

Corporate Communiqué

Understanding Your Rights as a Creditor

By Paul R. Yagelski, Esq.

In 2006, *The Pittsburgh Tribune Review* reported that federal bankruptcy filings fell to a 20-year low across the country. Many agreed that the low number of filings was a direct result of the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*. The goal of the Act was to improve bankruptcy law and practice, lessen the number of overall bankruptcy filings, and to promote alternatives to bankruptcy, such as credit counseling.

The legislation was successful – in the short term. However, a battered economy, stagnant hiring, mounting credit card debt, the whole mortgage fiasco, and the stock market scares have taken their toll. On October 8, 2008, *The Pittsburgh Tribune Review* reported bankruptcy filings rose 7% in the first nine months of the year over last year's numbers.

This can be alarming news to individuals and/or business owners who are owed monies or goods. Many creditors assume that bankruptcy means they will never recover their debt or that they have no alternatives. This is not entirely true. Creditors have certain rights, such as the following:

1. Depending on the priority of their claim, creditors may be able to receive a distribution out of the bankruptcy estate.
2. Creditors have the right to be heard in court before a debtor's plan is confirmed (in Chapters 11, 12 and 13 cases).
3. Creditors, under certain circumstances, can challenge an individual debtor's right to a discharge or object to the dischargeability of certain debts.
4. Under certain circumstances, secured creditors or landlords may be allowed by the Bankruptcy Court to pursue their state court remedies to obtain possession of their collateral or leasehold.

Bankruptcy law can be involved, so you may want to consider engaging an attorney who specializes in Creditors' Rights to look out for your interests. While each case is unique, here are a few of the basics of which you should be aware.

Creditors should file a Proof of Claim by the deadline established by the Court. A creditor's properly filed claim will constitute proof of the creditor's claim unless an objection is filed to the claim and approved by the court.

A creditor's claim may be secured or unsecured. A secured creditor will have a lien that grants rights to certain property, the creditor's collateral.

In this issue

Understanding Your Rights as a Creditor

Page 1

Rent or Buy?

Part One: Zoning and Tax Ramifications

Page 2

Rothman Gordon, P.C.
Attorneys At Law
310 Grant Street

Third Floor, Grant Building
Pittsburgh, PA 15219
(phone) 412.338.1100
(fax) 412.281.7304
www.rothmangordon.com

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Continued on page 4

Rent or Buy? Part One: Zoning and Tax Ramifications

By Bernadette L. Puzzuole, Esq.

Whether starting a new business or continuing in an existing business, the location of your place of business is always a major consideration. You have probably heard that the most important three words in real estate are Location! Location! Location! and they certainly apply when considering where to locate your business.

While many service type businesses, especially at the outset, operate from the owner's home, you have to consider that the location of your business is a form of non-verbal communication about that business. It will affect a potential customer's perception of the quality of the business, the price to be charged, and the professionalism of the provider.

If you've decided that your business should be located outside your home, the next question to be answered is whether you should lease or buy the space you need. While the analysis of that question may require consideration of the same issues as deciding whether to rent or buy your personal residence, there are some factors which are unique to the decision of choosing to rent or buy a commercial space, or even to build your own space on vacant land.

ZONING

In buying a personal home, most people never have to consider zoning approval. If you purchase an existing home in an existing residential development, the builder should already have resolved that matter. Commercial property, however, is a different matter. Even if an existing office building is zoned for commercial uses, there may be some types of offices that are not permitted without special approval. So, regardless of whether you elect to rent or buy your business space, once you've identified a potential location, the first stop should be the local municipal office to find out the zoning for the location and what is and is not permitted within that particular zoning district.

There are different types of commercial zoning, depending upon the sophistication of the municipality and its eagerness to attract or discourage business. You may find adjacent properties zoned industrial, light industrial, commercial office, commercial warehouse, or commercial business. Do not assume that just because a property is zoned commercial, your intended use is allowed. The financial risk can be substantial if you sign

a binding contract to purchase or lease space, and then investigate the zoning.

Regardless of the zoning district, property uses generally fall into four (4) categories – permitted, conditional, special exception, or prohibited. If the property you want is zoned to allow the use you intend as a permitted use, the only municipal cost you will generally incur to use that space is for the occupancy permit for your business. If, however, the use you intend is only allowed as a conditional use or special exception, the costs you will incur have escalated. In most municipalities, to obtain approval for either a conditional use or special exception, the applicant must first appear before the planning commission to obtain its approval to the use, and then before the governing body of that municipality. Either or both of those groups may elect to hold a public hearing on the application, at which all area residents can appear and testify in favor of or against the application.

The costs of going through a public hearing can be significant. The application cost itself is higher than normal, because it includes advertising costs for the public hearing. Because this public hearing is typically the only hearing that you will get, even if you appeal the decision of the governing body to court, you would be well advised to have legal counsel represent you at the municipal level to ensure that the record that the court will review contains all the information important to your cause. Sometimes the application process involves having traffic studies performed, or other engineering issues addressed, so that you will need to engage an engineer to testify at the hearing. Even assuming the use is granted, the municipality may impose conditions on that use that will increase the costs of making the property ready for your intended use.

