Weiss Berzowski Brady LLP
ATTORNEYS AT LAW

Volume 3, Issue 4 Fall 2009

The WBB Reporter

A newsletter for the clients and friends of Weiss Berzowski Brady LLP

Inside this issue

Tax

Bad debt deduction: A sign of the times

By David J. Roettgers

David J. Roettger's practice includes tax law. He can be contacted at 414-276-5800 or djr@wbb-law.com.

As a result of the poor economy, we are receiving more and more questions concerning how to take advantage of losses. One type of loss is a bad debt deduction.

A bad debt deduction is allowed for any bona fide debt that becomes worthless during the taxable year. It may seem simple but there are several considerations in determining the tax impact and the timing of the loss, including a determination of whether the debt is a business or non-business debt and when the debt became worthless.

Business or Non-business Debt

The first issue to be addressed is to determine whether the debt is a business or a non-business debt. A business debt is a debt that generally comes from operating a trade or business. All other debts are generally non-business bad debts. A business bad debt may be deducted as it becomes partially worthless or a taxpayer may wait until the debt becomes wholly worthless. A non-business bad debt can only be deducted when it is completely worthless.

Is Debt Worthless?

In determining whether a debt is worthless there are certain factors that should be considered, including: (i) has the debtor disappeared, liquidated or died? (ii) has the value of the property securing the debt declined? (iii) what is the financial condition of the debtor? and/or (iv) are there judgments against the debtor? It is important to note that a debt does not become worthless merely because the debtor decides not to enforce the obligation. The debt, based on the surrounding facts and circumstances, must be unrecoverable.

Tax Impact

The tax consequences of having worthless debt also depends on whether a debt is a business or a non-business debt. A business bad debt is deductible against ordinary income to the extent the underlying obligation becomes wholly or partially worthless during the particular tax year. A non-business bad debt is deductible only as a short term capital loss and is therefore limited to the net short term capital loss limitations and the capital loss carry-forwards.

In addition, a tax deduction is limited to the taxpayer's adjusted basis in the obligation. Therefore, a cash basis taxpayer may not be able to deduct a bad debt if income has not been recognized. For example, a cash basis taxpayer may not be able to deduct an uncollectible account receivable.

In conclusion, to determine if a bad debt deduction is allowable, your tax professional needs to evaluate the type of debt and all of the circumstances surrounding the debt. If you are planning on taking advantage of bad debt deductions, we strongly recommend you contact your tax advisor to discuss the tax affects of the bad debt and begin to document the worthlessness of the debt.•

Bankruptcy

Protecting yourself when your debtor files for bankruptcy

By Scott B. Fleming

Lending money or extending trade credit always has risk but following a few simple principles can substantially reduce that risk in the event of your debtor's business or personal bankruptcy.

Scott B. Fleming's practice includes bankruptcy litigation. He can be contacted at 414-276-5800 or sbf@wbb-law.com.

Before Filing

The best time to protect yourself from your debtor's bankruptcy is when you set up the relationship. Because secured creditors get at least the value of their collateral in bankruptcy, you should get security when extending credit, e.g. a mortgage, a security interest in personal property, an assignment of insurance proceeds, or a personal guaranty. If you cannot get collateral, establish favorable credit terms (e.g., net 30 days) and keep the debtor on those terms. If you fail to hold your debtor to the agreed terms you run the risk that you will have to return payments previously made as "preferences".

Preference law is complex but, with some oversimplification, preferences are certain transfers or payments of existing debt made within 90 days of the filing for bankruptcy or one year if the transfer or payment is made to an insider. Therefore, creditors receiving payment of old debt prior to bankruptcy might have to return the payments to the bankrupt's estate as preferences. Payments made in the ordinary course of business, that is, consistent with established credit terms, are usually not preferences and are not recoverable by the trustee.

After the Debtor Files

A business bankruptcy can be either a liquidation (Chapter 7) or a reorganization (Chapter 11), where the debtor's business continues. Filing for bankruptcy essentially creates a new business entity, operating in the short term based on income and expenses incurred after filing. Ordinary expenses of the debtor post-filing are paid as "administrative expenses" ahead of unsecured debt incurred before filing. Therefore, dealing with a post-filing debtor can be less risky than dealing with a pre-filing debtor.

