BURKE, WARREN, MACKAY & SERRITELLA, P.C.

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TAX LAW

Time Is Running Out On 2010 Year End Income Tax Planning

It is advisable in any year to take stock and consider tax planning before the year draws to an end. In 2010, in particular, Congress' continuing failure to resolve the current uncertainties surrounding the "Bush tax cuts" has created a profound dilemma for both individuals and businesses looking to optimize tax planning before year end. Some of the key issues and strategies to be aware of prior to the close of the 2010 year-end window of opportunity are discussed below.

1. The Bush Tax Cuts. As most everyone is aware, the 2010 tax rate applicable to both capital gains and dividend income is 15%. In the event the Bush tax cuts expire at year-end, the

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Skaters at opening night of the 2010/2011 season at the McCormick Tribune Ice Rink in Millennium Park. The Chicago Park District has ten outdoor ice rinks throughout Chicago including Grant Park and Wrigley Field. Our firm has been counsel to the Chicago Park District on many projects. Our work includes the development of Millennium Park. Skating information is available at www.chicagoparkdistrict.com.

BWM&S

FDIC Launches Full-Scale Attack on Bank Directors:

As financial institutions fail, government seeks money from former management

With bank failures piling up, the FDIC has initiated vigorous legal attacks on bank directors and officers. Reflecting the same tactics that yielded about $2.5 billion in settlements from directors and officers following the savings and loan crisis of the late 1980s, bank regulators are undertaking a full-court press against bank management.

Craig McCrohon

Aaron Stanton

However, if bank directors and officers take a few basic precautionary measures, the risks and the damages can be substantially mitigated.

First the Earthquake, Then the Tidal Wave

The tremors from the financial crisis triggered the collapse of 311 institutions and the official declaration that nearly 800

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INSIDE THIS ISSUE:

NEXT ISSUE: The firm grows again, the economy's green shoots and more.

Estate & Gift Tax Considerations: No Action Brings Significant Changes

For the past two years, we have been waiting for Congress to address the estate tax. To date, Congress has taken no action. As a result, the estate tax has been repealed for 2010 (repeal of the estate tax for 2010 was provided in the Economic Growth and Tax Relief Reconciliation Act of 2001, the "2001 Tax Act"). The 2010 repeal has created a windfall for the families of certain wealthy individuals that died this year. George Steinbrenner died with an estimated net worth in excess of $1 billion. If Mr. Steinbrenner had died in 2009, his estate would have faced a potential tax liability of more than $500 million. Dan Duncan, a Texas oil tycoon, died with an estate estimated to be worth more than $9 billion. Had he died in 2009, his estate would have faced a potential liability of more than $4 billion.

Greg Winters

While these wealthy families avoided very significant tax liabilities, the outlook going forward is not as promising for many families that have accumulated much more modest wealth. If Congress takes no action, the estate tax will return in 2011 with the same exemption amounts and tax rates that were in effect in 2001. Specifically, the exemption amount (i.e., the amount a decedent can pass free of estate tax to his or her heirs) will be $1 million. In 2009, the exemption amount was $3.5 million. Further, the top marginal rate will be 55%, versus 45% in 2009.

Most agree that an exemption amount of $1 million is too low and that it will pull too many families with relatively modest wealth into the estate tax web. However, there is no agreement as to what is an appropriate exemption amount or a top marginal rate. As a result, we continue to wait for Congress to act.

Some have facetiously stated that the best estate plan is to die prior to year-end. There are, however, several legitimate strategies individuals can utilize prior to year-end, and going forward, to reduce or eliminate their exposure to the estate tax. We summarize a few of these strategies below.

Annual Exclusion Gifts

In 2010, you may make a gift of $13,000 to any individual and certain trusts without any gift tax consequences. Married individuals may make gifts of up to $26,000. Gifts may be made outright or in trust and may be in the form of cash, securities, real estate, artwork, jewelry or other property.

While the economic downturn has hit everyone, making gifts of assets with deflated prices may prove advantageous in the long-run as you are able to remove more assets from your taxable estate without incurring a current gift tax obligation.

Giving property that you expect to appreciate in the future is an excellent way of utilizing your annual exclusion gifts because any post-gift appreciation on such property is no longer subject to gift or estate tax. While the economic downturn has hit everyone, making gifts of assets with deflated prices may prove advantageous in the long-run as you are able to remove more assets from your taxable estate without incurring a current gift tax obligation. To take advantage of your annual exclusions for 2010, gifts must be made by December 31. Gifts over $13,000 or gifts that will be "split" between spouses must be reported on a gift tax return, which must be filed in April 2011. The annual exclusion amount will remain at $13,000 in 2011 ($26,000 for married couples).

