

Staying in Business While Filing For Chapter 7 Bankruptcy – Part II

In Part 1, I discussed bankruptcy options available for self-employed business owners (sole proprietors) in California with debt problems but who may not be good candidates for repayment plans under Chapter 11 or Chapter 13 of the Bankruptcy Code. In Part 2, I will focus on the how owners of a corporation might be able file personal bankruptcy and form a new corporation in order to stay in business. This article is intended primarily for debtors and business owners in California because it is based on my experience with California law and the bankruptcy exemptions available to California residents.

One of the most important duties for a bankruptcy attorney is to have an understanding of the value of the debtor's assets. When filing for bankruptcy, debtors must list all of their assets and property. Some assets are "exempt", meaning that the debtor can keep the assets despite the bankruptcy. Other assets are "non-exempt", meaning that the trustee could sell the assets to pay creditors. Placing a business owner in a Chapter 7 bankruptcy is risky if the value of the business is not fully exempt.

If a business owner with an incorporated business wishes to file for Chapter 7 bankruptcy, I generally recommend obtaining two valuations of the business first. One valuation would come from a business broker to demonstrate the value of the business if it were to be sold on the open market to a third party. The other valuation would come from a Chapter 7 liquidation auctioneer to show the value of the business if it were shut down and the assets liquidated. This provides a range of value that can be used by the attorney to determine if staying in business after file for Chapter 7 is a viable strategy.

If the value of the business exceeds the available exemption money, the debtor may need to negotiate a payment plan or settlement with the trustee to keep the business. In most cases, however, the debtor's corporation has its own debts to the point that it would have little or no value to a potential buyer. In this type of case, the Chapter 7 trustee will typically have no interest in the day-to-day operations of the debtor's business or selling it.

If the debtor's existing corporation is totally exempt or the trustee abandon's the business as an asset of the bankruptcy estate, the debtor will retain ownership of it. The debtor then forms a new corporation which purchases the assets of the old corporation that it needs to conduct the activities of the business. I recommend that the new corporation pay the higher of the 2 valuations obtained prior to the bankruptcy. This will reduce the risk that creditors of the old corporation would attempt to sue the new entity to collect on the preexisting debts. If all goes well, the debtors will be free of any dischargeable debt and also own a brand new corporation with no debts.

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factual situation is different and you should seek independent legal advice from an attorney familiar with the laws of your state for specific advice. State law generally determines how much property the debtor will be able to keep when filing for bankruptcy.

About the Author: [Carl H. Starrett II](#) has been a licensed attorney since 1993 and is a member in good standing with the California State Bar, the San Diego County Bar Association and the National Association of Consumer Bankruptcy. Mr. Starrett practices in the areas of [bankruptcy](#), [business litigation](#), [construction](#), [corporate planning](#) and [debt collection](#).