



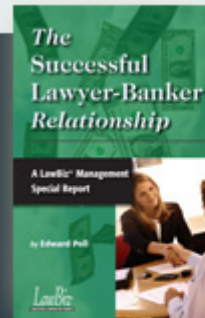
Week of **November 25, 2008**

## A Credit Line Belongs to the Bank-- Not to You

For many years some economists offered the soothing message that we Americans ought not to be too worried about the size of the federal budget deficit--after all, it was just money that we owed to ourselves. That of course may have been true in the 1950s and 1960s, when much of the rest of the planet was still rebuilding from World War II and our country was the only one generating excess cash. Today, however, when our huge and growing deficit is financed by money from China, Dubai and countless other nations, we no longer can have the assurance of saying that it's money we owe ourselves.

I thought about this issue after hearing more and more reports that law firms are increasingly paying staff salaries and even partnership draws by using their bank lines of credit. In a credit line arrangement, the firm borrows and repays at will up to the amount of the credit line, which is reviewed annually and extended, increased or terminated as the lender deems appropriate. The cost of such loans varies with factors such as the firm's bank balance, other services purchased, and credit rating.

No matter what kind of reasoning a firm uses, it is never a good idea to pay staff payroll using a bank loan. If you borrow for payroll and payroll tax funds in anticipation of collecting on accounts receivable and then fail to collect enough to cover payroll and taxes sufficiently, the result will be a damaged credit rating, not to mention civil and potential criminal penalties. The same risk is even greater for firms that use a line of credit to pay their partners for the month. Their rationale is that they are not going to go too deeply into debt for such a purpose and they have cash that's due in at any time. What's wrong with using a credit line, which, after all, the bank has agreed to extend to you, to pay yourself first?



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Law firms today are moving toward operating in a more businesslike fashion, rather than just as a group of professionals--and those that are truly businesslike will recognize that a key to responsible management is establishing a strong banking relationship. Importantly, banks are looking for profitable new niches so law firms and banks are natural allies in today's competitive world.

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It should be said that there is no IRS problem with doing this. The only question pertains to the rationale on which the line of credit was provided. This is a contract issue between you and your bank. However, using a bank line of credit to pay yourself is just as risky as using it to meet the firm payroll, and for the same reason. Too often, the anticipated payment or new work doesn't materialize--and then you have a major problem with the lender.

In today's difficult credit market, when banks are even unwilling to lend overnight to other banks, lines of credit are in danger of tightening or even drying up entirely. The simple fact is that banks need to be assured that they are going to be repaid or they won't loan money. When even large law firms like Heller Ehrman and Thelen Reid run into financial and economic difficulty in today's market, banks are going to be much more cautious in extending credit to any law firm customer--especially one that views a line of credit as a blank check to use at will.

Best wishes,

Ed Poll

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