Payment of Tuition and Medical Expenses

In addition to annual exclusion gifts, you may pay tuition and medical expenses for the benefit of another person without incurring any gift or generation-skipping transfer ("GST") tax or using any of your estate or GST tax exemption. These payments must be made directly to the educational institution or medical facility. There is no dollar limit for these types of payments and you are not required to file a gift tax return to report the payments.

Lifetime Gifts Using Gift Tax Exemption

In addition to annual exclusion gifts and the payment of tuition and medical expenses, individuals are also allowed a lifetime gift tax exemption. The gift tax exemption amount is currently a flat $1 million and is scheduled to remain at that level through 2011. Many clients make use of their $1 million lifetime exemptions by gift strategies such as grantor retained annuity trusts, qualified personal residence trusts and other techniques that leverage the use of the exemption. Again, a gift of appreciating property during your lifetime removes all future appreciation from your taxable estate at your death.

Taxable Gifts

In prior years, we rarely recommended individuals make gifts that would generate a current gift tax obligation. However, 2010 presents an exception to this rule. In addition to repealing the estate tax for 2010, the 2001 Tax Act also reduced the gift tax rate for 2010 to 35%. In 2011, the highest marginal gift tax rate will be 55%. For those individuals with substantial estates who will be subject to estate tax regardless of the exemption amount, they may want to consider making taxable gifts in 2010 to move assets out of their estates at a reduced rate.

Generation Skipping Tax

In addition to repealing the estate tax, the 2001 Tax Act also repealed the GST tax for 2010. Generally, the GST tax applies to lifetime and death-time transfers to or for the benefit of grandchildren or more remote descendants. The tax is in addition to any gift or estate tax otherwise payable. The GST tax exemption amount for 2009 was $3.5 million. In 2011, the exemption amount will be approximately $1.35 million (indexed for inflation).

The repeal of the GST tax for 2010 provides additional incentive for individuals to make taxable gifts in 2010. By making taxable gifts to grandchildren and more remote descendants in 2010, the individual not only takes advantage of the reduced 35% gift tax rate, but they also avoid the GST tax altogether.

Take Advantage of Today's Low Interest Rates

Interest rates remain at historically low levels. Low interest rates enhance the benefits of several gift and estate planning strategies. One such strategy is the "grantor retained annuity trust" or GRAT. A GRAT is an irrevocable trust to which a donor transfers property and retains the right to receive a fixed annuity for a specified term. At the expiration of the term, the property usually passes outright or in trust for the benefit of descendants or other named beneficiaries. The amount of the gift resulting from the transfer of the property to the GRAT is the present value of the remainder interest that passes to the beneficiaries at the end of the term. Under the valuation methods adopted by the IRS, the lower the interest rate at the time of the gift, the lower the present value of the remainder interest and the smaller the amount of the gift that must be reported to the IRS. Interests in closely held family businesses or marketable securities with high growth prospects are often ideal properties to transfer to a GRAT.

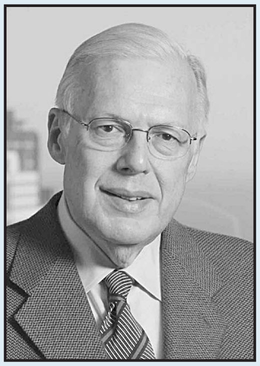
Low interest rates also make sales to "defective" grantor trusts more attractive. Under this strategy, a taxpayer creates a trust, typically for his or her spouse and descendants. The taxpayer then sells assets to the trust taking back a note requiring the trust to repay the taxpayer in installments. The trust is structured so that it is ignored for income tax purposes, resulting in no income tax consequences upon the sale. The interest paid on the note is typically at the applicable federal rate, published for the month of the sale. The lower the interest rate on the note, the greater the amount of assets that will accumulate in the trust free of estate, gift and GST taxes.

For more information, please contact a member of the firm's Wealth & Succession Planning Practice at 312/840-7000 or at www.burkelaw.com.

Serritella joins Music of the Baroque Board

Jim Serritella recently accepted an invitation to join the board of Music of the Baroque.

