

Money Matters

Chapter 2

Financing Your Business

Maybe you have been able to finance the start-up and early growth of your business through the use of your own capital. But now, in order to sustain or grow your business, you need additional financing. What financing vehicles are out there for the average “lifestyle” business that does not expect to be the next Google?

The most commonly used financing options available to your business can be grouped into six categories:

- 1) credit cards;
- 2) angel investors;
- 3) venture or private equity financing;
- 4) factoring;
- 5) asset-backed lending; and
- 6) working capital lines of credit.

Many entrepreneurs finance initial business growth through the use of personal, uncollateralized credit cards. While images of plunging personal credit ratings, high interest rates and unmanageable debt may make credit card financing unattractive, it should not be ruled out. A number of national organizations offer small business owners credit cards with low, fixed interest rates and attractive payment terms.

Angel investors are high net worth individuals seeking better returns than offered through more conventional investment vehicles. They enjoy investing money, and sometimes time, in attractive businesses. There are many angel investors throughout Ohio and the Midwest. Moreover, individuals in group angel funds sometimes invest their own money through *sidecar* investments. Business should be aware, however, that strings may be attached to angel funds.

Venture and private equity funds abound, but the trick is to find one that would be attracted to your type of business. Think carefully about who to approach and what type of debt and/or equity arrangement each might seek. Some funds require you to relinquish ownership control. Most want some vote in all important business decisions and all want to thoroughly understand your *exit strategy*. Moreover, most venture and private equity funds must exit your business within a short time period and return their capital to their respective investors. There are three exit options: 1) sell the company; 2) have a public offering; or 3) undertake a recapitalization. Without an exit strategy, you may have trouble attracting fund investors.

Factoring is a viable option for some, particularly those businesses with account receivables that are slow to be paid and, therefore, hurt cash flow. A factoring company buys your receivables at a particular percentage of their stated value (say 80 percent). Some factoring arrangements allow the factoring company to “put” the receivables back to you should they fail to collect. While the cost is certainly higher than traditional bank financing, it is often a good short-term arrangement for the business experiencing less than stellar credit, poor cash flow or rapid growth.

Bank financing, be it asset-based or working capital, is the most traditional financing vehicle and the most difficult to attract. Asset-backed financing may be available to the business owner who might not be able to attract a cash flow lender, but who has sufficient hard assets to cover the bank’s credit exposure. Cash-flow lending requires a lender to study the company’s financials and

determine whether the business will remain cash-flow positive so it can repay the bank. As added security, lenders traditionally will secure all the business assets and may seek to secure personal assets.

An experienced advisor can assist you in negotiating the maize of financing options and help prepare and review the necessary documentation any financing entity will require from you before investing in your company.

—by Thomas C. Washbush, an attorney with the Columbus firm of Benesch Friedlander Coplan & Aronoff.

Preparation Can Improve Bank Loan Experience for Business Borrowers

Whether you are starting or expanding your business, chances are you will need to ask a bank for financing. You may assume a bank will evaluate your business based on dollars and cents, but do you really know how bank lending officers evaluate loan applications? Are you aware of the importance of intangibles such as community standing, reputation, community benefit and your business's likelihood of repaying the loan?

You can assume that the lending officer and the bank want your business to succeed so you can repay the loan, but you should know that the bank (especially if it is community-based) also has an interest in your business's success because of its positive impact on the community.

Before making an appointment with a loan officer, you should know what the bank is looking for and be prepared to provide the necessary information.

Information

You will need to provide the bank with the following:

- two to three years of business tax returns;
- two to three years of personal tax returns;
- a current financial statement;
- a year-to-date income statement and balance sheet on your business entity;
- a history of your business and/or a business plan. If the business is a start-up, then you will need to provide projections for the next three to five years and the basis for those projections.

Collateral

Banks must make sure businesses have enough collateral to secure loan requests. To determine whether your business has the necessary collateral, the bank will use the following criteria:

- If you are using commercial real estate for collateral, the bank will want to know that, based on the property's appraised value minus any current mortgages, your business owns at least 20 percent of the interest in the property.
- If you are using accounts receivable as collateral, then typically the bank will use the following formula: 100 percent of the receivable accounts, multiplied by the receivable collection rate, multiplied by 70 percent, minus any current liens against accounts receivable assets.
- If you are using equipment and furniture as collateral, the bank will credit between 80 and 100 percent of a new purchase or 70 percent of the asset value after depreciation is figured and minus any current liens against the equipment or furniture.
- If you are using cash assets, then typically the bank will consider 100 percent of the assets minus any cash asset liens.
- If you are using marketable securities (such as stocks or bonds) as collateral, then the bank typically will consider 70 to 75 percent of the portfolio's value and 65 to 70 percent of the mutual fund value, minus any current liens against your marketable securities.

