

Bankruptcy for the Self-Employed

CONCURRENT SESSION

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Introduction

Representing consumer debtors who are self-employed or operate a business can add complexities in documenting and verifying assets and income to a case that debtor counsel should be prepared to address starting at the initial consultation. Determining the nature of the business and outstanding debts may obviate the necessity of filing a B22A form (the Means Test). How a debtor's income is derived and disclosed on the Means Test can impact the Applicable Commitment Period and consequently, plan length in a Chapter 13. Disclosure of assets and their valuation on Schedule B will be scrutinized by Chapter 7 and Chapter 13 Trustees. Self-employment or business income disclosed on Schedule I will trigger the requirement to file a detailed statement of income and expenses. Failure to properly document the income and expenses could lead to a motion to dismiss by the United States Trustee in a Chapter 7 or denial of confirmation and dismissal in a Chapter 13.

I. Petition and Preliminary Matters

The bankruptcy petition filed must accurately disclose the name of the debtor; however, the petition may no longer include an assumed name or the Court will issue a show cause order. The petition will also disclose the nature of the debts of the debtor. In a Chapter 7, the B22A form, otherwise known as the Means Test is required to be filed if a debtor's debts are primarily consumer debts. If a debtor alleges that their debt is non-consumer debt, certainly a Trustee will look for disclosure of residential mortgage debt, which consumer debt would undoubtedly require that the Means Test be filed. The B22C form is required to be filed in all Chapter 13 cases pursuant to Administrative Order 06-08. The remaining schedules and statement of financial affairs are required of all debtors without distinction. 11 USC § 521.

II. The Schedules and Statement of Financial Affairs

How do the schedules prepared by a self-employed debtor differ from those of other debtors? The primary differences will be in the disclosure and valuation of business assets. The manner in which a debtor has organized their business can impact the length of a Chapter 13 plan, debtor's eligibility for particular chapters, and the manner in which assets, debts and income are disclosed and defined in the schedules. Even if a debtor operates an incorporated business, the Trustee will scrutinize how or if the debtor maintained the formalities of the corporate form or whether the business is simply an alter ego of the debtor changing the form of the disclosures on the schedules.

A. Schedule B

1. Line 13 requires the disclosure of "Stock and interests in incorporated and unincorporated businesses. Itemize." Even if the tax laws allow for a "disregarded entity" for tax return purposes, disclosure of unincorporated businesses is required in bankruptcy.
2. Line 28, 29 and 30 require disclosure of "Office equipment, furnishings and supplies;" "Machinery, fixtures, equipment and supplies used in business;" and "Inventory," respectively. If the debtor is a sole proprietor, operating with or without an assumed name, there is no separate legal entity to disclose. Therefore, the assets are owned by the individual and must be listed on Schedule B. However, if the debtor operates a business under a corporation or limited liability company, then the assets may be presumed to be property of that corporation or limited liability company.

Practice pointer: Debtors frequently believe that business assets are owned by the company, when in fact, they are held in their individual name or vice versa. Debtor counsel should review the books and records of the business, including the schedule of assets attached to tax returns, bills of sale, titles, deeds and bank accounts to ensure accurate disclosure. The Trustee will expect a breakdown of the items.

3. Line 16 requires disclosure of “Accounts receivable” Even if the debtor operates the business as a corporation or limited liability company, capital contributions and loans made by the debtor to the business and retained earnings are assets of the debtor that must be disclosed on Schedule B.

Practice pointer: Debtor counsel should review tax returns, balance sheets and other financials of the business to ensure full disclosure.

B. Valuation and exemption of assets used by the debtor in the operation of their business

1. Valuation of the business assets on Schedule B can be a minefield for the debtor if insufficient or improper disclosure is made. Alternative methods – balance sheet analysis; schedule L to the corporate tax return (book values) vs. current fair market values; liquidation or going concern values.

Practice pointer: Debtor counsel should consider the impact, on the value of individual assets or the business as a whole, of: liens; liabilities of the business; interests of other shareholders or partners; restrictions on transfer of interests in corporations and limited liability companies and other attributes of the business.

2. How a business interest is disclosed and the value placed on that interest or the assets of the business will dictate exemptions and impact the liquidation analysis.

Practice pointers: Debtor counsel should consider using the tools of the trade exemption found in 11 USC § 522(d)(6), especially if the debtor has used the full amount of the (d)(5), “wildcard” and the (d)(2) vehicle exemption. Most courts will use a common sense approach and allow the exemption if an item is reasonably necessary for the use in the business.

C. Listing business or corporate debts in the schedules

1. If the debtor is a personal guarantor on debts of the business, eligibility for Chapter 13 under 11 U.S.C. § 109(e) with regard to debt limits may be an issue. Debts stemming from a personal guaranty may be considered unsecured in the Debtor’s personal bankruptcy even if they are secured by property held by the business. Further, a personal guarantee may be deemed a contingent debt for purposes of 11 USC § 109(e) if the primary obligor (the business) is current on the obligation at the time the Chapter 13 is filed.