Sixty of the Chicago area's finest professional musicians make up the chorus and orchestra of Music of the Baroque. Most members of the orchestra also perform with other leading groups, including the Chicago Symphony and Lyric Opera. Music of the Baroque performs primarily at the Harris Theater in Millennium Park and at First United Methodist Church in Evanston.



Jim Serritella

Baroque music describes a style of European classical music approximately extending from 1600 to 1750. It is associated with composers such as Johann Sebastian Bach, Antonio Vivaldi, and Claudio Monteverdi.

For more information, please contact Jim Serritella at 312/ 840-7040 or jserritella@burkelaw.com.

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2011 capital gains rate will rise to 20% and dividend income will be taxed as ordinary income with rates as high as 39.6%. The potential expiration of the Bush tax cuts has left many taxpayers and their advisors in a quandary regarding whether to accelerate or defer proposed property sales and recognition of income and expense.

As this issue of the newsletter goes to press, it is not certain whether the Bush tax cuts will be extended. It also is not clear whether, given an extension, such an extension will be temporary or permanent, and whether the ceiling above which the cuts will be made ineffective will be $250,000 (as currently proposed) or $1 million (as has been recently proposed as an alternative). The most widely believed view at the moment is that the Bush tax cuts will be extended for all taxpayers for at least 2011.

2. Dividend Planning. In the event that the Bush tax cuts are not extended, as mentioned above, the highest tax rate applicable to dividend income will increase from 15% to 39.6%. Therefore, for corporations with available earnings and profits, it would be prudent to begin contingency planning for special dividends or increasing planned dividends before year end. Liquidity concerns may be mitigated with a debt-financed distribution or a distribution of a note where applicable.

Although the Bush tax cuts may in fact be extended before the end of the year, it is important to ensure that the proper corporate law actions and financing are in place to allow for any year-end dividends if necessary. Moreover, in the absence of new legislation, starting in 2011 qualification of corporate redemptions by closely-held corporations as capital gains rather than as dividends (already important to avoid deemed dividends to non-redeeming shareholders) will have increased importance (as such redemptions will be subject to tax at a maximum capital gains rate of 20% rather than the 39.6% applicable to dividends).

3. S Corporation Planning. In the absence of legislation extending the Bush tax cuts, traditional tax planning for S corporations — accelerating deductions and deferring income — may be reversed in 2010. In general, accelerating income and deferring deductions (other than itemized deductions) this year may be advantageous for S corporation shareholders. In addition, S corporations with subchapter C earnings and profits may wish to elect, with the consent of all affected shareholders, to have 2010 distributions made first from subchapter C earnings rather than from the accumulated adjustments account. This election will apply to all distributions in 2010 and will cause these distributions to be taxable to shareholders as dividends to the extent of subchapter C earnings and profits at a 15% tax rate. If the Bush tax cuts are not extended, S corporations should consider distributing all subchapter C earnings prior to year-end in order to pre-pay the corresponding tax at 15%. The distributed earnings can be recontributed to capital with a corresponding increase in basis. The increase in basis will prevent such amounts from being taxed in the future upon distribution. In short, S corporations and their shareholders should already be working closely with their respective accountants to determine whether additional distributions should be made during 2010 to take advantage of the current rate of tax on dividends.

Rich Lieberman

4. Small Business Jobs Act of 2010. The Small Business Jobs Act of 2010 (the "Jobs Act") was signed into law by the President on September 27, 2010. Note that several of these changes are particularly important for tax planning this year and next because the changes are only applicable to the 2010 and/or 2011 tax years as indicated below. The Jobs Act includes the following provisions, among others:

A. **100% Exclusion of Gain from Sale of Small Business Stock — 2010.** Non-corporate taxpayers can generally exclude up to 50% (and, in certain circumstances, up to 60%) of the gain realized on the sale of qualified small business stock that the taxpayer has held for more than five years. Qualified small business stock generally includes stock of a C corporation that: (a) has gross assets that do not exceed $50 million; (b) was engaged in an active trade or business during the taxpayer's holding period; and (c) was acquired at its original issue. Prior to the Jobs Act, the American Recovery and Reinvestment Act of 2009 (the "Recovery Act") increased the exclusion from 50% to 75% for stock acquired between February 17, 2009 and January 1, 2011. The Jobs Act increases the exclusion to 100% for qualified small business stock acquired after September 27, 2010 and before January 1, 2011.

