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Answers to Your Bankruptcy Questions

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The Court of Last Resort

There are some big corporate names floating around in bankruptcy proceedings these days including Chrysler, Lehman Brothers, Circuit City, Linens 'n Things, General Growth Properties and Sharper Image.

In this troubled economic era, your company may be suffering financially because it has dealings with businesses that have filed for bankruptcy. Many industries are experiencing a domino effect. For example, Sirius XM Radio CEO Mel Karmazin recently explained the consequences. "Certainly Circuit City's bankruptcy did not help us ..." he said.

And while Sirius is "rooting for all of our partners," Karmazin added, he expects Chrysler's bankruptcy to be painful. "The negative part of the impact would be that they won't be providing us any (subscriptions), probably, or very few subs, over the next eight or nine weeks, as they have announced that they are shutting down the factories," he said.

Like Sirius, many companies and individuals have been touched by bankruptcy in recent months, or the recession has taken its toll on their ability to pay debts. Here are some frequently asked bankruptcy questions. However, these answers only provide general information. Consult with your attorney and accountant about how to proceed in your specific situation.

Q. Times have been hard and our business is considering bankruptcy. What are the pros and cons?

A. Bankruptcy filings are generally a last resort. They could ruin your company's reputation and damage its ability to get credit.

If you run into a brick wall with creditors and run out of alternatives, however, you may have no choice but to file for bankruptcy using one of the following four types of proceedings under the *United States Bankruptcy Code*:

Types of Bankruptcy and Characteristics	
Chapter 7	Corporation goes out of business and a trustee liquidates its assets, distributing proceeds to creditors. Most remaining debts are wiped out. Chapter 7 is also available to partnerships and individuals. Remains on credit history for 10 years.
Chapter 11	Company continues operating and negotiates a court-approved repayment plan with creditors. Chapter 11 is typically used by businesses but is available to individuals. Generally remains on credit history for 10 years but may be removed after seven years.
Chapter 12	Available only to family-owned farms.
Chapter 13	Individuals with regular income keep certain assets and pay debts under a court-approved plan. Typically takes three to five years. Not available to corporations but can be used by some businesses that are operated as sole proprietorships. Generally remains on credit history for 10 years but may be removed after seven years.

Under Chapter 7, the court may require a trustee to operate your business if it determines that would benefit creditors and help in liquidating assets. Filing for Chapter 7 doesn't mean your business will be debt-free. Mortgages and car payments are not discharged. If you don't pay these debts, you risk repossession and foreclosure, as well as having your wages garnished and bank accounts frozen. (Tax debts are explained below.)

Under Chapter 11, the amount of debt is generally reduced, but the reorganization may require your business to sell or swap assets to come up with a plan that is acceptable to creditors and the court.

Q.

One of our company's customers owes us a lot of money and has told us that the business is declaring bankruptcy. Should we back off?

Worried About Car Warranties?



Q. I bought a Chrysler car last year that is under warranty. Will repairs still be covered?

A. Chrysler will continue to honor consumer warranties. The federal government has made its Warranty Support Program available to Chrysler and, according to the White House Web site, \$280 million has been funded "to provide a backstop on the orderly payment of warranties for cars sold during this restructuring period."

In an earlier announcement about the federal warranty program made on March 30, President Obama assured consumers that if they buy cars from Chrysler or General Motors, they will be able to get the cars serviced and repaired. "Your warranty will be safe, the President said. "In fact, it will be safer than it's ever been, because starting today, the United States government will stand behind your warranty."

A. Yes, provided the customer has actually filed a court petition. That filing results in an automatic stay that prevents creditors from further collection efforts. Until the customer actually makes that filing, however, you can continue to try to collect the debt or negotiate a deal under which you might get more than you would in a bankruptcy proceeding.

Keep in mind that many debtors threaten bankruptcy to get creditors to back off.

Q.
If a customer or partner files for bankruptcy, will we get any of the money we are owed?

A.
It depends.

In Chapter 7 proceedings involving companies, there may be assets that are not exempt from liquidation or subject to valid liens. They can be sold and the proceeds distributed to creditors. Secured creditors that hold some form of collateral (or claim) to assets have priority, but unsecured creditors may want to have their attorneys file proofs of claim in case there's money left once the others have been paid.

Under Chapter 11, creditors and the court approve a plan for the company to pay its debts, either in full or according to terms negotiated with the creditors. Your attorney can file a proof of claim. You may have to return money collected during the 90 days before the bankruptcy filing. Secured creditors on average receive 77 cents on the dollar. Unfortunately, unsecured creditors average about two cents.

Q. **Will my company's tax debts be eliminated in bankruptcy?**

A. It's possible to wipe out tax debts in some filings but highly difficult.

For example, in Chapter 7, some tax debts can be eliminated. But the debt has to involve actual income taxes. Payroll or other trust fund taxes, as well as fraud penalties, cannot be eliminated. In addition, you must meet several other conditions such as: you did not commit fraud or willful tax evasion, the taxes are related to a return that was due three years before filing, the tax assessment is at least 240 days old, and tax returns were filed.

Consult with your tax adviser about the best way to handle tax debts. The laws and rules involving tax debts in bankruptcy are extremely complex.

Q. **I am on a corporate board. Are my personal assets at risk if the company files for bankruptcy proceedings?**

A. It's possible. It depends on the provisions of your directors and officers (D&O) liability insurance. Review your company's policy to determine if it covers defense costs and damage awards in the event of bankruptcy. Among other protections, the



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**Can't pay your company's creditors?
Try to work out lower payments over a longer time frame. This may buy more time to get back on track. Plus, your company might be able to settle its debts for less than the amount owed, while not ruining its credit record. Your accountant and legal advisers can provide guidance on how to go about these negotiations, as well as other options.**

policy should:

- Allow continued coverage for innocent board members.
- Require the insurer to pay covered defense costs and damages as they are incurred so that board members don't have to pay potentially millions of dollars and wait for reimbursement.
- Give directors priority over the company in receiving payments if there is a single limit of liability.

There are other significant provisions related to bankruptcy that should be included in a D&O policy. Your professional advisers can help determine the specific necessary coverage.

Q. I hold stock and bonds in a company in Chapter 11 bankruptcy. What happens now?

A. During bankruptcy proceedings, a company stops paying interest and principal to bondholders and dividends to shareholders. If the business comes out of bankruptcy, stocks may be swapped for new shares in a reorganized company, but holders may wind up with fewer securities that have less value than original holdings. Bond owners may receive new stock or a combination of new stock and bonds in the restructured enterprise.



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Dave is responsible for the coordination and delivery of tax planning and related compliance services. Dave works with business and individual tax clients in order to assure conformity with federal and state tax standards and to minimize taxes and related costs. He frequently lectures on topics related to personal and business tax planning, real estate matters, low-income housing tax credits, and business consulting issues.

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