Glaubitz v. Grossman, 10-C-927, 2011 WL 147931 (E.D. Wis. Jan. 18, 2011) – Debtor was a guarantor on multiple loans where the primary obligor on the debt was a corporation owned by the debtor. The amount owed on the debts if non-contingent would have disqualified the debtor from a Chapter 13 under 11 U.S.C. § 109(e) as they would exceed the limit for unsecured debt. The corporation had not defaulted on the loans as of the date of the bankruptcy filing. The Court held that a personal guaranty in its very nature is a contingent liability because it relies on the default of another party. The Court held that the debt was contingent and not to be considered for purposes of Chapter 13 eligibility as the primary had not defaulted on the debt and the debtor was not yet liable for the debt.

Issues raised by this opinion – How should the creditor file their proof of claim in the Chapter 13 and how should the plan treat the contingent debt?

In re Brown, 250 B.R. 382, 383 (Bankr. D. Idaho 2000) - Debtors were sole owners of a corporation. Debtors filed for Chapter 13 relief. Debtors were personal guarantors on a note that was secured by a mortgage against real estate owned by the corporation. The debtors scheduled the debt owed to the creditor as a secured obligation. With the debt classified as a secured debt both the debtors' secured and unsecured obligations were less than the debt limits. The creditor filed an unsecured claim for the full amount of the debt and moved to dismiss the case on the grounds that the amount of debtors' unsecured debt now exceeded the debt limits in 11 U.S.C. § 109(e). The Court held that because the creditor did not have a security interest in any property owned by the debtors, the debtors' obligation to the creditor was wholly unsecured. The classification of the debt placed the debtors above the debt limit and ineligible for a Chapter 13.

Practice pointer: It is important to discuss with the debtor prior to filing what impact the filing of a bankruptcy may have on debt owed on behalf of the business and the debtor. If the debtor is a personal guarantor on business debt the creditor may consider the loan in default even if the debtor's business continues to pay the loan. This can create some uncertainty for the business as a result of the filing of a personal bankruptcy.

2. The automatic stay does not apply to creditors secured against assets solely held by the debtor's separate corporate entity in a personal Chapter 7 or Chapter 13. Regardless of whether or not the corporation is individually owned, the assets of the business do not become assets of the bankruptcy estate for purposes of 11 U.S.C. § 362(a). While the corporation itself is an asset of the bankruptcy estate, the individual business assets are not protected from secured creditors by the automatic stay. The fact that the debtor is a personal guarantor on the debt is irrelevant. If the property is not held in the debtor's name a personal bankruptcy filing will not provide the protection of the automatic stay and

the property cannot be treated in a Chapter 13 plan (absent consent from the creditor). Further, the co-debtor stay does not apply in cases where the individual debtor personally guaranteed the note as 11 U.S.C. § 1301(a) only applies to consumer debts.

In re Nemec, BR 12-00986, 2012 WL 2803735 (Bankr. N.D. Iowa July 10, 2012) - Debtor was the sole shareholder of his business. The debtor executed a note with the bank and the note was secured by a mortgage against real estate owned by the business. The debtor personally guaranteed the note. The loan went into default and the bank sought foreclosure of the real estate. Debtor filed a Chapter 13 case just prior to the foreclosure of the property. The Court held that the automatic stay in debtor's individual case does not apply to actions of creditors against property owned by his solely-owned entity. While debtor's corporation is property of the bankruptcy estate the automatic stay does not protect the separate entity itself against actions of its own creditors. The Court held that the debtor having a possessory interest in the real estate as the sole member of the corporation was insufficient to render the real estate property of the estate.

In re Lane, 215 B.R. 810 (Bankr. E.D. Va. 1997) - Debtor was in possession of two trailers and one vehicle which were titled in the name of her corporation of which she was the sole owner. Debtor filed a Chapter 13 plan that proposed to treat the creditors that had a secured interest in the vehicles. Debtor argued that the Court should disregard the corporation as she had failed to abide by the corporate form. Debtor cited the fact that she commingled funds and used the corporation's property as her own. The Court rejected this argument holding that party should not be allowed to utilize corporate form on the one hand to protect herself from individual liability for the corporation's debts, and then on the other hand to nullify existence of the corporation to avoid reckoning with the obligations incurred by the corporation while it was a viable entity.

D. Schedules I and J

1. If the debtor discloses income on Line 7 of Schedule I – “Regular income from operation of business or profession or farm,” a detailed statement MUST be attached. This income/expense statement is essentially a monthly profit and loss of the debtor's business.

2. The Trustee will expect that the debtor can and will document the figures on the detailed statement as required by LBR 2003-2(a) and (b). Including fictitious or phantom expenses that may be allowed for tax return purposes is inappropriate in the bankruptcy context – the expenses listed must be the business’ actual monthly expenditures.

In re Culcasi, 2011 WL 4005451 (Bankr. D.N.H. Sept. 7, 2011)(self employed debtor not entitled to operate his business at a loss forcing unsecured creditors to subsidize his business to their own detriment and where debtor filing alone would not have been eligible for Chapter 13 relief).

E. Statement of Financial Affairs

1. Lines 18-20 of the Statement of Financial Affairs require disclosure of : debtor’s interest in businesses, identification of bookkeepers and accountants and the location of the books and records of the business; and information regarding inventories. “SOFA” 18 requires disclosure of debtor’s interest in **any** business “within **six years** immediately preceding the commencement of this case.”

Practice pointer: Debtor counsel should check the debtor’s tax returns for any businesses disclosed as well as conduct a Lexis search. Search of the State of Michigan’s Department of Licensing and Regulatory Affairs (“LARA”) (www.michigan.gov/lara) site can verify the existence of a corporation and its status.