B. **Reductions of S Corporation Holding Period for Built-In Gains Tax — 2011.** If a C corporation elects to convert to S corporation status, the S corporation will be taxed at the highest corporate rate (currently 35%) on the built-in gains of the corporation that existed at the time of the conversion if such gains are recognized by the S corporation during the 10-year period following the conversion. The Recovery Act reduced the 10-year recognition period to 7 years if the recognition event occurs in 2009 or 2010. The Jobs Act further reduces the 10-year recognition period to 5 years if the recognition event occurs in 2011 (i.e., if the conversion occurred prior to January 1, 2006, then the S corporation may recognize the built-in gain in 2011 without incurring the 35% corporate level tax).

C. **Section 179 Expensing.** Generally, businesses recover the costs of certain capital expenses over time through depreciation. In order to help small businesses quickly recover the cost of certain capital expenses, the Jobs Act allows small business owners to write off the cost of these expenses in the year of acquisition Under prior law, taxpayers could expense up to $250,000 of qualifying property — generally, machinery, equipment and certain software — placed in service in tax years beginning in 2010. This annual expensing limit was reduced (but not below zero) by the amount by which the cost of qualifying property placed in service in tax years beginning in 2010 exceeded $800,000. Under the Jobs Act, for tax years beginning in 2010 and 2011, the $250,000 limit is increased to $500,000 and the $800,000 limit to $2,000,000.

D. **Extension of 50% bonus first-year depreciation.** Businesses are allowed to deduct the cost of capital expenditures over time based on depreciation schedules. In previous legislation, businesses were allowed to deduct more rapidly capital expenditures of most new tangible personal property, and certain other new property, placed in service in 2008 or 2009 (2010 for certain property), by permitting the first-year write-off of 50% of the cost. The Jobs Act extends the first-year 50% write-off to apply to qualifying property placed in service in 2010 (2011 for certain other property).

E. **Carryback period of general business credits for 5 years.** Generally, a business's unused general business credits can be carried back to offset taxes paid in the previous year, and the remaining amount can be carried forward for 20 years to offset future tax liabilities. Under the Jobs Act, for the first tax year of the taxpayer beginning in 2010, eligible small businesses can carry back unused general business credits for five years. Eligible small businesses consist of sole proprietorships, partnerships and non-publicly traded corporations with $50 million or less in average annual gross receipts for the prior three years.

F. **Increased deduction for start-up expenditures.** The Jobs Act allows a new business to deduct start-up expenditures of up to $10,000 in 2010 ($5,000 under prior law). The $10,000 figure is reduced by the excess of the total start-up costs over $60,000 ($50,000 under prior law).

G. **Temporary Deduction for Healthcare Costs for Self-Employment Tax Purposes — 2010.** A taxpayer is generally permitted to reduce her taxable income by the amount paid for health insurance for the taxpayer and the taxpayer's (a) spouse, (b) dependants, and (c) children under the age of 27. Normally, self-employed taxpayers are not allowed to take this deduction when determining how much of their income is subject to self-employment tax. However, the Jobs Act provides that health insurance costs are deductible for self-employment tax purposes during 2010.

5. IRA Suspension Rules. In general, required minimum distributions ("RMDs") from IRAs must begin in the year you attain age 70½ (with the exception that the first year's payout may be deferred until the following April). For 2009, RMDs from retirement plans and IRAs were suspended. This did not impact someone who turned 70½ in 2008 and chose to wait until April 1, 2009 to get their first RMD — they still had to take that RMD in 2009; they just did not have to take a second one (the normal 2009 RMD) in 2009.

For 2010, the suspension of the rules governing RMDs has been lifted. All RMDs must be taken following the usual timetable. For individuals turning 70½ in 2010, you have until April 1, 2011 to take your first mandatory withdrawal.

6. Planning for Increased Form 1099 Reporting in 2012. The Patient Protection and Affordable Care Act (The "Health Care Act") expanded the scope of Form 1099 reporting such that Form 1099 reporting is now required for most payments of $600 or more, including purchases of property, to payees (now including corporations). As a result, taxpayers will need to provide Forms 1099 to the IRS and to each corporate provider of property or services of $600 or more. Further, this vast expansion of information reporting responsibilities also increases the potential liability for backup withholding if TINs are not properly collected prior to the time of payment from payees who were previously exempt from information reporting. Although there are legislative proposals to repeal or modify the expanded Form 1099 reporting and the proposal does not take effect until 2012, it is important for all business owners to evaluate and modify their internal systems, procedures and processes so that they can timely comply with the new law if necessary.