Analysis

The bank will consider the following questions when deciding whether to grant your business a loan:

- Is there sufficient collateral?
- What is the personal credit history, the *debt-to-income* ratio and the liquidity of the business owners (*guarantors* of the loan)? (Typically, banks look for a business to have no more than a 40 percent debt-to-income ratio.)
- Does the business have sufficient cash flow to service the debt? To find out if your business has sufficient cash flow to cover a loan, you may wish to contact a lender, an accountant, or an attorney.

–by Paul E. Peltier, an attorney and director of wealth management for Champaign Bank based in Dublin, and Timothy M. Oyster, a business banking officer for Champaign Bank. Updated by Jeffrey S. Rosenstiel, a partner with the law firm Frost Brown Todd LLC.

Should You Buy or Lease Your Business Assets?

Business owners often struggle with the issue of whether it is better to buy or to lease business assets such as vehicles, equipment, space, etc. Unfortunately, there is no one right answer. Rather, a business owner must look at a number of factors.

In many instances, an outright purchase of an asset makes more economic sense than a lease. A *lessor* who leases an asset to a business takes a risk, but also wants to make a profit, so risk and profit considerations are built into the lease price and paid by the *lessee* (the business). Obviously, a business owner can eliminate the lessor's profit by purchasing the asset directly.

When leasing makes sense

There are many situations in which the business owner is better off to lease an asset. Cash flow concerns may make leasing attractive. A lease generally requires less up-front cash and lower monthly payments, which can free up cash flow for other business needs.

Leasing also makes sense when an asset is only needed for a short period of time. Short-term leases work well for short-term asset needs and may be a smart decision when it is not known how long the business will need the asset. Another reason to lease is to avoid the risk associated with owning an asset.

Many business assets, especially high-tech equipment, are likely to decrease in value quickly. Many business owners are unwilling to assume this risk. A lease allows the business to pass this risk on to the lessor.

When buying makes sense

In general, it is more advantageous to purchase rather than to lease business assets. Purchasing assets will eliminate the lessor's profit, resulting in a lower overall cost for the business. Also, the law requires fewer disclosures for leases than for purchase loans, and lease agreements may be more complicated than purchase agreements or may contain undesirable limitations. Certain purchased assets (such as buildings) may provide equity for the business, and, over the long run, purchased assets should allow the business to retain more profits.

Weigh tax considerations

When determining whether it makes more sense to buy or to lease, a business must consider the tax ramifications. This is especially true if the business is looking at purchasing a luxury automobile that is subject to special depreciation and lease expense limits. Congress passed tax provisions a few years ago that limit the amount of depreciation that can be taken on many vehicles.

Similarly, there are some *income inclusions* that apply to more expensive vehicle leases. The amount reduces the lease expense deduction. Generally, the income inclusion rules are not as bad as the depreciation limitations. In other words, leasing can have a tax advantage over purchasing a luxury vehicle.

—by Bruce D. Bernard, Esq., tax strategist with Bernard Law, LLC in Worthington.

Retirement Plan Option for Small Employers May Make 401(k) Plan Affordable

Q: *What, exactly, is a 401(k) plan?*

A: A 401(k) plan is a type of profit-sharing plan under which employees can elect to defer a portion of their compensation. The employer may, but is under no obligation to, match all or a portion of the employees' deferrals.

Q: *My employees would like my company to consider offering a 401(k) plan, but my business is small. Is such a plan affordable for small business owners?*

A: Due to low employee contributions and relatively high administrative costs, 401(k) plans were not typically the most advantageous retirement plan option for many small business owners. However, plans can provide a significant design option that can benefit business owners at a relatively low employee cost. Although 401(k) plans previously allowed employees to defer a portion of their compensation to the plan, the owner's contribution was limited by the level of employee deferrals. Under Section 401(k)(12) of the *Internal Revenue Code*, the complex and costly nondiscrimination rules have been simplified by optional *safe harbor* rules.

Specifically, a business owner can defer \$16,500 in 2009 to a plan on his or her own behalf regardless of the level of participation by other employees, provided the employer makes a contribution on behalf of each eligible employee to the 401(k) plan equal to three percent of that employee's compensation. Alternatively, the employer can contribute a safe harbor basic matching contribution equal to 100 percent of the first three percent of compensation deferred by employees and 50 percent of the next two percent of compensation deferred (*e.g.*, if the employee defers five percent of compensation, the matching contribution will be four percent of compensation). An *enhanced match* of a 100 percent match on deferrals up to four percent of compensation may also be substituted for the basic matching contribution. Stated another way, for a three or four-percent employee cost, the business owner can obtain a significant contribution with administrative costs which should be significantly reduced from those with traditional 401(k) plans.