III. Meeting of Creditors

Documents required by LBR 2003-2 are the same for Chapter 7 and 13 debtors. The Rule is as follows:

Rule 2003-2 Debtor's Documents at the Meeting of Creditors

In a case under chapter 7, 12 or 13, or in an individual case under chapter 11, to the extent they are in the debtor's possession or are readily available, the debtor shall have available at the meeting of creditors, neatly arranged, all of the following for one year prepetition:

- (a) Documents to support all entries on schedule I, other than previously provided payment advices and tax returns;
- (b) Documents to support all entries on schedule J, including canceled checks, paid bills or other proof of expenses;
- (c) Certificates of title (originals if available, otherwise copies) for currently owned titled assets, including vehicles, boats and mobile homes (regardless of when acquired);
- (d) A current statement from each secured creditor stating the amount owed;
- (e) Originals of bank books, check registers, other financial accounts, bonds, stock certificates, and bank, brokerage and credit card statements;
- (f) Copies of leases, mortgages, deeds and land contracts (These documents shall be provided for the time period six years prepetition.);
- (g) Copies of life insurance policies either owned by the debtor or insuring the debtor's life; (h) Current property tax statements;
- (i) Asset appraisals;
- (j) Keys to non-exempt buildings and vehicles;
- (k) Divorce judgments and property settlement agreements;
- (l) Casualty insurance policies;
- (m) Documents establishing the scheduled amounts of joint debts, if the debtor claims an entireties exemption;
- (n) The name, address and telephone number of each holder of a Domestic Support Obligation; and
- (o) Any other specific document requested by the trustee relating to the schedules or statement of financial affairs, if requested in writing at least 7 days before the first meeting of creditors.

A Chapter 13 Trustee may spend less time, if at all, at a § 341 First Meeting of Creditors reviewing title documents, which differs from a Chapter 7 Trustee, because a Chapter 13 Trustee is not charged with collecting and liquidating estate assets where debtors are able to retain their assets by making periodic payments to the Chapter 13 Trustee. However, with respect to a self-

employed debtor or a debtor that operates a business, a Chapter 13 Trustee will request and review numerous documents to determine the accuracy of the disclosure of business assets, their value and the amount of the income the debtor derives from the business. LBR 2003-2(o) allows the Trustee to request any other specific document as long as the request is in writing at least 7 days before the 341 First Meeting of Creditors. The typical request for documentation is: the last two years' corporate tax returns, if filed; 6-12 months of business bank statements; 1-2 years of monthly profit and loss statements; and paid invoices. Some Chapter 13 Trustee's request that a debtor complete a questionnaire answering questions ranging from requesting a description the nature of the debtor's business to questions regarding the number of employees and withholding taxes. The more information and documentation a Trustee is provided in advance of the First Meeting of Creditors, the more likely that the 341 can be concluded without the necessity of adjourned hearings. See Exhibits 1 and 2 for examples of a business questionnaires that may be used by a Chapter 13 Trustee.

Practice pointers: The following documents are necessary to determine the debtor's bankruptcy options, properly fill out bankruptcy forms, and successfully have the 341 meeting of creditors held:

- **Corporate tax returns / Schedule C of personal tax returns** - Tax returns provide good insight into the historical gross income of the debtor's business. If your client's business is seasonal it can give a good indication of income over the course of a full fiscal year as opposed to just the six months prior to filing. Be wary of business expenses on the tax returns as many of them may not be equivalent to actual expenses. If your client files a corporate return, the return may state the value of the business. Be ready to discuss any variation in the value on the returns and the value determined by the debtor for schedule B. Consult with the person who prepared the taxes and make sure you understand (and can explain to anyone interested) the difference between book value and fair market value. Corporate returns are also useful in determining the ownership stake of the debtor in a business, as well as whether your client has told you about all of the businesses or investments they have an interest in.

- **Profit and loss statements** – Debtors should provide the last 6 months of profit and loss statements for the lookback income for the Means Test. A full 12 months is helpful to calculate income for schedule I if the debtor’s income varies throughout the year. If the debtor has not kept a monthly profit and loss statement instruct them to create one using past bank statements, invoices, receipts, etc. Question the debtor on how the statements were created as the debtor may have to provide actual verification of the income and expenses on the profit and loss to the trustee or creditors. Review any profit and loss statements for personal expenses of the debtor.
- **Statement of business assets and values** – Have your client provide a detailed list of assets held by the business or used by the business. Provide as much detail of these assets as possible when filling out Schedule B.
- **Business bank statements** - Review to determine if all of the gross income appears on the profit and loss statements, any personal expenses paid by the business, and to verify business expenses. The funds in the account need to be considered when valuing the business in Schedule B.

IV. Other Issues

A. Chapter 7 issues

1. Line 3 of the B22A form; corporate form issues – sole shareholder vs. sole proprietor– surviving the scrutiny of the United States Trustee and a 707(b) motion.

In re Smith, 229 B.R. 895 (Bankr. S.D. Georgia 1997)

Self employed real estate agents - underestimate income and business expenses - Trustee moved to dismiss - Chapter 7 case dismissed because filed in bath faith.