7. Proposed Regulation for the Tax Treatment of Series LLCs. On September 14, 2010, the Internal Revenue Service ("IRS") formally published in the Federal Register its proposed regulation regarding the classification for Federal tax purposes of series limited liability companies ("series organizations") and

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each underlying series of a series organization (a "series"). The proposed regulation will be finalized following the IRS's review of public comments submitted in response to questions raised in the proposed regulations. It is not likely that the final regulation will modify the proposed regulation in any material respect.

In general, under the proposed regulation the IRS has decided to establish a bright line methodology that each series files as a separate entity in order to avoid implementing a facts and circumstances approach that would have required taxpayers to look to state law and terms of the applicable operating agreement to elect between a separate entity or single entity approach.

The proposed regulation specifically defines a series organization as a "[legal] entity that establishes and maintains, or under which is established and maintained, a series." A "series" is defined as a "segregated group of assets and liabilities that is established pursuant to a series statute by agreement of a series organization."

8. "Protective" Disclosures for Year-End Transactions In Light of Codification of the Economic Substance Doctrine.

The Health Care Act codified the economic substance doctrine and introduced a 20% strict liability penalty for underpayments attributable to a transaction that is determined to lack economic substance. Importantly, this penalty is increased to 40% if the taxpayer does not disclose the transaction in its return. While disclosure is not required until the return is filed, taxpayers should consider whether "protective" disclosure of any year-end transactions would be prudent in order to avoid the increased 40% penalty. Furthermore, if they have not done so already, taxpayers should be certain to discuss with their accountants whether procedures and processes to ensure that such "protective" disclosures are considered with respect to all transactions on a going-forward basis.

9. 2010 Tax Legislation Affecting Future Tax Years.

A. **The Health Care Act of 2010 Medicare tax increase.** Beginning in 2013, the Health Care Art imposes an additional 0.9% Medicare Hospital Insurance (HI) tax on self-employed individuals and employees with respect to earnings and wages received during the year above specified thresholds. This additional tax applies to earnings of self-employed individuals or wages of an employee received in excess of $200,000. If an individual or employee files a joint return, then the tax applies to all earnings and wages in excess of $250,000 on that return.

B. **Unearned income Medicare contribution.** Beginning in 2013, the Health Care Act imposes a 3.8% unearned income Medicare contribution levied on "unearned" income, including income from interest, dividends, capital gains (including otherwise taxable gain on the sale of a personal residence), annuities, royalties, and rents. Excluded income includes distributions from qualified plans and income that is derived in the ordinary course of a trade or business and not treated as a passive activity. The tax is applied against the lesser of the taxpayer's net investment income or modified adjusted gross income (AGI) in excess of the threshold amounts. These thresholds are set at $200,000 for single filers and $250,000 for joint filers. For estates and trusts, the tax applies on the lesser of the undistributed net investment income or the excess of AGI over the dollar amounts at which the 39.6% tax bracket for estates and trusts begins.

C. **Limit on health flexible spending arrangements.** Beginning with years after 2012, the Health Care Act imposes a limit of $2,500 per taxable year on employee salary reductions for coverage under a cafeteria plan FSA. The limit, which does not apply to health reimbursement arrangements, is indexed for inflation after 2013. If a cafeteria plan does not contain the required limitation, then benefits from the FSA will not be qualified benefits.

D. **Itemized deduction for medical expenses.** The Health Care Act increases the threshold for claiming an itemized deduction for unreimbursed medical expenses for regular tax purposes from 7.5% of the taxpayer's AGI to 10%. The Health Care Act does not change the current-law 10% of AGI threshold that applies under the AMT. The change generally applies for taxable years beginning after December 31, 2012. For any taxpayer who is age 65 and older or whose spouse is 65 or older, the threshold for regular tax purposes remains at 7.5% until 2017.

Given the change in leadership in Congress following the November elections, it is not clear whether some or all of the tax changes enacted as part of the Health Care Act will be modified or eliminated. While it seems a certainty that the new rules governing 1099 reporting will be modified given the onerous impact such rules will have on small businesses, it is not as clear whether other portions of the Health Care Act will likewise be modified.