Further, an employee aged 50 or older can defer additional *catch-up* contributions into the 401(k) plan up to \$5,500 in 2009. The catch-up contribution is in addition to the normal \$16,500 limit. Thus, the maximum elective deferral for an employee aged 50 or older is \$22,000 (*i.e.*, \$16,500 + \$5,500) for 2009. The dollars limits for both the elective deferral and the catch-up contributions will be adjusted for cost of living in future years.

Q: *What, exactly, are the benefits to a small business owner?*

A: The following example illustrates the significant benefits available to the small business owner. Assume the following: annual revenues are \$400,000, staff compensation is \$108,000, and owner compensation \$170,000.

EXAMPLE:

- 1) The owner has \$170,000 compensation.
- 2) \$170,000 x 3 percent (safe harbor contribution) = \$5,100.

- 3) The owner can defer \$15,500 (\$20,500 if aged 50 or older) to the plan because the safe harbor three percent contribution is satisfied.
- 4) Total for owner: $\$5,100 + \$15,500 = \$20,600$ (or $\$25,600$ if age 50).
- 5) The employer cost for non-highly-compensated employees is three percent of compensation or $\$3,240$, *i.e.*, $\$108,000 \times \text{three percent} = \$3,240$.

Under a safe harbor 401(k) plan, the benefit to the business owner is as follows: for a staff cost of three percent or $\$3,240$, the business owner can receive a total retirement plan contribution of $\$20,600$ ($\$25,600$ if age 50) from a total contribution pool of $\$23,840$ or 86.4 percent ($\$28,840$ or 88.7 percent if owner is age 50 or older) of all monies put into the retirement plan by the business and the owner.

Additionally, employees have been provided with the opportunity to save for their own retirement through the 401(k) plan.

Due to the safe harbor rules for 401(k) plans, the administrative burdens for such plans have been reduced. With the availability of significant contributions to the business owner which, in practice, may not have been previously available, small business owners should consider changing both traditional profit-sharing plans and/or costly cross-tested plans into safe harbor 401(k) plans.

—by Richard A. Naegele and William P. Prescott, attorneys in the Avon firm of Wickens, Herzer, Panza, Cook & Batista.

Key Considerations When Adding Private Equity to Your Portfolio

A private equity investment is an investment in a privately held company either made directly or, more typically, through private investment funds. The investment fund professionals actively guide the companies the fund acquires to optimize their value.

Private equity seeks to earn a higher return than publicly-traded stock to compensate for the lack of a public market to which the investment can be sold. Here are some things to consider when adding private equity to your portfolio:

- 1) **Diversification.** Avoid “one-shot” deals where all can be lost.
- 2) **Quality sponsors.** It all gets down to an investment in people. Be proud of the character, integrity and judgment of the people in whom you are investing.
- 3) **Quality co-investors.** Similarly, ask yourself if you are proud to be among the investment group. Can you speak to the character, integrity, judgment *and investment acumen* of your co-investors?
- 4) **Simple, understandable products or services.** Do you understand what you are investing in? Compare an electric toothbrush with disposable brushes to a free space, optical transceiver (whatever that is). If you do not understand it, you probably should not invest in it.
- 5) **Use of proceeds.** Understand how your money will be spent. For pure research and development? To test a product? To commercialize a proven product? To enrich the promoter?
- 6) **Projected return.** As Yogi Berra said, “If you don’t know where you’re going, you’ll probably end up there.” You should know the projected return and the risks assumed in trying to achieve it. Higher risk investments should yield higher returns—annualized Internal Rate of Return of 15-30 percent. If less is projected, you should probably not bother. If more is projected, you should probably run for cover.
- 7) **Legal rights.** Before committing to invest, understand your rights (and obligations) as a minority shareholder or limited partner with respect to, among other things,
 - management fees and carried interests;
 - dilution;
 - distributions;
 - capital calls;
 - transfers of interests;
 - tag-along/drag-along rights;
 - registration rights.

—by Joe Juster, chair of the General Corporate Group at the Cleveland office of Calfee.

Bill Collection: How To Get the Money You're Owed

Q: *I own a small business and my accounts receivable increase every month. I have sent my customers statements and many sternly worded letters to little effect. What can I do?*

A: You can begin collection proceedings against your customers by first getting a judgment in court, and then *executing* on that judgment by garnishing bank accounts or wages, filing liens against their homes, or ordering certain assets to be seized.

Q: *If I have decided I have no choice but to sue my customers, what should I do next?*

A: It may be easier to retain an attorney to file these lawsuits, but if you have only a few customers to sue and the amount you are owed is small enough, you might be able to file a lawsuit yourself in small claims court.

Q: *If I sue my customers and receive judgments against them, they will be forced to pay me, won't they?*

A: Many people do not realize that a judgment is only an official acknowledgment that money is owed to you and not a directive for money to transfer hands. It is your job to try to collect that money. The easiest way to do this is to garnish the debtor's bank accounts or wages. To garnish someone's wages, you must file paperwork asking the court to seize the money from the judgment debtor's bank account or wages. The debtor, in turn, will have a chance to be heard by the court before any garnishment is granted.