In re Smith, 2007 Bankr. LEXIS 2173 (Bankr. N.D. Ohio 2007)

Debtor was a self employed carpenter; motion to dismiss filed. Debtor testimony indicated he has no employees and maintains the records for his business. UST offered testimony of bankruptcy analyst concerning income/expenses. Debtor had to explain deposits into checking account and which were attributable to business income. UST argued presumption of abuse since Debtor did not properly calculate income and deduction and Debtor failed to accurately report business expenses. Court agreed that the business expenses were overstated. Motion to dismiss was denied.

In re Reese, 402 B.R. 43 (Bankr. M.D. Florida 2008)

Debtor was a self employed therapist. Non-filing spouse unemployed, but assisted with business and took draws. Debtor unable to answer questions concerning business, draws,

profits, losses, overhead, etc. Debtor's schedules, means test, exhibits and testimony all varied concerning business income and expenses. However, court did not find bad faith.

In re Hickman, 2008 Bankr. LEXIS 3253 (Bankr. W.D. Washington 2008)

Debtor failed to produce documentation to establish actual business expenses. Instead, the Debtor relied on the tax returns. Debtor failed to list one business. Court concluded based on totality of circumstances, abuse to grant Chapter 7.

In re O'Brien, 373 B.R. 503 (Bankr. N.D. Ohio 2007)

Self employed Debtors did not provide itemization for expenditures as requested by UST. Debtors were not completely forthcoming with their financial figures and failed to provide accounting of business expenses to UST. Court found case should be dismissed under totality of circumstances and bad faith standards.

Bodenstein v. Wasserman (In re Wasserman), 332 B.R. 325 (Bankr. N.D. Illinois 2005).

Debtors contended they had no business records. No documents regarding the business income/expenses/disposition of funds were provided. Despite having extensive business experience, Debtors provided only small assortment of documents covering random periods of time that prevented adequate tracing of assets. Under these circumstances, Debtors not entitled to discharge.

UST v. Knowling (In re Knowling), 2011 Bankr. LEXIS 4080 (Bankr. Oregon 2011)

Debtor is a business owner and maintained his own records. Debtor failed to create or maintain any ledgers of his income and expenses. UST argued he deliberately kept his income unknown to avoid paying taxes and to minimize liability. Court held it is questionable whether Debtor ever maintained business records that would allow him or anyone to prepare tax returns accurately. Discharge denied.

Haupt v. Belonzi (In re Belonzi), 2012 Bankr. LEXIS 4158 (Bankr. W.D. Penn 2012)

Debtor failed to explain disposition of equipment and use of proceeds from sale of business, did not provide adequate records such as income statements or balance sheets for the business. Disclosure required under 727(a)(3) may include disclosure of books and records of an entity in which the debtor holds an interest. When an individual debtor's income is derived almost entirely from an entity controlled by the debtor, the records of that entity can be critical in determining the financial condition of the debtor.

Roberts v. Debusk (In re Debusk), 2008 Bankr. LEXIS 4662 (Bankr. E.D. Tenn 2008)

Inconsistencies (under-reported expenses, failed to provide financial records) made it impossible for creditors to ascertain true income from the operation of the businesses. Debtor failed to disclose the true nature of his business. Debtor had not produced adequate records, intentionally made false statements and did not explain dissipation of assets. Discharge denied.

Gray v. Jackson (In re Jackson), 453 B.R. 789 (Bankr. E.D. Penn 2011).

Debtor's disclosure requirement extends beyond the property of the estate to include all "business transactions" which shed light on the financial condition of the debtor. In appropriate circumstances, the debtor's disclosure requirement extends to the books and records of a closely held corporation in which the debtor holds an equity interest. A debtor's failure to file timely tax returns — especially for several years in a row — is a blatant example of a failure to maintain adequate records. Checking account ledgers, cancelled checks, bank statements, and tax returns do not enable creditors to track financial dealings with any degree of accuracy, as these types of records do not disclose the sources of funds or substantiate expenses. Commingling of assets between the debtor and another entity can lead to a violation of § 727(a)(3). When an individual debtor's income is derived in substantial part from a closely held corporation controlled by the debtor, the books and records of the corporation can be critical in evaluating the financial condition of the individual debtor for purposes of § 727(a)(3) -- if for no other reason, because the debtor is in a position to commingle corporate and personal assets.

B. Tax Debt Issues

1. Determine if debtor has any unfiled returns. – If the debtor has any unfiled tax returns, debtor should file all tax returns prior to filing, if possible, so that they can be reviewed when preparing the case. Advise the debtor that unfiled tax returns are cause for dismissal of the bankruptcy and that any liabilities on late filed returns are non-dischargeable in both Chapter 7 and Chapter 13 pursuant to 11 U.S.C. § 523(a)(1).
2. Is the debtor liable for any payroll taxes (trust fund taxes)? -- If the debtor has had ownership of a business does the business have unpaid payroll taxes. If the company failed to pay payroll taxes an officer or employee may be subject to a penalty in the amount equal to the unpaid taxes. These payroll/trust fund taxes can be accessed against the debtor and are a priority debt under 11 USC § 507(a)(4) and (5). This renders the debt non-dischargeable in both a Chapter 7 and Chapter 13. In a Chapter 13, the plan must provide for full payment of the tax debt under 11 USC § 1322(a)(2). Additionally, the debtor could have issues with the debt limits provided in 11 USC § 109(e) as the debt will be considered an unsecured debt absent a tax lien.