Please give Julia Turk 312/840-7033, Greg Winters 312/840-7059 or Rich Lieberman 312/840-7011 a call to discuss these and the many other tax changes enacted during 2010.

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Firm Welcomes New Associates

Amy C. Biesenthal and Adrienne M. Sevilla, firm summer associates from 2009, recently became attorneys at the firm.

Amy Biesenthal, a member of the firm's Corporate and Real Estate practices, worked in the supply chain field for a major corporation prior to studying law. Ms. Biesenthal's undergraduate research thesis in supply chain, titled "The Implications of Customer Prioritization on Lead Time," won her a national award.


Amy C. Biesenthal

Ms. Biesenthal received her undergraduate degree, *summa cum laude*, from Ohio State University in 2005, with degrees in Business Administration and German. She was a member of Phi Beta Kappa. Ms. Biesenthal was awarded her J.D., *cum laude*, from Loyola University Chicago School of Law in 2010. She received CALI awards for Negotiable Instruments and Antitrust in Health Care Field.


Adrienne Sevilla

Adrienne Sevilla, a member of the firm's Litigation practice, interned for The Honorable Ruben Castillo in the Northern District of Illinois as well as at the Office of Legal Affairs at Resurrection Health Care while studying law. She previously volunteered in Zimbabwe with ALERT, an organization dedicated to sustaining the lion population throughout Africa.

Ms. Sevilla received her undergraduate degree, with high honors, from the University of Michigan in 2006, with degrees in French and Comparative Literature. She was awarded her J.D., *cum laude*, from the Loyola University Chicago School of Law in 2010. Ms. Sevilla received CALI awards for Civil Procedure and Law of Risk Management. While at Loyola, she was a member of the Annals of Health Law and served as an academic tutor for first-year law students.

Ms. Biesenthal can be contacted at 312/840-7086 or abiesenthal@burkelaw.com. Ms. Sevilla can be contacted at 312/840-7087 or asevilla@burkelaw.com.

WEALTH & SUCCESSION PLANNING

Ten Essential Rulings for the Estate Planner's Tool Box

Melissa C. Selinger, senior associate in the firm's Wealth and Succession Planning practice, co-authored "Ten Essential Tax Rulings for the Estate Planner's Tool Box" for the November/December 2010 issue of the ABA's Probate & Property magazine, a national publication for attorneys practicing estate planning law.


Melissa C. Selinger

Selinger and co-author, Tye J. Klooster, an associate in the Chicago office of Katten Muchin Rosenman LLP, wrote the article to provide an overview of certain landmark cases and tax rulings essential to estate planners. Selinger and her co-author worked with the editors of Probate & Property to solicit reader feedback in an earlier issue of the magazine. Readers were asked to review and rank 37 rulings by importance using an online voting site. The votes were tallied and a list of the top ten rulings was created. The survey results revealed that, from a long list of important cases and tax rulings, a handful of cases generate consistent interest among estate planning practitioners. The article gives an explanation of each of the 10 rulings in hopes of providing estate planners with a working knowledge of each ruling.

"The original article was over 40 pages, filled with case history and footnotes, but we chopped it down to 10 pages for publication. The end product provides an overview of each ruling, highlighting the fundamentals of some of the most important concepts in our practice area," says Selinger. "I am happy to have the opportunity to contribute to the estate planning community."

Selinger is the current co-chair of the Estate and Gift Tax Division of the Chicago Bar Association's Federal Taxation Committee. She also serves on the Young Professional Advisory Committee for the Chicago Community Trust and sits on the junior board of Metropolitan Family Services, two of Chicago's oldest and largest charitable organizations.

For a copy of the article or for more information, please contact Ms. Selinger at 312/840-7097 or mselinger@burkelaw.com.

FDIC

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more could come tumbling down soon.

Among the debris of the latest wave of bank failures is the following:

- The FDIC announced in November that it was considering lawsuits against 80 officers and directors, and working on 50 possible criminal claims.
- The law firm of Bryan Cave was sued by the FDIC to produce documents they were holding in connection with five failed banks.
- The FDIC has sent hundreds of letters to banks notifying them of possible claims and advising these institutions to notify their liability insurers.
- The FDIC filed the first lawsuit in the nation against directors and officers of a recently closed Illinois bank.

