

## **Business Cases in Chapter 13 from Simple to Complex.**

**Level One – Debtor is a “1099 employee”**, he usually works for the same company or person but the employer does not withhold taxes and issues the debtor a 1099 instead of a W-2. These debtors are not responsible for generating their own business.

### **If the debtor has no out of pocket expenses associated with generating this income:**

Schedule I – Name the employer in Part 1, state that the debtor receives a 1099. Report the gross income on Line 2.

Schedule J – Report estimated average monthly tax **liability** on Line 16; include a note that this is debtor’s estimated tax liability for 1099 income. Use the debtor’s tax returns as a resource if possible.

SOFA #4 – Report gross income as if debtor was employed.

Form 122C-1 – Report gross income on Line 2 as if debtor was employed.

### **If the debtor does incur out of pocket expenses associated with generating this income:**

Schedule I – Name the employer in Part 1, state that the debtor receives a 1099. Report the net income on Line 8a and attach a statement showing gross receipts, ordinary and necessary business expenses, and the total monthly net income.

Schedule J – Report estimated average monthly tax **liability** on Line 16; include a note that this is debtor’s estimated tax liability for 1099 income. Use the debtor’s tax returns as a resource if possible.

SOFA #4 – Report gross income as if debtor was employed.

Form 122C-1 – Report gross receipts (income) on Line 5, report ordinary and necessary business expenses on Line 5 and report the net business income on Line 5 Column A.

### **If the debtor is paid by check:**

Provide the trustee with copies of checks and a year to date print out summarizing payments from the 1099 employer to the debtor.

**Before the 341 Meeting:** Submit the best available proof of income with a YTD statement of income and expenses to [payadvices@lisle13.com](mailto:payadvices@lisle13.com). Review the documents before you send them, they should support the income disclosed on Schedule I.

Be sure to submit the debtor’s complete tax return including Schedule C.

Submitting a statement that the debtor is self-employed and therefore has no pay advices is useless and patently wrong. You must make a reasonable inquiry into the debtor's circumstances; you must be able to show how the debtor's income was calculated.

**Level Two – Debtor is a sole proprietor.** Debtor may be a carpenter, a painter a manufacturer's representative, an accountant, an insurance agent, a realtor.....

Petition #4, disclose any business names and EIN used by the debtor in the last eight years.

Petition #12, report any business the debtor owns as a sole proprietor.

Schedule A/B – If the debtor maintains a bank account for business use only, disclose it on Line 17; interest in an unincorporated business must be disclosed on Line 19, accounts receivable and other liquidated business related debts owed to the debtor are to be disclosed on Line 38; vehicles used in the business that are titled to the debtor must be disclosed in Part 2; equipment, supplies and inventory must be disclosed on Lines 39, 40 and 41.

Schedule E/F – The debtor must disclose any business debts the debtor has personally guaranteed including any unpaid income taxes, withholding taxes or sales taxes.

Schedule G – Disclose any property leases or equipment leases.

Schedule I – State that the debtor is self-employed in Part 1. Disclose the address the debtor uses for the business in Part 1. Report the **net income** on Line 8a and attach a statement showing gross receipts, ordinary and necessary business expenses, and the total monthly net income.

Schedule J – Report estimated average monthly tax **liability** on Line 16. Use the debtor's tax returns as a resource if possible. Do not report any business related expenses on Schedule J, see Schedule I, Line 8a.

SOFA – Report gross income in #4 and complete Part 11.

Form 122C-1 – Report gross receipts and ordinary and necessary operating expenses on Line 5; report the net business income on Line 5 Column A.

**Before the 341 Meeting:** Submit the best available proof of income with a YTD statement of income and expenses to [payadvices@lisle13.com](mailto:payadvices@lisle13.com). Review the documents before you send them, they should support the income disclosed on Schedule I. Make sure that the expense side of the income statements shows only business expenses. Be prepared to tender supporting documents such as invoices, ledgers and bank statements. Be sure to submit the debtor's complete tax return with Schedule C.

If the debtor derives a majority of their income from a handful of clients, submit check registers or settlement statements from those clients and the most recent 1099's the debtor received.

If the debtor maintains separate business and personal bank accounts be prepared to submit statements for both. Identify any funds taken out of the business for personal use.