In re McVey, BKR. 08-12301, 2010 WL 724366 (Bankr. D. Kan. Feb. 23, 2010) An officer or employee of a corporation may be subject to a penalty under IRS section 6672 if he or she is under a duty to collect, truthfully account for, and pay over any such tax (*i.e.* a “responsible person”) and **willfully** fails to do so.

3. Who is considered a responsible person? -- “[A] corporate officer or employee is responsible if he or she has significant, though not necessarily exclusive, authority in the ‘general management and fiscal decision making of the corporation.’” Denbo, 988 F.2d at 1032 (quoting Kizzier v. United States, 598 F.2d 1128, 1132 (8th Cir.1979)). In this circuit, we have set forth a non-exclusive list of factors demonstrating “indicia of responsibility.” Specifically, we examine whether the person: (1) held corporate office; (2) controlled financial affairs; (3) had authority to disburse corporate funds; (4) owned stock; and (5) had the ability to hire and fire employees. *Id.* If an individual possesses sufficient indicia of responsibility, he is a “responsible person” under § 6672 regardless whether he: (1) has the final say as to which creditors should be paid, Bowlen v. United States, 956 F.2d 723, 728 (7th Cir.1992); Gephart v. United States, 818 F.2d 469, 475 (6th Cir.1987); or (2) has the specific job within the corporate structure to see that the taxes are paid over to the government, *see* Denbo, 988 F.2d at 1032; McGlothin v. United States, 720 F.2d 6, 8 (6th Cir.1983) (“[I]t is not necessary that a [responsible] person be the one who prepared the tax returns, kept the books and records, paid the wages or withheld the taxes.”)(footnote omitted).
4. What qualifies as “willfully”? -- a “voluntary, conscious and intentional decision to prefer other creditors over the Government.” Burden v. United

States, 486 F.2d 302, 304 (10th Cir.1973), *cert. denied*, 416 U.S. 904, 94 S.Ct. 1608, 40 L.Ed.2d 109 (1974). Although negligence does not give rise to section 6672 liability, “[t]he willfulness requirement is ... met if the responsible officer shows a “reckless disregard of a known or obvious risk that trust funds may not be remitted to the government....” Smith v. United States, 894 F.2d 1549, 1554 n. 5 (11th Cir.1990) ... A responsible person's failure to investigate or to correct mismanagement after being notified that withholding taxes have not been paid satisfies the section 6672 willfulness requirement. Mazo v. United States, 591 F.2d 1151, 1154 (5th Cir.), *cert. denied*, 444 U.S. 842, 100 S.Ct. 82, 62 L.Ed.2d 54 (1979)(footnote omitted).

D. Chapter 13 issues

1. Income disclosed in Part I of the Means Test and Plan length -- Disclosure of income on Lines 2, 3 or 4 of the Means Test during the 6-month lookback period impacts plan length and even the minimum dividend to unsecured creditors. The manner in which the debtor's business is organized may affect whether their income is below or above the median and the length of the Chapter 13 plan. There is a conflict between the Means Test (Official Form B22A for Chapter 7 and Official Form B22C for Chapter 13) and § 1325(b)(2)(B). Following the clear instructions of the form, a self employed debtor operating a sole proprietorship will enter their average gross business revenue on Line 3(a) of the Means Test. The form then instructs the debtor to enter business expenses on Line 3(b).

Finally, business expenses on 3(b) are subtracted from gross income on 3(a) to give net income on 3(c). The net income on line 3(c) is then compared to the gross median income of a similarly sized household in their county to determine the applicable commitment period for the debtor. This calculation will likely result in the debtor's income being below the median and allowing for a 36 month plan length; however, this will draw an objection by the Trustee.

Courts have interpreted 11 U.S.C. § 1325(b)(2)(B) to require that deductions of necessary business expenses are taken **after** current monthly income is calculated. Business expenses must to be taken after Line 17 on the Means Test. Therefore, it is improper to follow the official form and take business expenses on Line 3(b). The official form does not provide a line after Line 17 to deduct the business expenses when calculating disposable monthly income. In re Arnold, 376 BR 652 (Bankr. M.D. Tenn. 2007)(Bankruptcy Code prevails over the form.)

This issue also affects debtors that have rental income as a portion of their income. Line 4 is also set up on the official form with Line 4(b) and (c). If a debtor that receives rental income the gross rental receipts will be included in "current monthly income" on Line 4, but the expenses (mortgage payments, maintenance, property taxes, home insurance, etc.) may not be considered until after the "applicable commitment period" is determined.

The ultimate effect is that self-employed debtors are more likely to be placed in five year plans despite having net income similar to wage earners in three year plans. The self-employed debtor's gross receipts are compared to the median income of similar household sizes in their county. With the median income being calculated from primarily gross income figures of classic wage earners, the comparison is not relative. For example, a self-employed truck driver may have gross income of \$6,000.00 per month with monthly business expenses of \$3,000.00 per month for a net income of \$3,000.00. When determining plan length his gross receipts of \$6,000.00 will be used to determine whether or not his income is above or below median. The Bankruptcy Code places him in a similar position to someone earning \$6,000.00 from wages. If the debtor operates a business that is organized as a separate entity, the Means Test could be filled out differently. Current monthly income is defined in 11 U.S.C. § 101(10A) as the "average monthly income from all sources that the debtor receives...without regard to whether such income is taxable income, derived during the 6 month period" before the dates stated in § 101(10A)(i) & (ii). Therefore, if the gross income is in fact received by a separate corporate entity it does not need to be considered as income of the debtor. Only income actually received by the debtor would be used on the Means Test. Debtor would only enter the flow through net income of the business on the Means Test. The business expenses can then be considered before entering income figures into the Means Test.