Q: *How does the wage garnishment work?*

A: A person's wages can be garnished only up to 25 percent per pay. If, however, the person is paying other court-ordered deductions such as child support, the amount that can be garnished will be reduced. Garnishments are continuous orders, meaning that once you file the paperwork, employers must withhold funds from an employee's paycheck until your judgment is satisfied. Unfortunately, if another creditor is already garnishing the debtor's wages, you may have to wait as long as six months until the other garnishment is complete.

Q: *What other property can be garnished?*

A: In addition to wage garnishment, a debtor's real and personal property is also subject to collection, including interests in residential property, motor vehicles, and household items. However, recent changes to Ohio's exemption laws have increased protection for debtors. Specifically, the new law significantly increased the dollar amount of already existing exemptions for certain categories of property that an Ohio debtor may hold exempt from execution and garnishment. For example, the new law exempts from collection a debtor's interest in one motor vehicle in the amount of \$3,225. Previously, the exemption was \$1,000.

Q: *Are there any other options for collections?*

A: Yes. For instance, you may take your judgment and file it as a lien against a person's house and foreclose upon it. Also, you may ask the court to seize tangible items (*e.g.*, jewelry, computers, equipment) and sell them at auction, then give you the proceeds. These are fairly complex procedures which are difficult to do without a lawyer's advice.

—by Christopher Ernst and Nellie So, attorneys with Bricker & Eckler LLP. Mr. Ernst is in the Cleveland office and Ms. So is in the Columbus office.

A State Tax Time Bomb

You just finished reading a memo from your company's treasurer advising you that a southern state had billed the company for six figures worth of back taxes, interest and penalties dating back to 1989. To make matters worse, he told you that the company had also received questionnaires from two more state revenue departments indicating that they thought your company may be "doing business" in their states.

How can we owe money to these states? We don't have offices or employees in those states. Did not one of our advisors tell us that we were engaged in interstate commerce and, therefore, not subject to such taxes?

The situation becomes more complex over the next few weeks as the company receives questionnaires from several more states. Another state has sent you a bill, which is larger than the first. How far back can they go and how do they know about us?

Unfortunately, many small companies are beginning to experience events similar to what has just been described. What formerly was a non-issue for small- and medium-sized businesses has become an expensive and frightening nightmare. What is going on and why does it seem to be getting worse?

As in every other area of life, state and local governments require money to operate. In order to effectively increase revenues, governments must either increase tax rates or do a better job of collecting taxes that it believes are owed. Accordingly, over the last few years, two trends have occurred with regard to business taxes. State and local governments have pressed for court interpretations that would allow them to tax companies doing business in interstate commerce. At the same time, those governments are devoting more resources toward collecting their taxes.

Courts appear to be moving in the direction of allowing states to tax companies based upon "economic presence" in the state even when the company in question has no physical presence in the state. For example, in October 2008, the Indiana Tax Court held that an out-of-state credit card issuer is subject to the state's financial institutions tax, despite the fact that the company does not maintain any tangible property or employees in Indiana. The Indiana court cited the rationale of a similar decision issued by the Supreme Court of West Virginia. Many more states may now become emboldened to follow the leads of Indiana and West Virginia and press for taxation of the activities of out-of-state entities.

Thus far, the U.S. Supreme Court has declined the opportunity to settle the debate over whether mere economic presence in a state is sufficient to permit state taxation of business activities. Congress could clarify matters, and, in fact, multiple bills have been introduced in the U.S. House of Representatives that would prohibit state taxation of an out-of-state company unless the company has a physical presence in the taxing state. However, as of this writing, no such bill has emerged from the House Subcommittee on Commercial and Administrative Law, and the fate of the proposed legislation is unclear.

Given the uncertainty in this area, and the potential for tax liability in dozens of states across the country, companies doing business of any kind across state lines should obtain the services of a

multistate tax professional to assist them in making an analysis of the company's methods of business and its tax exposure.

—by David L. Chilcoat, a partner (retired) in the Columbus law firm of Campbell Hornbeck Chilcoat & Veatch. Updated by Jon Murphy, an associate with the Columbus law firm of Means, Bichimer, Burkholder & Baker Co., LPA.

Business Taxes: Part of the Cost of Doing Business

Q: I just started a new business in Ohio. What do I have to do about taxes?

A: First, your business should file for its federal Employer Identification Number (EIN), commonly known as the tax identification number. Your business should have an EIN even if it has no employees. To obtain the number, complete Internal Revenue Service Form SS-4. Through the form, the IRS asks basic questions such as the business name and address, the names of the owners or officers, the form of business (for example, corporation, limited liability company, partnership or sole proprietorship), the starting date of the business, a brief description of the business, its accounting year end and the number of employees expected over the next year. Form SS-4 and other IRS forms and instructions may be obtained from the IRS Internet site, www.irs.gov/.