Debtors engages in a retail business must submit sales tax returns.

**Level Three – Debtor is Self Employed and has employees or employs subcontractors.**

In addition to the foregoing, submit records regarding payments to employees or subcontractors such as: check ledgers, 1099 forms, 941 returns (payroll tax returns).

**Level Four – Debtor is the sole shareholder of a Subchapter S Corporation.**

Petition #4, disclose any business names and EIN used by the debtor in the last eight years.

Schedule A/B – Ownership of the shares of stock in the corporation must be disclosed on Line 19. Disclose ownership of any business related property in Part 5.

Schedule D – Any debts of the business secured by assets of the debtor are disclosed here.

Schedule E/F – Any unpaid income taxes, withholding taxes or sales taxes are personal liabilities of the debtor and must be disclosed and paid through the plan as priority debts.

Schedules E/F and H – Most lenders and wholesale suppliers require personal guarantees to extend credit to small businesses. Any debts of the business secured by assets of the business have almost certainly been personally guaranteed by the debtor; if the debtor does not own the collateral the debt is unsecured as to the debtor.

Schedule G – Disclose any property or equipment leases the debtor has signed or guaranteed.

The debtor's method of compensating himself determines how his income is disclosed.

**If the debtor writes checks to himself from his business account from time to time:**

Schedule I – Disclose his average monthly gross income on Line 2.

Schedule J - Report estimated average monthly tax **liability** on Line 16.

Provide copies of all such checks and banks statements.

**If the debtor pays himself a salary and withholds taxes:**

Schedule I – The debtor's income will be reported largely as if he were an employee.

Net profit over and above salary would be disclosed on Schedule I Line 8a or 8h and 122C-1 Line 5.

**In all cases:**

SOFA – Complete #4, and Part 11.

Form 122C-1 – Report gross income on Line 2, profits over and above periodic payments on Line 5.

**Before the 341 Meeting:** Provide detailed profit and loss statement and balance sheet. Be sure to disclose all assets owned by or titled to the business. Provide at least two years Corporate tax returns (Form 1120S). If the S Corp has any employees the debtor must provide detailed payroll records and payroll tax returns. Debtors engaged in a retail business must submit sales tax returns.

**Level Five – Debtor is a shareholder of a corporation, there are other shareholders.**

In addition to the foregoing, provide copies of any shareholder agreements, particularly if insolvency of one of the shareholders triggers any provisions of the shareholder agreement (Liberty Tattoo).

**In all cases:**

1. Does the debtor incur trade credit in the production of income? In other words, at the time of filing the case does the debtor have open accounts with trade suppliers? Will these trade suppliers allow the debtor to maintain open account privileges going forward? If the answers to all these questions are Yes, then the debtor is engaged in business as defined by §1304, see below.
2. A debtor who incurs trade credit in the production of income must provide the Chapter 13 Trustee quarterly income statements, balance sheets, detailed payroll records, detailed accounts receivable records and detailed accounts payable records.
3. Review documents before submitting them to the trustee.
4. Make sure income and expense documents provided can be reconciled with entries on Schedules I and J and Form B22C and the Statement of Financial Affairs.
5. If you send a mountain of bank statements and check registers without reviewing them, do not be surprised when the trustee says they paint a very different picture of the debtor's income than your Schedules I and J do.
6. Know whether or not your debtor has employees, incurs trade debt, owes income taxes or sales taxes, has guaranteed any business debts or leases or owns business space,
7. Remember, the amount of a debt is never "unknown", the trustee will not believe this.
8. The trustee will not believe that debts are truly contingent or unliquidated.

## **§1304 Debtor engaged in business.**

(a) A debtor that is self-employed **and incurs trade credit in the production of income** from such employment is engaged in business.

(b) Unless the court orders otherwise, a debtor engaged in business may operate the business of the debtor and, subject to any limitations on a trustee under sections [363 \(c\)](#) and [364](#) of this title and to such limitations or conditions as the court prescribes, shall have, exclusive of the trustee, the rights and powers of the trustee under such sections.

(c) A debtor engaged in business shall perform the duties of the trustee specified in section [704 \(a\)\(8\)](#) of this title.

### **If the debtor incurs trade credit in the production of income then the debtor must perform all the duties required under § 704(a)(8)**

(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;