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Business Law Newsletter

Volume 15, Issue 1 January 2015

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FirstPay Decision: IRS Bests Trustee in Local Tax Case

By Andrea Davison

A decision last month from the U.S. Court of Appeals for the Fourth Circuit marks a disappointing end to a decade-long tax case affecting many Washington-area businesses. The case, *Wolff v. United States of America*, Adversary Proceeding No. 13-2116, stems from the bankruptcy case of FirstPay, Inc., a Silver Spring, Maryland-based payroll management company.

In 2003, FirstPay provided payroll services to more than 1,500 employer clients. In accordance with its master services agreement, FirstPay would, prior to each payroll date, withdraw funds from the client's bank account. The withdrawal would be of an amount sufficient to cover the payment of the client's employees' wages, the payroll taxes due on those wages and the fees owed to FirstPay for its services; FirstPay would then issue checks to the employees and pay the IRS for its clients' tax liability. When FirstPay suddenly shut down, clients learned that the company's owner was dead, and he had been skimming millions from the funds owed to IRS by its clients. Victims of fraud, however, are not exempt from tax payments. Although some of FirstPay's clients' taxes were paid in full, some were only paid in part and some not at all.

In May 2003, creditors put FirstPay into an involuntary chapter 7 bankruptcy in the US Bankruptcy Court for the District of Maryland. Michael Wolff was appointed trustee, and in 2005, he filed a nine-count complaint against the IRS on behalf of the bankruptcy estate. He sought recovery, under several theories, of $28 million that FirstPay had actually remitted to the IRS on behalf of its clients in the ninety-days prior to its bankruptcy filing. His count to avoid the payroll tax payments as a preference under 11 U.S.C. § 547 is the subject of the recent appeal and decision.

The Bankruptcy Code gives a trustee in bankruptcy the power to avoid and recover certain payments made by an insolvent debtor to creditors in the ninety day period prior to bankruptcy in order to avoid any "preference" of one creditor over another. The bankruptcy court first granted summary judgment in favor of the IRS on the Trustee's preference count; the district court reversed and remanded, and over the course of many years the case went up and down the court system. Most recently, the bankruptcy court determined that the funds transferred to the IRS were not the property of FirstPay's estate and therefore could not be recovered as a preference.

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The district court agreed, and the Trustee appealed to the Fourth Circuit. The sole issue on appeal was whether the $28 million transferred to the IRS during the preference period was property of the bankruptcy estate and could be recovered by the Trustee.

The Fourth Circuit decided that it was not property of the estate and could not be recovered. First, the Court determined that under Maryland law, FirstPay held the $28 million in an express trust and therefore had no equitable interest in the funds. This is despite a provision in the master services agreement that FirstPay became indebted to its client for the amount of taxes included in their routine withdrawal; the Court refused to accept what they referred to as a "stipulated" "legal conclusion." Second, the Court, using common law principles, determined that FirstPay's commingling of funds did not defeat the express trust for the benefit of FirstPay clients and the U.S. government.

In the end, the Court expressed regret that the victimized FirstPay clients would remain liable to the IRS for moneys already paid to their payroll manager. The IRS has, in many cases, waived fees and interest, and in certain charitable cases, the entire tax liability to the fraud victims.

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Privacy Policies for Mobile Apps: One Size Does Not Fit All

By Laura Marston

Online privacy is a growing concern for us all. As a mobile app owner or developer, you must include a privacy policy in your app that details the information you collect from users and the manner in which that information is stored and used. Although borrowing a privacy policy from a similar app or purchasing a template online may be tempting, doing so can potentially create huge legal and financial liability for your company, and ultimately carries more risk than benefits.

The key to your app's privacy policy is transparency - say what you do and do what you say when it comes to users' information. If your app tracks cookies or IP addresses, say so in your privacy policy. If you share information with a third-party company, tell your users and direct them to that company's data privacy practices or policy.

If your company makes misrepresentations to consumers about its privacy practices, you risk charges by the Federal Trade Commission that can result in consent orders in which the government will regulate your privacy practices for extended periods of time. For example, recently, the popular app "Snapchat" settled FTC charges that its privacy policy statements saying that photo messages disappeared were false[1]. Specifically,

the complaint alleged that Snapchat "misrepresented its data collection practices," such as stating in its privacy policy that it did not track geolocation information, but in practice, transmitting "geolocation information from users of its Android app." This resulted in a strict FTC consent order with which Snapchat must comply until 2034.[2] Any violations by Snapchat of the numerous directives in the FTC order will result in significant fines of up to $16,000 per violation.

In addition to transparency, your privacy policy should also detail user-customizable privacy settings, opt-outs, or other ways for users to control how their personal information is collected and shared. If your app collects sensitive information, such as geolocation data, get the users' affirmative assent before you collect the data from them.

Keep your users' data secure. Even if your privacy policy does not detail the security steps your company takes to ensure the protection of user information, under federal law, you still must take "reasonable steps" to keep sensitive data secure. Thus, only collect the information you need, as collecting data without a specific need for it only adds liability to your company for protection of the information.

Don't forget that your privacy policy must remain accurate over time, so as your information practices change, so too must your privacy policy.

Perhaps most importantly, make sure your privacy policy complies with the Children's Online Privacy Protection Act (COPPA), which governs the collection of data from children under the age of 13, and the California Online Privacy Protection Act (CalOPPA), which governs any mobile application that may impact a California customer. Failure to comply with FTC regulations, COPPA, and CalOPPA can have dire consequences. For example, in 2013, Path social networking app paid $800,000 to the FTC for collecting children's personal information without their parents' consent.[3]

Drafting a privacy policy unique to your app's data usage and security is imperative, and will protect you from unnecessary legal and financial risk. A technology attorney can ensure your compliance with the laws and regulations about data-usage, and will guide you through the process of learning exactly how your company collects data, how it uses the data, and how it shares the data with others.

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[1] Federal Trade Commission Press Release dated May 8, 2014, "Snapchat Settles FTC Charges That Promises of Disappearing Messages Were False, found at <http://www.ftc.gov/news-events/press-releases/2014/05/snapchat-settles-ftc-charges-promises-disappearing-messages-were>.

[2] *In the Matter of Snapchat, Inc.*, Docket No. C-4501, United States Federal Trade Commission, at <http://www.ftc.gov/system/files/documents/cases/141231snapchatdo.pdf>

[3] Federal Trade Commission Press release dated February 1, 2013, "Path Social Networking App Settles FTC Charges It Deceived Consumers and Improperly Collected Personal Information from Users' Mobile Address Books," at < http://www.ftc.gov/news-events/press-releases/2013/02/path-social-networking-app-settles-ftc-charges-it-deceived>.

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Trademark Fees are Decreasing

On January 17, 2015, the United States Patent and Trademark Office will reduce certain trademark filing fees by $50 to $100, pursuant to the Leahy-Smith America Invents Act. See the USPTO website for detailed information on the new fee amounts.

What does this mean for my business?

Registering your trademark and protecting your brand is now even more affordable. Trademark registration, renewal and additional-class fees are all decreasing. Protect your hard work today – contact our Intellectual Property team at 703-525-4000.

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