Q: What happens after I complete Form SS-4?

A: You may complete and file Form SS-4 online through the IRS Internet site or you may telephone the information on the form to the IRS. By applying online or by telephone, you will receive the EIN immediately. Alternatively, you may apply for an EIN by facsimile or mail. The instructions for Form SS-4 contain the addresses and telephone numbers for filing the form. Whatever method is used, after the IRS processes the registration, the IRS will send your business the applicable federal income tax and payroll and withholding tax forms. Your business may still need to register with state and local authorities.

Q: What about state and local registrations?

A: If your business will have employees, it must file for employer identification numbers in the state and locality where the employees work. These filings will establish the business's accounts for state and local payroll and withholding taxes. In Ohio, unemployment compensation and workers' compensation also require registrations. In addition, certain types of businesses may need local licenses or permits before opening. Finally, if your business will collect and remit sales tax as a retailer, your business will need an Ohio vendor's license. You may obtain information and forms about Ohio taxes from the Ohio Department of Taxation at its Internet site, <http://tax.ohio.gov> or by mail from the Ohio Department of Taxation, P.O. Box 530, Columbus, Ohio 43216-0530. Ohio's state government Internet site has a section about registration and taxes for new businesses at <http://business.ohio.gov/starting>.

Q: What taxes will my business pay?

A: Essentially, your business could be taxed by three levels of government: 1) federal; 2) state; and 3) local. In addition, for income taxes, your business could be taxed at its location and anywhere it conducts business if its business activities establish some connection or nexus to other locations beyond sales solicitation. Business taxes and the concepts of nexus and solicitation are involved; therefore, no short, definitive answer is possible here. However, Ohio businesses typically will owe federal, state and local income taxes; federal, state and local payroll and withholding taxes; state and local sales or use taxes; and local real property taxes.

In addition, because some taxes depend upon the type of entity or the type of business conducted, other types of income, excise, property or transaction taxes could apply.

Q: When will my business pay these taxes?

A: Timely payment of taxes is required to avoid penalties and interest. Deadlines for filing some tax returns may be extended, but generally the time for payment of the tax owed may not be extended without incurring interest charges.

For calendar-year corporations, federal income taxes are payable in estimated quarterly installments on March 15, June 15, September 15 and December 15. Local income taxes usually follow the federal quarterly schedule. For corporations doing business in Ohio, the Ohio franchise tax is due in three payments on January 31, March 31 and May 31. The Ohio franchise tax will be phased out in 2010.

Ohio has a commercial activity tax (CAT), a business gross receipts tax that replaces the Ohio corporation franchise tax and the Ohio personal property tax. Depending upon the amount of gross receipts, CAT filers file and pay the tax annually or quarterly.

For pass-through entities, such as partnerships, sole proprietorships and some limited liability companies, the owners pay the income taxes. For the owners of such pass-through entities who are persons, the personal income tax rules apply and both federal and Ohio income taxes are paid quarterly on April 15, June 15, September 15 and January 15. Local income taxes may be due on quarterly basis, too.

Federal, state and local payroll and withholding taxes are generally due monthly or semi-weekly. After registration, tax authorities will give your business payroll and withholding tax payment schedules that will vary according to the estimated amount due.

Real property taxes in Ohio are due twice a year. The due dates are December 31 and June 20, but most counties extend these dates.

Q: When are the tax returns due?

A: For calendar-year-end corporations, the federal corporate income tax return is due the March 15 following the year end. Local income tax returns may be due then too. For corporations, Ohio requires the corporation franchise tax return on January 31. For Ohio's commercial activity tax, annual filers file a return on February 9, and quarterly CAT filers file returns on May 10, August 9, November 9 and February 9.

For calendar-year-end partnerships, the federal partnership return is due March 15. For other pass-through entities, the personal income tax rules apply to owners who are persons, making April 15 the due date for reporting business income (or loss) on a personal income tax return. Local governments may require income tax returns on these dates too.

Ohio sales tax returns are due semi-annually, quarterly or monthly depending on the sales tax due and whether the business holds a vendor's license or a direct pay permit.

Federal, state and local payroll and withholding tax return due dates also vary depending upon the amount due.

Finally, the IRS, Ohio and most local governments require annual reconciliations of the prior year's payroll and withholding taxes by January 31. Also, the IRS requires businesses to provide employees and others certain information returns, such as Form W-2 or the Form 1099 series, by January 31.

Business and personal taxes are detailed and have many variables. Therefore, the information presented here considers only some basics. No general answer can cover all situations.

–by Scott F. Sturges, an attorney with the Columbus office of McNamara and McNamara, LLP.