The Bankruptcy Code also provides a new administrative priority for goods received by the debtor within 20 days of filing for bankruptcy and under certain circumstances a right to reclaim goods shipped to the debtor within 45 days. If these criteria are met, you can go from being an unsecured creditor likely to get pennies on the dollar to an administrative priority creditor likely to be paid in full or, under certain circumstances, get your goods back.

By following the above principles and acting promptly you can limit your exposure to a debtor's bankruptcy.•

Tax Law

Losing deductions: Does the IRS think your business is a hobby?

By Robert B. Teuber

Over the past year, the IRS has increased the number of "Hobby Loss Audits." When the IRS determines that a business should be treated as a hobby, loss deductions will be limited to the amount of income from the activity. Where a hobby exists, losses from the activity cannot be used to offset other income on a tax return. This means that, if the IRS audits three years of tax returns, prior year losses that exceed the income will be denied and the tax due in those years could increase tremendously together with penalties and interest.

Robert B. Teuber's practice includes tax law. He can be contacted at 414-276-5800 or rbt@wbb-law.com.

Hobby Loss Rules

Knowing the rules concerning when an activity constitutes a "business" or a "hobby" can help in structuring business affairs to defend against a hobby loss audit. For an activity to be a business, it must have a profit motive.

The hobby loss rules outline the methods for making a determination as to whether an activity rises to the level of a business. First, there is a safe harbor rule that creates a presumption that an activity is a business and not a hobby if a profit is shown in three of five consecutive years or in two of seven years for certain horse-related businesses. This presumption can be rebutted by the IRS which is on the lookout for a manipulation of numbers. If the safe harbor rule is not satisfied, the IRS looks to the following nine factors in deciding if an activity is a business or a hobby.

Nine Factors: Business or Hobby?

1. The manner of carrying on the activity
2. The expertise of the taxpayer or advisers
3. The time and effort expended in carrying on the activity
4. The expectation that the assets used may appreciate in value
5. The success in carrying on other activities
6. The history of income or loss with respect to the activity
7. The amount of occasional profits earned
8. The financial status of the taxpayer
9. Elements of personal pleasure or recreation

How these factors are applied turns on the specific facts and circumstances, yet they can be used in planning a business operation to fight back against the assertion that an activity is not a business. It is important to mention that no single factor controls and that other factors may be considered. The mere fact that the number of factors indicating a hobby exceeds the number indicating a business, or vise versa, is not conclusive. That is, it is not a question of simply adding up how many factors fall on the hobby or business side.•

Pet Law

Who did you get to watch the dog?

By Michael M. Berzowski

It goes without saying that pets play an extremely significant role in the lives of many individuals, ranging from companion or exercise partner to positively impacting health such as lowering blood pressure; reducing stress, anxiety and depression; and accelerating recovery following hospitalization. This article addresses the issue of who will take care of your pet if you are unable to do so.

Michael M. Berzowski's practice includes general practice. He can be contacted at 414-276-5800 or mmb@wbb-law.com.

Planning for Pet's Care

It is often assumed that a family member or a close friend will undertake the responsibility for caring for your pet. Since this is not true for all pet owners, some planning may be in order to provide for the health and welfare of your pet. Planning would be particularly desirable if you live alone, have a challenging pet or multiple pets, if your pet requires special care or if you do not know anyone who would meet your standards.

Some people pursue informal arrangements which amount to a discussion resulting in an implied arrangement where an individual will assume responsibility for the pet. Besides being unenforceable, these arrangements frequently overlook the financial demands that would make custody successful.

In order to increase success, you should consider formalized planning. The first step should be preparation of an animal card that includes a photo of the pet, its location and the individual to contact in the event of an emergency. A related activity would be the preparation of more detailed instructions for the animal's immediate care if you die or become incapacitated.

Pet Trusts

There are various choices with regard to pet protection. One technique creates an enforceable lifetime or testamentary trust in favor of a human beneficiary with the trustee being required to make distributions to the beneficiary to cover the pet expenses, provided the beneficiary is taking care of the pet. Another technique would follow the Wisconsin Pet Trust Law, Wis. Stats. §701.11, which allows for the creation of an honorary trust for the benefit of the pet. The problem is that the trustee cannot be forced to use the property for the pet because honorary trusts are unenforceable. If the trustee fails to act, then a resulting trust arises in favor of the transferor's estate and a court is authorized to order the transferee to transfer the property.

