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Recession: Major legal challenge to small business

By Brian Wargo
Staff Writer

The recession has taken a toll on many Las Vegas businesses, bringing them to the brink of failure.

But several attorneys said some of those companies are guaranteeing their demise and putting themselves at risk without knowing it. Some have jeopardized their legal protections and increased personal liability if their business fails.

State laws require corporations and limited liability companies to have meetings and record minutes, and not doing so could pierce the veil of legal protection, said Gregg Benson, a tax attorney with Holland & Hart.

That would allow creditors to come after business owners to pay debt that they otherwise would have been shielded from, he said. Even making payments for personal expenses out of a business bank account or using company assets such as vehicles for personal use jeopardizes that standing, Benson said.

"You have owners of the business who are not on the hook for the debt of the company,

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but if they don't comply with the state laws, they can be personally on the hook," Benson said. "You need to respect that separation. You can't pay your mortgage or buy your groceries out of the company account."

Benson said owners who ignore that separation do so more out of convenience since it is easier to have one bank account than two or to transfer money into their personal account.

Business owners don't anticipate that problem because they don't expect to fail, but it's shortsighted to think that way, especially in this environment, attorneys said.

"With the economy impacting them now, a lot of creditors are coming after that debt," Benson said. "You really have to respect the formality of the business."

Another mistake troubled companies are making is not paying payroll taxes on a quarterly basis, attorneys said. The Internal Revenue Service will go after the business owners' personal assets if they do that, they said.

Mom-and-pop businesses are the most vulnerable to this, attorneys said. They are trying to keep their heads above water and pay their rent and don't understand the consequences.

"That is the biggest mistake I see them make, and it is illegal to do so," said Bruce Beesley, a bankruptcy attorney with Lewis and Roca. "That debt is not a dischargeable obligation, and it becomes the debt of the individual. You need to pay your taxes before anything else."

Another tax mistake that many property owners make is when lenders write down loans, attorneys said. If a bank loans \$1 million on a property, but has written it down to \$400,000 because of falling values, the owner is responsible.

"You have to pay taxes on the \$600,000 and not everyone knows that," Benson said.

Those businesses in danger of going under should focus on paying any debt personally guaranteed before paying other debt.

It's best to work with creditors by contacting them and being truthful, Beesley said.

"If you call your creditors and say you are not making money, but will try to pay in the future, you will have better results than if you say the check is in the mail and it's not," Beesley said. "It even makes the business owner face the truth. You may not be able to stay in business, but you will have much better goodwill and it will be easier for you with creditors if you go back into business."

Bill Urga, managing partner of Jolley Urga Wirth Woodbury & Standish, warns business owners about signing personal guarantees when they apply for credit. They don't think about the implications of their liability when they start up, he said.

Those companies faring best are the ones that are well managed and don't have a lot of debt, attorneys said. Some companies got in trouble by taking on debt in their aggressive expansion and didn't expect the recession.

"What is happening in a down economy is those that are well managed are still around, but the ones in trouble are those that are highly leveraged, whether it is a retailer or a law firm," Benson said. "The companies that are well managed will get through this and come out strong when this turns around."

Beesley said there are many small businesses that didn't make any mistakes. Instead, they responded to a demand for service only to have the economy collapse.

"Lots of people are struggling," Beesley said. "They were stuck with more lease space than they could use and more employees and equipment than needed. They might have been more cautious, but it is easy to say that looking from a distance. Most of them just responded to the boom and hoped the market would go on forever."

Mark Hutchison, a business attorney with Hutchison & Steffen, said a mistake that many

failing business owners make is not winding down the affairs of the corporation, which is required under Nevada law. Failing to do so makes them personally liable, he said.

"One of the big mistakes is selling off the assets. They think they can close the doors and be done," Hutchison said. "They can't. If they don't follow the process by Nevada law, personal liability is a big problem for them."

Companies must get approval from the board of directors and shareholders to dissolve a company and must file a certificate with the secretary of state's office to make sure creditors are satisfied before assets can be taken for personal use, Hutchison said.

"People forget about the creditors and sell off the equipment, and they are coming after you for these corporate debts," Hutchison said.

Sometimes, company owners aren't willing to face reality and don't shut down the business and try to limp along and operate,

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Hutchison said. Some firms don't consider bankruptcy early in the process that would shield them from creditors and reorganize.

"That oftentimes will solve a lot of problems that businesses otherwise try to solve on their own," Hutchison said.

"We got kicked in the teeth in Las Vegas, but we are getting over it right now," Benson

said. "We are not out of the woods yet, but I am seeing some positive signs and opportunities along the road ahead. It is not going to spike overnight, but I am optimistic."

Nile Leatham, managing partner of Kolesar & Leatham, said it appears the business climate in Las Vegas is more negative than the rest of the country and the decline in the construction and gaming industries is taking its toll on many companies.

"That's the most important sector in the local economy and it's trickling down to affect everyone else as well," Leatham said. "They are doing what they can to survive. I wish I had a magic bullet or an answer to fit everyone's needs."

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