This "rolling thunder" of FDIC actions duplicates the tactics from 20 years ago. Then, as now, the FDIC notified banks as they were being closed to prompt the filing of insurance claims. However, the lawsuits did not begin to fly until two or three years following the closing of the bank or savings and loan, hence creating a backlog of bank director and officer litigation well into the 1990s. Expect the same. The first lawsuit against a failed bank was filed this fall — nearly two years following the closing of the bank. Based on this schedule, directors and officers of failed banks should prepare for legal battles that will not be concluded until 2015 or later.

Director Checklist — Troubled Banks

For a "troubled" bank, directors should begin putting plywood over the glass windows of their management style as hurricane FDIC comes ashore. The troubled bank is one that is effectively on probation by the FDIC — usually the subject of a cease and desist order or memorandum of understanding. These regulatory orders often direct the bank to rapidly improve the management and finances of the institution. Also, the bank may show significant losses due to loan write-offs, and does not have much capital to absorb another dropping shoe of a non-accrual loan.

Directors and officers should take the following steps, among others:

- **Work overtime to address as many of the criticisms as possible in the memorandum of understanding or cease and desist order.** These days, safety and soundness is king — which means addressing problems in making and managing loans. Have the files reviewed, organized and completed. Frequently a troubled bank has a troubled history of documenting loans. Staff will need to stay late to organize loans and complete missing documents. If the regulators demand new management, look for ways to supplement or shift management responsibilities. If regulators demand higher capital ratios, adjust the balance sheet and solicit more investors. Failure to substantially address criticisms will provide great ammunition to the FDIC as it tells a judge that the directors repeatedly demonstrated a fatal nonchalance toward regulatory orders.
- **Update and complete policies and procedures.** All policies should be vetted to ensure that they are at least as good as those of similar banks, if not better. Since a court will subject management practices to unrealistic scrutiny, the policies and procedures should likely be more complete than those of bank peers.
- **Create committees of independent directors.** Banks should demonstrate a willingness to separate oversight of the board from the daily management of the institution. Frequently, banks encounter problems when the owner is the president and the dominant director. If the board is more of a rubber stamp than an independent overseer, the FDIC will more likely sue the directors individually. The bank should empower outside directors, even if this requires establishing independent committees to review loans and prior procedures.
- **Document personal effort.** FDIC lawsuits are personal attacks, and therefore the director needs a personal defense. This requires that the director document the effort to persuade the board to take actions requested by the regulators; if the other board members balk at addressing the problems, the minority squeaky-wheel director should send emails and memoranda that demonstrate an effort to convince the board to address problems.
- **Review the directors' and officers' insurance policy.** Notify the carrier if a claim is imminent. Be aware of actions that would trigger an exclusion.

Director Checklist — Failed Banks

Once the FDIC has closed the bank, the game changes dramatically. For the bank director, everything is history — which may be written by a hostile judge. The time for hard work and conscientious documentation is over. The FDIC becomes the "receiver"; the brain and body of the private sector bank becomes inhabited by the government. Internally, the FDIC will initiate a formal inquiry into the actions of the bank's officers and directors, including a dragnet-like review of the bank's records, interviews of bank employees and subpoenas of former management. The process culminates with a lawsuit, the first of which was filed this fall, and more will likely follow.

Therefore, after the failure, directors (or rather, former directors) should quickly undertake the following:

- **Hire a personal lawyer with experience with FDIC litigation.** The moment the bank is seized, the counsel to the bank is beholden to the government receiver. The director's relationship has been completely and permanently severed. Rights to advice, documents and confidentiality cease. Ironically, the attorney to whom management confided in the days before the closing becomes the legal warrior for the FDIC the day after the closing. Anything said to the lawyer can, and probably will, be used against the director.
- **Limit discussion with other directors.** Unfortunately, the rules of the game require that each individual director and officer may be sued for different reasons. Outside directors with ownership stakes of less than ten percent of the bank will be at odds with senior management or a controlling owner. The FDIC lawsuit will be a zero-sum game — the defense of one individual will come at the expense of the defense of another.
- **Review the directors' and officers' insurance policy — again.** Now that the bank has closed and the facts have been established, a professional experienced with insurance should review the policy to determine limits, deductibles, and coverage exclusions.
- **Gather documents.** The FDIC will almost certainly demand a copy of all records and correspondence of the director regarding the bank. Therefore, the director should work with his personal counsel to gather and organize documents. In addition, a professional can review the documents to determine the basis for a possible claim by the FDIC.