There are other available courses of action and issues. This article merely scratches the surface of this subject with the goal of triggering general awareness about planning for your pet's care.•

A Letter to Readers

Changes in store for 2010

Dear Readers:

The quickly approaching new year will bring with it changes to The WBB Reporter, the newsletter published by Weiss Berzowski Brady LLP and written by its attorneys.

After three years of publication, The WBB Reporter will be revamped. The newsletter's new look will be revealed with the Winter 2010 issue in February. The column widths and typeface will change to make for easier reading. The new layout will allow for longer articles with the goal of providing more comprehensive information on the varied legal topics covered quarterly in the newsletter.

Weiss Berzowski Brady will be unveiling a new firm logo in the first quarter of 2010. That logo will grace the cover of The WBB Reporter.

Also in the new year, the firm will launch a redesigned website, which will offer improved navigation and contact pages, new multimedia features and a format that will allow us to provide the newsletter articles in searchable, full-text format instead of pdf files.

Watch for these changes in 2010.

Thank you for reading The WBB Reporter.

Sincerely,

Faymarie A.Pluskota, Editor

P.S. We'd like to hear from you. Please email comments to: reporter@wbb-law.com.

Weiss
Berzowski
Brady LLP
ATTORNEYS AT LAW

Milwaukee Office:
700 N. Water St., Ste. 1400
Milwaukee, WI 53202
P: (414) 276-5800
F: (414) 276-0458
Delafield Office:
400-D Genesee St.
Delafield, WI 53018
P: (262) 646-5812
F: (262) 646-3340

Find us on the web:
www.wbb-law.com

The WBB Reporter is a Weiss Berzowski Brady LLP publication. This newsletter is for general information purposes only and should not be construed as legal advice. Consult an attorney for interpretation and application of the law.

Subscription Information: To subscribe to the print or the electronic version of *The WBB Reporter* call 414-270-2559 or send an email to reporter@wbb-law.com

Comments? We'd like to hear from you. Send an email to the Editor: Faymarie Pluskota at reporter@wbb-law.com.

At the Firm. . .

- **Randy S. Nelson, John A. Sikora, Philip J. Miller, Dwight H. Ellis and Robert B. Teuber have been selected for inclusion on the 2009 *Wisconsin Super Lawyers* and *Rising Stars* lists.**
- **The staff and attorneys at WBB have supported a number of charitable endeavors this fall. We held a Lee National Denim Day event, which is a fundraiser in support of breast cancer research and programs, a food drive for the CH Coakley & Company Dinner on the Mayflower Food Drive benefiting Food for Families and our annual Toy Drive for The Hope House of Milwaukee.**
- **Everyone at Weiss Berzowski Brady would like to wish you:**

A Very Happy Holiday Season and a Prosperous and Healthy New Year!

Client Corner

My Home, Your Home Inc.

As one of only nine Milwaukee-based social service agencies to have been awarded accreditation from the Council on Accreditation, an independent accreditor of human service organizations, My Home, Your Home Inc. is well placed to continue serving Milwaukee's central city.

To the approximate 900 children and adults it assists annually, My Home, Your Home not only provides shelter and treatment but also care and encouragement. Through its many programs, the agency offers

Constance Palmer-Jones, is the CEO of My Home, Your Home Inc.

transitional housing at Lissy's Place to homeless/abused women and women formerly in foster care, helps severely abused and neglected children find foster homes, provides assistance to children with severe emotional and mental health needs, gives teenage boys with emotional or behavioral problems temporary shelter at AMAD's Place and helps adults seeking assistance with alcohol and drug issues find Access to Recovery.

The care, encouragement and attention given My Home, Your Home's clients is evident at Lissy's Place, where the women are not only provided housing but are also taught to develop skills to attain economic self-sufficiency. Residents are required to enroll in a job-training program or to find employment. For many women, the experience at Lissy's Place is the first time they have felt the care and compassion resembling that provided by family.

The agency was founded twenty years ago by the late Irma Walker and her husband Aubrey. They focused on improving the foster care system. Today, under the direction of Chief Executive Officer Constance Palmer-Jones, My Home, Your Home has advanced and expanded its original mission—"Bringing families hope, one individual at a time"—by successfully caring for the increased number of children and adults whose stories require them to seek shelter, treatment and care.•

—My Home, Your Home Inc. (www.myhomeyourhome.org) is a Weiss Berzowski Brady LLP client.