small business health care tax credit. These FAQs deal with both taxable and tax-exempt businesses, which are subject to somewhat different rules, but they are nevertheless a helpful resource a tax exempt employer can look to for some

further, more detailed guidance. Included are some specific numerical examples about how the available credit reduces when the FTE employee count is above 10 or the average annual FTE wage is above $25,000, how to convert part-time employees into FTE employees, and how to compute FTE average annual wages when there are part time employees. The web address for the IRS FAQs is: http://www.irs.gov/newsroom/article/0,,id=220839,00.html.

Back To Top