***Scribbles Squibs # 5 (March 8, 2013):*** As Dorothy said, there's no place like home (except, maybe, for John Doe).

*By Attorney Jonathan Sauer*

Contractors and Friends: You think *you* have problems? Poor Dorothy! She's in the land of OZ and does not know how to get back to Kansas. Hey, who needs a cowardly lion, a squeaky tin man requiring frequent squirts of 3-in-1 oil or a scarecrow who easily catches fire? And, if you step on a Munchkin, they'll probably lock you up in a Munchkin jail. You have any idea how *small* those cells are? Fortunately, Glinda, the Good Witch of the North, has Dorothy click her red shoes together a number of times saying: 'There's no place like home', which helps Dorothy get home. But, how many of us has a good witch working for us? And, if this happened today? Dorothy would probably be wearing Sketchers. You can click those suckers together all day and all night and have nothing to show for it except two sore feet. And, the fact that she got back to Kansas doesn't mean she could stay there for good. After all, this *was* Aunty Em's home and farm – not hers. How does Aunty Em, possibly a DBE or WBE during the winter when there are no crops growing, protect her home from creditors? My wife recently got a very fancy food processor that can do many things. Not to be outdone, I went to Staples and got their most expensive 'multi-tasker', the salesman telling me that 'multi-tasking' is akin to rubbing one's tummy and chewing bubble gum at the same time, such simultaneous talents this writer sadly generally lacks. So, let's see if we can look at *two* related problems this *Squib*: protecting your home when you do business as a corporation/limited liability company (LLC) or when you are in business as a sole proprietorship. This *Squib* is only four pages in length.

***Two Problems:*** Both problems arise within the context of business failure and/or lawsuits which are not covered by insurance. Namely, what responsibility does an individual have for corporate debts when the corporation goes belly up? And, the related question: what happens when the business is a sole proprietorship, rather than a corporation or limited liability company (LLC)? And, how do we keep our house?

**(1) Individual responsibility for business debts.** One of the primary reasons that one does business through a corporation or through an LLC is to separate one's business life from one's personal life. The fact that one may put one's company in bankruptcy may discharge general corporate debts but may not discharge specific debts as to individual owners, such as withholding taxes, which some corporate officers may still have to pay. And, since most lines of credit and surety lines require personal guarantees and indemnity, the fact that the principal debtor – the corporation, for example – has obtained discharges as to its debts does not generally affect the obligations of the guarantors and indemnitors. And, since the goal of Bankruptcy is to get out from under business debts, the individual guarantors' and indemnitors' personal obligations lessen the benefit of bankruptcy for some. Generally speaking, though, a corporate owner, officer or director is *not* liable for the corporation's basic debts. Similarly, an LLC member, also, is not liable for the LLC's basic debts.

One who is a principal of a corporation or LLC assumes that the entity will go on forever. Bitter experience suggests otherwise. Business motivational speakers say that 'failure' is just one way station along the path of one's career, hopefully, generally leading to success. A corporation is just a thing. Actually, it is less than a thing in that it basically is just an idea. At my seminars, I say that a corporation should be seen as a nice suit. It lasts for a while but, at some point, you may need another one. Forewarned is forearmed! One needs to plan for one's future *if* the corporation or LLC *does* fail.

**(2) Doing business without creating a corporation or LLC.** Those individuals who are content to do business as 'John Doe d/b/a John Doe Construction' can *only* file bankruptcy as an *individual* to get rid of *business* debts. But, if John Doe forms a corporation or LLC, then it is the *entity* which files bankruptcy, getting rid of the *business* debts while generally leaving John Doe's *individual* assets intact, subject to various statutory exemptions (e.g. withholding taxes) and personal guarantees and indemnity for the line of credit and the surety line. Since corporations and LLC's can be filed relatively quickly and inexpensively, there is simply no reason for someone to take such risks as exposing his/her personal assets to obligations one might incur in business. And, while having good insurance coverages for one's business does cover many business risks, they may not provide protection for *all* of one's business risks and, certainly, not for issues relating to failure. When I advise my clients as to doing business with 'John Doe d/b/a John Doe Construction', I especially advise them to be very careful as this individual is most likely uninformed, probably naïve and possibly pig-headed and without assets. For, if there *were* any assets, this individual would not be doing business in this fashion. In addition, when one is dealing with a corporation or LLC, I think there is an assumption, most of the time, that the corporation or LLC is more substantial. That it probably has *some* assets, which would be necessary for prequalification purposes, borrowing and bonding. Thus doing business as a sole proprietorship could cost John Doe some jobs. Besides, I must confess that I have never liked the guy. This goes back to a bar fight we had some time back. But, I don't really want to talk about it just now.