Thus, seeking to obtain a permit for a conditional use of the property, or a special exception to the zoning ordinance, can cost from \$2,000 to over \$10,000, depending upon how far you are willing to challenge the ordinance. How those costs are paid, whether totally by you, shared with or paid wholly by the landlord or seller, is a matter of negotiation. Aside from costs, however, there is the timing problem created by having to seek approval for your particular use. If you need to be in your property by a specified date, recognize that the

zoning approval process described above can take a minimum of three (3) months, and up to a year or more, if court intervention is required.

To protect yourself from either a bad or an untimely decision on zoning, you should include a contingency in the lease or purchase agreement for the property that allows you to cancel if the needed zoning approval is not received by a specified date. In this way, you may lose the costs paid to obtain the approval and the time spent in seeking the approval, but shouldn't have to pay five years of rent for a space you cannot use, or have to seek a subtenant or assignee to use that space.

TAX RAMIFICATIONS – LEASE AND PURCHASE

The tax effect of leasing or owning your business space is significantly different, and will affect your annual expenses for the business. If you lease space, you can deduct annually the rent and other costs you pay on your income tax return, as business expenses. Generally, if you purchase the location, however, the purchase price (including the down payment) and costs of major repairs can only be deducted as depreciation expenses, over a 39 year period. Interest paid to any lender is deductible annually, as are taxes paid on the property. Regular maintenance costs would also be deductible annually.

OTHER WAYS TO FINANCE THE PURCHASE

If you decide to purchase your business location, you may want to do it in the name of an entity other than your business. There are several reasons for this.

1. The property would then not be subject to liability for debts of the business, unless pledged as security for the business debts.
2. The business would not be subject to liability for debts or judgments against the property, unless it would agree to guarantee those debts.
3. You could finance the purchase of the property through private investors who would view an investment in the real property as better than an investment in your business.
4. The entity which owns the real estate can lease it to your business, with the lease making the business pay all costs associated with ownership of the building (e.g., rent equal to mortgage payments, tenant responsible for insuring and maintaining the

building) making those costs now deductible to your business annually, rather than being depreciation expenses deductible over time.

If you decide to purchase the property in the name of a different business entity than your company, the appropriate business entity in Pennsylvania has traditionally been the limited partnership because it is not subject to capital stock tax. As that tax is being phased out, however, you may want to consider a corporation, general partnership, or limited liability company.

A general partnership can be formed without any formal filing – a mere agreement between individuals (there must be at least two (2)) to share profits and risks creates a general partnership. Registration of the name of the partnership as a fictitious name with the Pennsylvania Department of State is strongly recommended. General partners in a general partnership are liable for all the debts and obligations of the partnership in accordance with their ownership interests and the terms of their partnership agreement – there is no statutory shield from liability.

Corporations, limited partnerships and limited liability companies are each formed by filing a document with the Pennsylvania Department of State. Shareholders in corporations and members in limited liability companies each share a full shield from liability so long as certain “formalities” are followed by the owners at formation and throughout the existence of the entity. A limited partnership provides the same shield for limited partners (subject to similar compliance with formalities), but any general partner (there must be at least one) is fully liable for the debts and obligations of the entity.

Obviously, deciding to purchase real estate in the name of an entity involves complex tax and business decisions, and should only be accomplished with the assistance of your legal counsel and tax advisor.

In our next issue we will discuss cost factors when considering lease versus purchase.

Bernadette Puzzuole is an attorney in the Real Estate and Corporate Departments. Her practice centers on land-use planning, condominium and planned community development law, and zoning as well as entity formation and related business transactions. Bernie can be reached at (412) 338-1129 or blpuzzuole@rothmangordon.com.



These rights are often created by a mortgage on real property or a security interest in personal property. In such cases, the secured creditor is normally entitled to be paid in accordance with its mortgage or security agreement.

Creditors should be proactive. As a creditor, you can challenge the debtor's right to a discharge. You may also contact the trustee if you suspect some assets have been concealed and are entitled to question the debtor under oath.

Creditors may want to have the debtor reaffirm the debt. Even if the debt is discharged, you may be able to negotiate some type of repayment with the debtor.

If a creditor is unsecured, or it has no collateral for the debt owed, the unsecured creditor may still be entitled to monies from the bankruptcy estate with the size of the distribution depending on the amount of monies

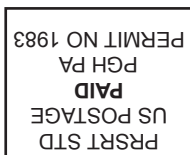
available for distribution, the priority of its unsecured claim, and the number of other creditors in the same class.

In our next issue, we will discuss workouts and strategies for discharging debt.



Paul Yagelski was certified by the American Board of Certification in the field of Creditors' Rights in 2002 and recertified in 2007 through a rigorous process of practice, peer review, and continuing education. In addition to his Creditors' Rights practice, Paul also has a robust civil litigation practice that includes commercial litigation, tort litigation, remedial litigation, tax litigation and bankruptcy actions, with extensive involvement in Chapter 11 proceedings. Paul has litigated before state and federal trial courts and the American Arbitration Association. Paul can be reached at (412) 338-1124 or pryagelski@rothmangordon.com

ROTHMAN GORDON: JUST RIGHT



310 Grant Street
Third Floor, Grant Building
Pittsburgh, PA 15219
Rothman Gordon P.C.

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