With the surprisingly severe downturn in the economy in general, and real estate market in particular, banks and their directors have suffered disproportionately. For the directors especially, the hundreds or thousands of hours sacrificed to assist the bank and the community will be rewarded with only an accusatory lawsuit. However, if directors undertake some early actions, and avoid mistakes that compound the legal problems, they should be able to weather the storm and continue their successful business careers.

Craig McCrohon and Aaron Stanton are partners who represent directors subject to FDIC scrutiny, including defending the first FDIC lawsuit filed nationally.

McCrohon is a banking, acquisitions and securities partner. He began his bank regulatory and corporate legal career working with the legal staff of the United States Senate Banking Committee during the passage of laws regarding the savings and loan crisis; he is past chairman of the Consumer Financial Services Committee of the Chicago Bar Association; and he served as lead legal instructor for the Illinois Bankers Association new bank directors school. You man contact Craig McCrohon at 312/840-7006 or cmccrohon@burkelaw.com.

Stanton is a litigation partner who was named one of the top "40 under Forty" attorneys in Illinois (attorneys under the age of 40) by the *Chicago Law Bulletin* in 2009. Stanton has experience representing officers and directors in breach of fiduciary cases and in securing insurance coverage for his clients. You man contact Aaron Stanton at 312/840-7078 or astanton@burkelaw.com.

Troubled Bank Director Liability Audio Conference

Presented by Craig McCrohon and Aaron Stanton of Burke, Warren, MacKay & Serritella, P.C. and Thomas O. Deneen of Aon Corporation.

Burke Warren and AON are presenting a national audio conference focusing on the escalating regulatory and legal risks for directors and officers of troubled banks and the steps banks should take to mitigate the liability. Partners Craig McCrohon and Aaron Stanton, together with Thomas O. Deneen of Aon, will provide the background and guidance necessary for directors to navigate risks in connection with FDIC litigation.

Time: Thursday, December 16, 10:00 – 11:00 a.m. central time. Presentation includes audience Q&A.

There is no charge for the conference, however registration is required. Please contact Cy Griffith at cgriffith@burkelaw.com for dial-in information.

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WEALTH & SUCCESSION PLANNING

Documents Parents of Minor Children Should have in Place

As a parent of small children, there are a number of documents that should be prepared to protect your children's physical and financial well-being in the unlikely event you are not available or are deceased. Four of the most essential documents are detailed below.

Designation of Guardian of the Person and the Estate. In the unlikely event of the death of a couple with minor children, guardians of the person and guardians of the estate should be nominated. The guardian of the person controls the physical whereabouts and well-being of the child. Typically, people designate as guardians of the person either family or close friends who have children or would otherwise be able to provide a safe and comfortable living environment for the children. The guardian of the estate controls the financial resources and monetary expenditures of the child. With respect to the guardian of the estate, typically, it should be an individual who has sufficient financial expertise to adequately manage the child's assets. This can be done in a separate document or in the parents' Will.

Medical Consent Form. To the extent that your children will be left for extended periods of time with a friend or caregiver, a letter of medical consent granting the individual taking care of your child should be made giving the authority to obtain medical care and assistance if necessary. The consent should include the authorization under the recent "HIPAA" laws for the caretaker to discuss the medical condition with the health care provider, as well as have a copy of your insurance card.

College Education Planning. Whether your child is in preschool or is a high schooler, the costs of a college education are continuing to spiral. This can be addressed in a trust created for your child (discussed below) or in a separate savings vehicle, such as a 529 plan.

Melanie Witt

Planning for a Child's Financial Well-Being. In the event of the death of both parents, a mechanism must be in place to financially support the child. This is best typically accomplished in a trust that directs an individual or corporate fiduciary named as trustee to make distributions for the child's health, education, support, and maintenance needs at least until adulthood. In the absence of such a document, in Illinois when assets are distributable to a child in excess of $10,000, a guardianship estate must be created in the county court where the child resides. This is a cumbersome procedure whereby the guardian of the estate is required to hire a lawyer to present and have approved annual accountings. In addition, no distributions may be made without court order. With a trust, the trustee steps in and makes these distributions to or for the benefit of the child. Typically, the guardian of the estate (discussed above) is named as trustee, however, some people prefer to name different individuals as a check and balance. In addition, the guardian of the person (discussed above) who is entrusted with the physical well-being and care for the child does not necessarily have to be named as trustee either.

More information is available from Melanie Witt at 312/ 840-7041 or mwitt@burkelaw.com.