

Consumer Bankruptcy and small business owners

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As the economy is slow to recover, bankruptcy is becoming a reality for more and more Americans. Many are finding that their hard work is simply not enough to pull them through these tough times, including many small business owners. A common scenario that I see with my small business owner clients is that the fear of what would happen to their business has kept them from filing for so long that by the time they come see me, they are so over their heads with debt, they are struggling to feed their children and pay their utility bills. Bankruptcy law allows for debt relief while suffering financial hardship. To avoid the above scenario, small business owners need to be aware that they have options.

You, as a small business owner, must first distinguish whether or not it is your business that needs to file bankruptcy or if it is you as an individual that needs to file. If the debts are solely in the business' name, and the business is incorporated or is an LLC, then the company itself needs to file for relief. The business has two options: Chapter 7 or Chapter 11. A Chapter 7 would be appropriate when the business needs to shut its doors and liquidate, or restructuring the debts would not be feasible. Note that if your business is a partnership, the business itself is not a separate legal entity from the general partners and they may be sued individually for the debts. A Chapter 11 is a restructure of the business' debts and would be appropriate when a business could be profitable if it were not for the burden of the debts. In a Chapter 11, the business may continue to operate and remain in possession of its assets. The Debtor/business will create a restructured plan. Creditors whose legal rights are affected will be able to vote on the confirmation of the proposed plan. A Chapter 11 is a lengthy and costly bankruptcy and should be entered into with caution.

If you are a sole proprietor the business is an extension of you personally, so in this case a personal bankruptcy is appropriate. More often than not, in my practice even in the case of small business owners, it is the individual who needs to file for bankruptcy relief. In addition to a sole proprietor, a small business owner in an LLC or a corporation may also file personal bankruptcy with little effect on their business. The Debtor here has two options. She may file a Chapter 7 or a Chapter 13. Again, a Chapter 7 is a complete discharge of the unsecured debts. Something to keep in mind is that the creditors of an LLC or corporation will still be able to collect against that business entity, even though the individual's personal guarantee will be discharged. Relief under Chapter 7 is appropriate when the individual's income received from the business and all other sources falls below a certain amount set by the IRS. So, long as the business does not have substantial assets exceeding the state exemptions, a Chapter 7 is often the best route for a small business owner. It provides a fresh start for individuals so that they may focus on the success of their business.

A Chapter 13 is an individual reorganization and is appropriate when you may be behind on mortgage or car payments, have substantial assets – including assets of the business exceeding the exemptions, or when high income triggers a “substantial abuse” objection if filed under Chapter 7. Unlike a Chapter 11, the Debtor proposes a reorganization plan and the creditors must accept it without a vote. The plan will require future monthly income from the business, after personal expenses are met, to be paid into the plan. During the life of the plan, the Debtor is protected from her creditors and after the Chapter 13 plan is complete, many of the unsecured debts will be discharged. The debts of an LLC or corporation may not be included in the Chapter 13 plan, the 13 is solely an individual reorganization and will allow you to stay in business even if the business has assets and is not the source of the debt.

If overwhelmed with debts, a small business owner has options and will not be required to shut its doors. Bankruptcy can be a powerful tool to help you through these financial trying times and achieve a fresh start.