In my business, having graduated from Harvard Law School doesn't generally hurt one's resume or career path! In the construction business, doing business as a 'd/b/a' hurts you on a whole variety of levels. The fact that you are willing to do business this way, risking your and your family's home and other assets, suggests almost a complete lack of sophistication and which may also suggest possible inadequate funding and, perhaps unfairly, not being particularly good at your trade. Not being incorporated suggests someone whose business is probably pretty small and/or someone who is a 'newbie', just getting started in business. Is working in such a manner really *wise?* How would you explain to your spouse losing the family home when there is a business problem with a determined creditor? If you lose the family home, you may have issues with your spouse that make your business problems pale by comparison. Sadly, there are a lot of divorces associated with business failures. Don't learn this by your own experience. *Please!*

***A (partial) solution to both problems: a homestead.*** Other than an automobile, the two basic assets an ordinary individual has are one's pensions/retirement accounts and one's home. The retirement accounts have some protection under ERISA, a federal program and scheme. The home has a limited protection against creditors. Since recent amendments to the Massachusetts homestead laws, a person has an automatic exemption against debts in the amount of $125,000 as to one's home, even if he or she does absolutely nothing in terms of filing a homestead. However, if one files a declaration of homestead at the registry of deeds for the county in which the property is located, one gets an exemption of $500,000 as to one's home. So, in essence, you get $375,000 additional debt protection simply by filing a simple form and paying a very nominal filing fee, currently around thirty-five dollars. Unless both spouses are over the age of 62, filing a bankruptcy means that between the two of them, the protection is $500,000. (Under the newly amended statute, both spouses may file a declaration of homestead. Under earlier law, it seemed clear that only one spouse could file an effective homestead.) However, once both spouses are over 62, then the total homestead apparently goes up to one million dollars between the two. Moreover, under the recent amendments, those having beneficial interests in real estate held by trusts are now covered. As our friends in Manhattan say: '*such a deal*!'

Those material suppliers, subcontractors and general contractors who have been in business for a while know that if they do any significant amount of business they will have disputes. This is a given, a simple fact of business life. Those of us engaged in the construction industry for the past five plus years know that a great many companies have gone out of business during this time. Therefore, protecting your assets as best you can, as *early* as you can, is in your own and your family's best interests. After all, your kids don't know anything about corporations and LLC's. Also, they don't know anything about homesteads. For the vast majority of us, protecting them is *the* paramount goal in life.

***How to proceed:*** There are two lessons here. First, for those who work as contractors in a d/b/a capacity, one word of advice: *don't.* For those of us owning homes, look into filing a homestead on your home for some excellent (and, comparatively, inexpensive) debt protection. Further information as to both can be found by typing into your browser 'Massachusetts Secretary of State.' For homestead information, on the first page of the website, click 'Registry of Deeds' in the left column. The first page you come to has a Q&A booklet on homesteads and sample forms. For information on forming a corporation, click on 'Corporations' in the left column. In the words of my first Irish boss, then "follow your nose"!

***Lessons Learned****:* Be very careful in dating girls named Dorothy. Whatever you do, if you are both together in a very bad windstorm, *stand away from her*, as this is a girl who may be going places! And, don't get too friendly with John Doe. I mean he's, like, a stiff. But, as I said earlier, I don't really like the guy. Who won the bar fight? Sure, I had a shiner or two, a broken right hand and a broken nose. Not to brag, but you should have seen the *other* guy!

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