Practice pointers: This illustrates a potential benefit of advising self-employed clients to set up a separate entity for their business. This also applies to individuals that have rental income or 1099 income. A simple LLC could be organized to receive the rental income and/or 1099 income and pay necessary business expenses. Once net income is established determine how much in personal tax liabilities the debtor is likely to owe on an annual basis. Instruct the debtor to withhold the proper amount and use these figures as deductions on Line 30 of the Means Test and Schedule J. These deductions are helpful in reducing disposable income and insuring your client doesn't end up paying more than necessary to unsecured creditors while incurring tax liabilities.

In re Wiegand, 386 B.R. 238, 239 (B.A.P. 9th Cir. 2008)

The Court held that a chapter 13 debtor engaged in business may not deduct ordinary and necessary business expenses from gross receipts for the purpose of calculating current monthly income as defined under § 101(10A). Rather, such deductions are authorized under § 1325(b)(2)(B) and, therefore, are to be subtracted from current monthly income when calculating disposable income pursuant to § 1325(b)(2). To the extent that Part I of Form 22C requires a business debtor to calculate current monthly income by subtracting ordinary and necessary business expenses from gross receipts, we hold that Part I of Form 22C is inconsistent with § 1325(b)(2). The Court held that the statute was unambiguous and that an interpretation that would render the statute provision a nullity should be rejected. The court went on to state that if the statutory language is clear, it must be applied by its terms unless it would lead to absurd results. The Court reasoned that placing certain self-employed debtors in five year plans as opposed to similarly situated wage earners is not absurd. This holding placed the debtor in a 60 month chapter 13 plan. By taking business expenses after determining current monthly income the debtor's income was above median. The opinion gives very little detail regarding the nature of the debtor's business. It appears the business was organized as a limited liability corporation.

In re Sharp, 394 B.R. 207, 211 (Bankr. C.D. Ill. 2008)

Debtor filed a Chapter 13 plan and proposed a 36 month plan. Debtor deducted business expenses from gross revenue and carried over just the net income from his self-employment as a Tae Kwon Do instructor in Part I of the B22C. The debtor did not appear to have had a separate corporate entity. The Trustee objected to the plan on the grounds that the gross revenue should be used for Part I and business expenses should be taken after current monthly income is determined. The Debtor argued that requiring the use of gross business receipts in the Debtor's income calculation without allowing a corresponding deduction of business expenses unfairly skews the results on the B22C. The court reluctantly adopted the holding in *Wiegand* and relied on the clear language of § 1325(b)(2)(B). The court does go into extensive analysis as to why the result is unfair to self-employed debtors but determines that it cannot deem the statute absurd.

In re Geiger, 09-62433, 2010 WL 2756760 (Bankr. N.D. Ohio July 12, 2010)

The debtor in this case argued that current monthly income as defined under § 101(10A) does not include the gross receipts received by a business that is a separate legal entity. Debtor was the sole shareholder of an S corporation organized under the laws of the State of Ohio. The factual record makes clear that the corporation follows virtually no corporate formalities other than filing a separate tax return. All income of the business was deposited into debtor's personal account. Further, the customers of the business made payments to both the debtor directly as well as the corporation. When preparing Form B22C, the debtor entered the corporation's net income onto Line 9. The objecting Chapter 13 Trustee argued that the corporation was really an "alter ego" of the debtor and asked the Court to disregard the corporate form and treat the debtor as a sole proprietor. The debtor would then be required to use gross receipts on Line 3c and propose a sixty month plan. The Court held that as a sole shareholder, only the corporate net income flows through to the debtor and only that income is used to calculate *current monthly income*. The Court rejected the Trustee's alter ego argument and reasoned and upheld the corporate form. The Court found the facts of this case distinguishable from those of *Weigand* where it was not clear if the debtor had a separate corporate entity.

2. Verification of income -- The Trustee requires **independent** verification of the debtor's business income and expenses. Providing self-prepared (or by the business' accountant) tax returns and profit and loss statements is not sufficient – bank statements and paid invoices are required. If the debtor is unable to provide these documents or otherwise verify business income and expenses, then they cannot meet the requirements for plan confirmation under 11 USC 1325, including good faith under (a)(3) and feasibility under (a)(6).

Practice pointers: It is imperative as debtor counsel to inquire into all forms of debtor's self-employed income. How is income received by the self-employed debtor? Do they receive 1099 income, cash, have ongoing contracts, or a combination of the above? A review of the debtor's business will be necessary if the debtor has a separate business entity. Do the debtors pay themselves by paycheck, file 941 returns, receive year end profits, monthly draws, or pay personal expenses from the business? If the debtor has not previously maintained separate business records or bank accounts, you should counsel them to do so immediately or they risk denial of confirmation and dismissal of their case.

3. Additional duties and reporting requirements for a “debtor engaged in business.” -- Section 1304(a) defines a debtor engaged in business as “[a] debtor that is self-employed and incurs trade credit in the production of income from such employment.” In re Whitcomb, 310 B.R. 428, 431-432 (Bankr. W.D. Ark. 2004)(the language of the Code is conjunctive – debtor must be both self-employed *and* incur trade credit to be considered to be “engaged in business for purposes of 1304). A debtor engaged in business is charged with the duties set forth in section 704(8) – “if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires.” *See also* FRBP 2015(c)(1) and LBR 2015-2. The Trustee is also required to perform additional tasks, including making an investigation of the business and filing a report on their findings. In practice, most self-employed debtors are not considered to be engaged in business.

