

NEW BANKRUPTCY LAW FAVORS CORPORATIONS OVER SOLE PROPRIETORSHIPS AND PARTNERSHIPS

An Article by William A. Taylor One of the Business Lawyers

Question What effect will the new bankruptcy law have on the owners of small businesses?

Answer It will drive sole proprietors and partners into the loving arms of incorporators.

Reasoning The new bankruptcy law was designed to change the rules regarding individuals, making it harder for them to file and stay in bankruptcy, but changes affected corporations only a little.

Question What's an incorporator?

Answer An incorporator is either the person who will own the corporation and who files the papers with the state – OR – some person (or company) who holds himself out to be able to incorporate that owner.

On October 20th just passed, the president signed into law revisions to the federal bankruptcy law. The law was aimed squarely at individuals – and their credit cards. One net effect of those revisions will be to cause a stampede of businesspeople into the corporate form of doing business.

The new law places significant restrictions on the ability of individuals to file and maintain a case in bankruptcy court. It does so by eliminating some of the grounds used by individuals for filing in the first place. Many of those grounds revolve around credit card debt – which is now much harder to discharge (write-off).

Businesspeople and Credit Cards Businesspeople are notorious for using their personal credit cards to finance their business working capital. With the new law, much of that credit card debt will not be dischargeable in bankruptcy and the businessperson will be held personally liable for those business debts.

October 20 Deadline The law will not take effect until October 20, 2005, six months after the date of the signing by the president. People who are teetering on the edge, trying to decide whether to file for bankruptcy or not, should hurry to their bankruptcy attorneys to have it determined if they would benefit more by filing before that six month deadline or if they should not file.

Incorporate New business owners need to consider corporations now, like they never considered them before – to shelter their personal world from the ups and downs of doing business. Consider this: If PG&E (a billion dollar business) can file for bankruptcy (as it did a couple of years ago) ANY BUSINESS can suddenly flip upside down – causing its owner to need the protections of the bankruptcy courts. Business owners will get the message and will incorporate. The incorporators will be waiting with an entity that was not greatly affected by the new law.

For those who do not, the new rules for individuals will affect almost everyone who can afford to pay at least \$100 per month and whose income is above \$50,000 (California) by forcing them to enter a repayment plan – as opposed to discharging (i.e., writing off) the unsecured debt. Additionally, the process will be more expensive.

The net effect of the new law will be to cause businesspersons to separate business from personal, by

creating a separate entity which can develop its own credit and will be treated more kindly in the bankruptcy courts than an individual.

Possible Sales Tax on Services

California legislators have introduced a proposal to tax labor in order to fund the state's education deficit.

It will be recalled that California sales tax is levied on the sale of "goods" not the sale of "services." All of that might change with a bill entered into the record of the California Assembly (AB 9).

AB 9 will, if enacted, impose a sales tax on certain services to fund education. If it becomes law, beginning January 1, 2006, the state will impose a sales tax on "specialized" services including, but not limited to:

- *Accounting and bookkeeping
- *Legal services
- *Custom computer programming
- *Engineering, architectural, or surveying services
- *Management, scientific, or technical consulting services

It is not yet clear if the bill will affect tax preparation services.

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