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ASKED & ANSWERED

Help! My Business Is Failing

By [Colleen DeBaise](#) | [Colleen DeBaise Archive](#) | Published: August 9, 2007

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QUESTION: My business, in operation for over eight years, has been slow lately. There is little cash flow and debts are past due. Unsecured credit cards and business lines are up to their limits. Basically, we can't afford to pay our bills. The company is an LLC. Will I be held personally liable for the debts and liabilities of the company? Will this affect my personal credit? What are the consequences of filing bankruptcy?

— C. Smith

ANSWER: Your company has fallen into the precarious position of needing more cash than what's available — a very common and painful scenario, says Wayne Lorgus, a partner with B2B CFO, a Phoenix firm that provides part-time CFO services to small businesses.

First, let's examine what went wrong — and whether you can dig your way out. Here's a simple version of what often happens: An entrepreneur with a big idea launches a business and snares numerous customers. As the business grows, the owner takes the focus off sales and gets bogged down by administrative tasks, like whether more space and employees are needed. "They start focusing on those issues rather than growing sales," says Lorgus. "That's a mistake." (B2B CFO founder Jerry Mills has written a book on this problem, called [The Danger Zone](#).)

Small-business owners in this position have a few options. One is to jumpstart cash flow by finding new customers, or tending to existing ones. A second is to analyze receivables: Do customers owe the business money? If so, then it's time to collect. On the flip side, if creditors are circling, consider using the services of a debt turnaround [firm](#) to get back in line.

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The alternatives aren't pretty. Can one be held personally liable if his or her company defaults? Most likely, yes. "Most small-business credit-card issuers do base their decision on the owner's personal credit, and require the owner to assume personal liability," says Gerri Detweiler, a credit-card specialist in Sarasota, Fla., and co-founder of [BusinessCreditSuccess.com](#). That means most issuers "will report it to your personal credit reports if you default," she says.

And what about bankruptcy? It's painful, messy, expensive — and should only be used after all options are exhausted, says Lorgus.

For a video on how business's can manage cash flow, click [here](#).

QUESTION: I own a lumber and building materials retail store, structured as an S Corporation. At the end of each year, unsaleable inventory must be dealt with. Would it be better to write this off as bad business debt or to donate the material to an organization that offers tax-deductible contribution receipts?

— B.C.

ANSWER: You do have two choices here, but writing the lumber off as "bad debt" isn't one of them. Technically, a [bad debt](#) is when someone owes you money that you can't collect. That's not the case here. Instead, the lumber is something you bought but can't sell — more likely, what the Internal Revenue Service deems as obsolete or damaged inventory. And that you can write off. (See [IRS Publication 538](#) for details.)

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But is it more worthwhile, at least financially, to donate it to charity? As far as write-offs go, "it would be the same," says Catherine Fox Simpson, tax partner in BDO Seidman's retail and consumer product practice in Dallas. However, there are more limitations when it comes to charitable deductions, she says. Keep in mind, S corps are "pass-through" entities and all business income is reported on your personal tax returns. Generally speaking, one can deduct up to 50% of taxable income to a 501(c)(3) charity. So, if you've got, say, \$100,000 worth of lumber that you want to donate to Habitat for Humanity, you must be making at least \$200,000 in income to claim all of it as a deduction.

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Could you write the unsaleable inventory off as a business expense — and then donate the merchandise to charity, without taking a charitable deduction? That's problematic, too, says Simpson. It's too difficult for the IRS to determine your intent. For instance, did you deem the inventory "unsaleable" just so you could donate it to a favorite cause? Most businesses will destroy bad inventory and keep a record (photos, videos or receipts) of the destruction, in case the IRS raises questions.

QUESTION: I live in New Jersey and would like to obtain a tax/merchant ID number. How is that done?

— A. Donohue

ANSWER: Like most states, New Jersey warmly welcomes new taxpayers and provides a wealth of small-business tax information on the web. You can access the N.J. Division of Revenue's online tax/employer registration service [here](#). And it's one-stop shopping: The online service also directs users to the IRS's online application for a federal tax identification number, also called an employer identification number or EIN. Generally, all businesses need an EIN; check with your state to see if you need a state number, too. (For other state tax agencies, click [here](#).)

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