Conclusion

Knowledge of the expectations of the Chapter 7, 13 and United States Trustees relating to representation of a self-employed debtor is imperative *before* filing the petition and completing documents to avoid a motion to dismiss or a tortuous plan confirmation process.

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**OFFICE OF THE CHAPTER 13 STANDING TRUSTEE - DETROIT
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TRUSTEE'S QUESTIONNAIRE
RE: BUSINESS OPERATIONS

NAME OF DEBTOR(S) D/B/A CASE NO.

PETITION DATE DATE OF 341 & ADJ. CONFIRMATION HRG.

1. Circumstances leading to filing the Chapter 13.
2. Description of business.
 - A. Current name & past names.
 - B. Type of business.
 - C. Main product or service.
 - D. Incurs trade credit Yes No
 - E. Sole proprietorship: Partnership: Corp.: LLC:
 - F. Name of owner(s).
 - G. Date operations began.
 - H. Business location.
 - I. Lease of business premises & terms of lease (assume or reject).
 - J. Lease of equipment & terms (assume or reject).
 - K. Seasonal business (if yes, specify good months v. bad months).

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- L. Are any assets pledged as collateral? If yes, provide detail (i.e. name of creditor, type of loan, collateral, perfection documents, etc.)
-
- 3. Assets
 - A. Description of all assets > \$500.00

 - B. Fair market value of real estate and how value was determined.

 - C. Fair market value of personal property and how value was determined.

 - D. Fair market value of inventory and how value was determined.

 - E. Fair market of general intangibles (patents, trade marks, etc.) and how value was determined.

 - F. Value of business as a going concern.
-
- 4. Location and type of bank accounts (provide copies of statements for last 6 months).
-
- 5. Authorized signatory(ies) on bank accounts.

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6. List all employees, with position, salary or hourly wage, and part or full time.

7. Proof of payment of withholding taxes.

8. Proof of payments of sales taxes.

9. Tax Returns.
 - Copies of Federal Tax Returns (last 2 years).
 - Are all tax returns filed?
 - Copies of State Tax Returns (last 2 years)

10. Insurance – provide copies of all policies or binders for:
 - Liquor liability.
 - Workers' Compensation
 - General liability.
 - All other policies.

11. Licenses – provide copies of all applicable licenses necessary to operate business.

If a license is not required explain why.
 - Seller's permit.
 - Contractor's license.
 - All other applicable licenses.

12. Have any grievances been filed with any federal agency?

13. Who maintains the financial records?

14. What records are maintained?

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- Cash receipts journal
- Cash disbursements journal
- General journal
- Accounts receivable ledger
- Accounts payable ledger
- Payroll ledger
- Fixed asset ledger
- Inventory ledger
- General ledger
- Balance Sheet
- Profit & Loss Statement
- Cash Flow Statement

15. Where are the records located?

16. Who is responsible for preparing financial statements?

17. How often are financial statements prepared?

18. Calendar year or fiscal year?

19. Do you have an Accountant? If yes, provide name & address.

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OFFICE OF CHAPTER 13 TRUSTEE, TOBY L ROSEN
BUSINESS CASE QUESTIONNAIRE

Check one: Debtor Name _____ Date Form Completed _____
 Joint Filing
 Single Filing Business Name _____ Case No. _____

Are you currently operating a business?
 Yes Date on which business began _____
 No

If "No," please indicate the date on which business operations ceased.
Business operations ceased as of _____
Do not complete the rest of the questionnaire

TYPE OF BUSINESS

If business is currently in operation please answer all the following questions:

A. Indicate the type of business which you are operating-

Sole Proprietorship
 Partnership
 Sub-S Corporation
 "C" Corporation
 Other (describe) _____

If above answer indicates anything other than a sole proprietorship, please answer the following:

PARTNERSHIP:

Give partner's name: _____
Relationship, if any, to debtor: _____
Percentage ownership of debtor: _____
Written partnership agreement?
 No
 Yes If "yes", copy of agreement, must be provided to Trustee's office within 10 business days.

CORPORATION

Identify corporate shareholders: _____
Percentage of ownership in corporation: _____
State in which business is incorporated: _____
Is the corporation in good standing with the Secretary of State?
 Yes
 No If "no", please indicate why it is not. _____

Is your spouse active in the operation of the business?

Yes No Not applicable

How you as an owner and your spouse, if applicable, are paid from the business:

Draw regular salary from the business, paid by business check.
 Take a portion of cash receipts as salary, before being deposited into the bank account.
 Since all proceeds from business are deposited into personal bank account, write checks as needed.
 Other-explain _____

DETROIT CONSUMER BANKRUPTCY CONFERENCE

OFFICE OF CHAPTER 13 TRUSTEE, TOBY L ROSEN
BUSINESS CASE QUESTIONNAIRE

BUSINESS ASSETS

Value of business assets as shown on business records: _____

Basis of valuation of assets:

- Cost less depreciation
 Fair Market Value (must have appraisal made by qualified appraiser).

Are assets of the company listed in schedules "A" or "B"?