Tax Planning for Mature Companies

Tax planning opportunities abound for companies that are fortunate enough to reach a mature state. A company is considered to have reached a mature stage when it no longer needs to retain significant earnings to sustain growth and expansion. Such a company has gone through the painstaking years of accumulating equity and struggling with financing growth, and its planning needs are far different from those of companies in the start-up or growth and expansion phases.

A company may continue in the growth and expansion mode for many years, but may manage its growth and become profitable. However, when the owners of such a sustained-growth company near retirement age, they must address many of the tax-planning issues they would normally consider if their company had already reached maturity.

Whether a company is in the start-up or growth and expansion phase, or is a mature company, business owners are wise to “keep the company in a saleable position.” The succession plan for many business owners is to eventually sell the company to insiders or strategic buyers. Tax planning is one of many ways business owners can increase the value of the business to a prospective buyer.

One important factor that may affect an eventual sale is the type of business entity owners choose. When a company reaches maturity, it is usually beneficial for it to be a flow-through tax entity such as an S-corporation, a limited liability company or a partnership. These business types generally will result in only one layer of tax when the business is sold. An S-corporation may be especially attractive to buyers since certain opportunities are available only when there is corporate stock.

A mature company that no longer needs to retain earnings for growth and expansion should normally be a flow-through entity, regardless of the potential for sale. The flow-through entity generally will result in the lowest level of overall taxes. Further, the flow-through entity is better for estate planning.

There are, however, situations where a company should remain a C-corporation, even if a sale is anticipated. For example, a company should consider remaining a C-corporation if it has lower levels of retained earnings (say less than \$100,000) from year to year and there are other tax planning opportunities available to avoid tax problems upon a sale. It is sometimes possible to take advantage of the lower current rates without compromising on the tax planning available upon a sale.

It is often advantageous to vertically or horizontally segregate a business into separate business entities. Sometimes this is desirable for liability issues. There can also be lower current income taxes and eventual lower taxes upon the sale of the company. Estate planning is often facilitated with separate entities.

Several other tax planning ideas that may be of value include the following:

- A deferred compensation or non-qualified stock option plan can create deductions at the company level to offset gains.
- Document times when owners are under-compensated, even though they are providing employee services, so you can justify providing a bonus in the future if it is advantageous to do so for tax reasons.

- Review any non-compete and employment agreement to make sure the company can maximize *shareholder intangibles* upon a sale.

Many tax-planning opportunities arise at the time of a sale. However, other ideas need to be implemented well in advance of the sale. Maximizing after-tax proceeds is the key.

Tax planning for mature companies is not limited to a potential sale of the business. Business owners also should consider implementing or updating qualified retirement plans. The key is to establish a plan that benefits the people the owners want to benefit. A qualified plan can allow current reduction of taxes, tax-free accumulation of income and deferral of income to be taxed at lower rates upon retirement.

Other fringe benefits should be reviewed. A medical reimbursement plan, long-term care insurance and health insurance for key employee retirees (including the owners), should be considered.

Reimbursement plans should be reviewed. Is the maximum tax advantage being received for work-related expenses incurred by the owners?

Key men and *buyout* life insurance policies often have not been structured properly for the succession plan. The tax and non-tax considerations of such policies must be reviewed.

In general, the owners should be looking at their overall succession and estate plans. These issues come to the forefront with mature companies. It may be appropriate for owners of such a company to build a new line of key management, shift wealth, shift income and identify potential strategic buyers for the future, etc.

—by Bruce D. Bernard, Esq., tax strategist with Bernard Law, LLC in Worthington.

Dealing With Your Bank When Your Company Is Underperforming

If you are not meeting your banker's expectations, your loan is considered a "troubled loan." Here are some tips to improve your chances of turning your business around. Current market conditions and financial institution consolidation and volatility make it even more important to maintain a strong relationship with your bank and banker.

- **Establish a strong relationship with your lender.**
Relationships matter. Get to know your banker. Invite him or her to your business. Share pertinent company information.
- **Provide information.**
Bankers never complain that one of their portfolio companies is providing too much information.
- **Be honest.**
Lenders can work through a myriad of problems with you, but dishonesty will sour the relationship, probably beyond repair. Failing to inform your lender about something significant is akin to lying.
- **Have a plan.**
Lenders invest in people more than companies. It is critical to keep your lender's confidence. Take the time to work with your key staff and advisors to create a business plan that can get you back on track.
- **Be flexible.**
Maybe your strategy is flawed. Do not be afraid to adjust market, customers, pricing and personnel to allow you to be profitable.
- **Be humble.**
You are no longer dealing from a position of strength. You may be asked to enter into a forbearance agreement. You may be presented with tighter financial covenants, closer monitoring and more frequent reporting. Embrace these constraints; you probably do not have many viable alternatives.
- **Keep your eye on the ball.**
With everything else going on around you, do not forget to mind the store. It is easy to fall into a catatonic state and do nothing.
- **Hire a qualified attorney to help you through the process.**
Yes, your interests must be protected, but by someone who understands the art of pre-workouts.
- **Safeguard your collateral.**
Whatever security was originally taken by the bank, make sure you keep it in working order. That collateral provides comfort to the banker. If the value of the collateral falls, the pressure on the banker to call your loan will continue to increase.

- **Continue to explore options.**

Look for other funding sources. There are many alternatives to traditional banks. But remember, they all are going to be more expensive, making your recovery more difficult.

Remember, your banker wants you to succeed. If you are successful, so is the banker. Follow these suggestions and your odds of turning your business around will increase markedly.

–by Thomas C. Washbush, an attorney with the Columbus office of Benesch Friedlander Coplan & Aronoff.

Knowing about Foreclosure Can Help You Avoid It

Q: *What is a foreclosure?*

A: A foreclosure is a type of lawsuit. In a foreclosure case, a lender sues any borrower who has failed to make mortgage payments as required under the terms of the loan contract. The lender seeks a court order to sell the borrower's real estate to raise money to pay off the debt owed to the lender. There is usually a promissory note signed by the borrower that defines the debt, and a mortgage signed by anyone with a title interest in the land. The borrower is known as the *mortgagor*, and the lender as the *mortgagee*.

Q: *Who can initiate a foreclosure?*

A: A foreclosure in Ohio is initiated by the filing of a complaint in the common pleas court in the county where the real estate is located. Your lender can initiate a foreclosure, either in its name or in the name of a company, called a servicer, which your lender has hired to collect payments from you and to administer your loan account. Due to the complexities of modern mortgage lending practices, your lender might not be a company or bank that services its own loan. Often, your lender or servicer is located out of town or even out of state. This makes dealing with your lender more difficult than in the "old days" when you could walk down the street and talk to the people in the bank who had lent you the money to buy your property. Servicers usually have "800" numbers for you to call toll-free to discuss your loan or Web sites so you can communicate with them. This information will appear on most letters sent to you from either the lender or servicer.

Q: *Can a foreclosure be prevented before it is filed?*

A: Yes! If you fall behind in your mortgage payments, contact your lender or its servicing agent immediately. Lenders do not want their customers in foreclosure, which is costly and time-consuming to lenders. Often, the proceeds of the foreclosure sale are insufficient to pay off the loan. Most lenders have a workout or loss mitigation department. These people will talk to you to see if there is a solution other than foreclosure.

Q: *What types of alternatives are there prior to foreclosure?*

A: The most frequent alternative is a repayment agreement, sometimes called a *forbearance* agreement. The terms are flexible, but generally you will need to resume payments and make arrangements to pay the past due amounts over a short period of time. Another type of workout is called a *loan modification*. A modification can lower your principal balance or interest rate, or even extend the final due date of your loan to make current payments lower. A modification is like a new contract amending the prior contract.

Q: *I have other loans with my lender besides my mortgage; will these be affected?*

A: Possibly. If you have obtained equipment financing, lines of credit, or other loans from the lender that holds your mortgage, your loan documents might contain a provision called a cross-collateral agreement. This provision states that a default on one agreement will constitute a default on any other agreement also containing that provision. Thus, the mortgage default can lead to a *domino effect* where your lender calls all your other loans due with drastic results for your business.

Q: While I do not have other loans with my mortgage lender, I do have different loans with other lenders. Will these loans be affected by the foreclosure?

A: Possibly. Some business loans have provisions stating that if the lender “deems itself insecure,” it can call your loan due. Defaulting on your mortgage loan might give your other lender grounds to call its loan due even though you have continued to pay that other lender according to the terms of that loan. In addition, credit cards often have *universal default* provisions under which they can declare default because of a foreclosure even though payments on the credit card are current.

Q: Is a lender required to work with me prior to filing the foreclosure complaint?

A: Generally, no. Most loan agreements provide that if you fall behind on one payment, the lender has the right to call the entire balance of the loan due and start a foreclosure case. Few lenders proceed in that way after only a one-payment default. However, by the time a loan is three months delinquent, lenders are looking very closely at whether to foreclose. The key to preventing the filing of a foreclosure is communication.

However, if you signed a *cognovit note*, the lender can have an attorney of its choosing confess a judgment against you with no notice before the *cognovit* judgment is entered. You will receive notice after the judgment is entered. Finally, please also note that a lender is not required to accept partial payments, which means that it can even reject a tender of three-and-one-half payments when you are four months past due.

Q: What alternatives to foreclosure do I have after the lawsuit is filed if I want to keep the property?

A: Generally, the same types of alternatives exist: forbearance agreements or loan modifications. In addition, you can bring your account up to date by a process known as a *reinstatement*. You often will have to pay your lender’s attorney fees and costs if you reinstate your loan. Or you can pay the loan in full by refinancing your loan with a new lender. In that case, under Ohio law you will not have to pay the lender’s attorney fees. Last, you might be able to complete a *short sale* in which the lender agrees to accept less than a full payoff through a private sale.