- No
 Yes If "yes," please list: _____

Are any liabilities of the company listed in schedules "D", "E", "F", or "G"?

<input type="checkbox"/> No		
<input type="checkbox"/> Yes	If "yes," please identify:	Amount
<input type="checkbox"/>	Accounts Payable	_____
<input type="checkbox"/>	Payroll Taxes Payable	_____
<input type="checkbox"/>	Federal Income Taxes Payable	_____
<input type="checkbox"/>	State Income Taxes Payable	_____
<input type="checkbox"/>	Long Term Debt to Financial Institutions or Individuals	_____
<input type="checkbox"/>	Rent or Lease Agreement Expiration Date	_____
<input type="checkbox"/>	Other (identify) _____	_____
	Total of liabilities	=====

NATURE OF BUSINESS

Describe the products and/or services produced by your business (what you do). _____

Nature of sales made by your business:

- Cash Only
 Credit Sales Only (sales on account, which create accounts receivable)
 Combination of Cash and Credit Sales
- Percentage of sales made on cash basis _____ %
 Percentage of sales made on credit basis _____ %
 What percentage of payments received are made by customers in cash? _____ %
 What percentage of payments received are made by customers by check? _____ %

If credits sale are made, what payment terms are allowed to customers (how long do you give them to pay)? _____

How much money is currently owed your business by customers? _____

Does your business maintain a separate bank account, recording nothing but deposits and withdrawals relative to the business?

- Yes Identify bank where account is maintained. _____ Date Opened _____
 No, if no indicate which of the following best explains your practice:
 All funds received by the business are deposited into a personal banking account.
 Some funds received by the business are deposited into a personal bank account, some funds are paid direct to creditors, without deposit. _____ % of funds are deposited into a personal bank account.

OFFICE OF CHAPTER 13 TRUSTEE, TOBY L ROSEN
BUSINESS CASE QUESTIONNAIRE

EMPLOYEES OF THE BUSINESS

Number of people employed by the business:

Others-- Number of other employees _____ if none, continue on page 4

Are W-2 tax forms issued to all employees at year end?

Yes

No If no, why? _____

Does the business employ "casual" labor (labor from individuals not considered to be employees)

No

Yes If yes, how is such labor paid?

Checks from business

Cash from business receipts

Check from debtor's personal bank account

Other (explain) _____

How are payments to such casual labor reported at year end?

Form 1099

Other

Not Reported. If not reported, why? _____

How are salaries for the employees of the business paid?

Checks drawn from a Business checking account.

From cash taken in by the business (no checks issued).

Checks drawn from a personal checking account.

Who prepares the payroll for the business?

Payroll is prepared internally, by employees of the business.

Payroll is prepared by outside company, specializing in payroll preparation --Identify _____

Payroll is prepared by other means (CPA, etc). Identify _____

Are payroll taxes (Social Security, Federal and State) withheld from employees salaries?

Yes If yes, name of financial institution where funds are deposited. _____

Frequency of deposits. _____ Date of last deposit _____

No If no, state reasons why. _____

How are payroll tax payments made and accounted for ?

A separate tax escrow account is maintained

Tax payments are paid from the business checking account.

Tax payments are made from the debtor's personal checking account.

Tax payments are not being made.

Other (explain) _____

Are payroll tax payments current at present?

Yes

No If no, how long since last payment was made and what dollar amount of payments are now due?

The last month in which a tax payment was made was _____. That payment represented taxes due for the period _____

DETROIT CONSUMER BANKRUPTCY CONFERENCE

OFFICE OF CHAPTER 13 TRUSTEE, TOBY L ROSEN
BUSINESS CASE QUESTIONNAIRE AND STATEMENT OF FINANCIAL CONDITION

FEDERAL AND STATE INCOME TAX LIABILITIES OF THE BUSINESS

Are all federal and state income taxes current as of the date of completion of this form?

- Yes
- No

If no, what is the current amount of taxes due, but unpaid? \$ _____

Have all federal and state income tax returns been filed up to the current year

- Yes
- No

If no, indicate what years have not been filed and to which entity filing has not been made.

Year

- | | | | | |
|------|--------------------------|---------|--------------------------|-------|
| 19__ | <input type="checkbox"/> | Federal | <input type="checkbox"/> | State |
| 19__ | <input type="checkbox"/> | Federal | <input type="checkbox"/> | State |
| 19__ | <input type="checkbox"/> | Federal | <input type="checkbox"/> | State |
| 19__ | <input type="checkbox"/> | Federal | <input type="checkbox"/> | State |
| 19__ | <input type="checkbox"/> | Federal | <input type="checkbox"/> | State |

Do you understand that during the Chapter 13 process, that all business and personal tax obligations must be kept current?

- Yes
- No

Are sales taxes due to the state for sales from the business current at the time of completion of this form?

- Yes Date of last filing and payment _____
- No Date of last filing and payment _____
- N/A Why N/A? _____

COMPANY INSURANCE

Do you have full insurance on all assets of the company?

- Yes If yes, name and policy no. of carrier(s) _____

- No If no, why? _____

Do you have liability insurance?

- Yes If yes, name and policy no. of carrier(s) _____

- No If no, why? _____

Please enclose the following, if applicable, for the month of filing the case

- Profit and loss statement for business year to date
- Balance sheet for business
- Bank statement for business operation.
- Bank statement for personal account.