Q: What alternatives do I have after the lawsuit is filed if I do not want to keep the property?

A: You can pay off the loan by a private sale (as opposed to a court-ordered sale) of the property. This might not be a preferred resolution for a business owner who seeks to continue doing business in the location its customers have come to know. A private sale must be for an amount sufficient to pay off your loan and all other lienholders, although some lenders might voluntarily agree to take less or even nothing.

Also, you can ask the lender to take the property back in full satisfaction of the debt. This is called a *deed-in-lieu of foreclosure* (DIL). Because many times the value of the property is less than what you owe on the mortgage, a DIL protects you from a likely deficiency judgment. A lender can obtain a judgment against you for the amount you still owe after the court-ordered sheriff’s sale if the proceeds of the sale are not enough to pay off the debt; this is called a *deficiency judgment*. The lender could then garnish your bank accounts or take other steps to collect the deficiency. By accepting a DIL, your lender is forgiving you from the obligation to repay the remainder of the debt. Lenders will accept a DIL only if there are no other liens against the property and if the property is vacant.

Please also note that Ohio has a statute limiting a lender's right to collect a deficiency balance on a primary residence foreclosure to only two years after the sheriff's sale is confirmed. This might arise when you pledge your home as extra collateral in a business loan. In addition, in 2008, Congress enacted a law preventing lenders from filing a Form 1099 after a deficiency balance is charged off.

Q: Can bankruptcy help me avoid foreclosure?

A: Yes, depending on the type of bankruptcy case you file. Small business owners can file for protection under Chapter 11 or Chapter 13 of the Bankruptcy Code. A Chapter 13 bankruptcy permits you to repay the delinquent amount you owe your lender over time, up to five years. You have to pay the regular monthly payments and an additional amount each month until the loan is current according to the contract. A Chapter 11 filing can provide much greater flexibility in how to deal with a delinquent mortgage loan. You should consult with a bankruptcy lawyer for assistance in determining what type of bankruptcy case might help you to avoid foreclosure.

Q: What are the steps in a foreclosure?

A: A foreclosure is a judicial process with a number of steps, which we will call the early, middle and late stages of a case.

Q: What happens in the early stage?

A: Before the case is ever filed, the lender sends a foreclosure referral package to an attorney. The attorney will review records at the courthouse in a process called a *title examination* to identify all persons who have an interest in your property, which will include individuals, their spouses for *dower* rights, partnerships, and corporate or governmental entities. Any person who has some type of ownership interest or lien against the property will be named a defendant in the suit. In addition to parties with an interest in the property, the complaint usually names any borrower or co-signer on the loan. By having all interested parties involved in the case, the court can make decisions that are binding upon everyone concerned.

After the complaint is filed, the attorney will instruct the court to send you a copy of the lawsuit, usually by certified mail and/or through delivery by a sheriff's deputy. You are entitled to know about the lawsuit and you must be served with a copy of it before your lender can proceed to sell your property. Once you receive a copy, you have only 28 calendar days (including weekends) within which to respond formally to the court. If you do not do so, the court can enter a default judgment against you. Anytime you receive a lawsuit filed against you, including a foreclosure case, you should consider discussing your rights, options, and responses with an attorney.

Q: What happens in the middle stage?

A: After all the parties to the case have been served with a copy of the lawsuit, your lender will make a request to the court to order the sale of the property to pay the debt. This is usually through a motion for a judgment entry. In cases where you also signed a promissory note evidencing your promise to repay the money that was lent to you, the lender will ask for a money judgment to be awarded against you. Usually, the court orders that a money judgment be awarded and that the property be sold to raise money to pay the debt.

Q: What happens in the late stages of a foreclosure?

A: After the court orders the property to be sold, the sheriff will appraise your property, schedule a sale, and advertise the sale to the public. The sheriff's sale is a public auction, and any adult can bid and purchase real estate at a foreclosure sale. The property must sell for at least two-thirds of the appraised value of your property. The sheriff reports the results of the sale to the court. Then the lender requests the court to validate the sale, to order a new deed to be drawn to the purchaser, and to distribute the sale proceeds. This process is known as the *confirmation* of the sale. The purchaser is also entitled to possession of the property after the sale is confirmed. The purchaser will then be entitled to seek the sheriff's assistance in evicting you if you remain in the property after the sale is confirmed. In the vast majority of cases, the lender buys the property back for an amount less than what was owed, which, as discussed above, results in a *deficiency balance*.

Q: Can I save my property even after the foreclosure sale?

A: Yes. You have a right under an Ohio statute to purchase your property back after the sale and before the sale is confirmed if you can pay in full the amount that you owe in the judgment entry. This right is known as your *right of redemption*. See an attorney for details about how to accomplish this.

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