

The Tax Debts of Small Business Owners in Bankruptcy

By Rafael Efrat, 2008. 36 pages.

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Purpose

The objective of this study is to investigate the burden tax obligations impose on small business owners (both individuals and entities) at the time of their bankruptcy filing. This is an important area to study given the existing documentation on the adverse impact tax debts have on the financial viability of petitioners both before and after bankruptcy filing.

Overall Findings

This study documents the pervasiveness and the magnitude of the tax burden among small business owners in bankruptcy. The data suggest that the tax burden is more pervasive among small business owners in bankruptcy than among consumer petitioners. While fewer than one-quarter of all consumers in the bankruptcy sample reported tax debts, more than half of individual small business owners reported owing some tax debts. Individual small business owners in bankruptcy proceedings who are encumbered with high tax debts are generally in a precarious financial condition and are worse off financially than small business owners who have low or no tax debt.

Highlights

- Men, who constituted 57.1 percent of the sample, were significantly more likely to be in the bankruptcy sample compared with the general U.S. population, where men constitute 49 percent (U.S. Census Bureau, 2005). Women petitioners were more likely to file under Chapter 7 and Chapter 13 of the Bankruptcy Code rather than Chapter 11, where they made up only 19.1 percent

of petitioners. Most individual petitioners were married, one-third were single, and one-fifth were divorced or separated.

- Differences between the two groups are also reflected in homeownership rates. Almost two-thirds of the population own homes nationwide, compared with 47 percent of individuals in the bankruptcy sample. Similarly, the median fair market value of the houses owned by individual bankruptcy petitioners was \$107,200, compared with a median value of \$217,000 across the nation in 2006.

- The heavy debt burden, along with the lower homeownership rate, contributes to the negative net worth in the bankruptcy sample. The mean net worth of the individual bankruptcy petitioner was -\$28,299, and their median net worth was -\$19,110. More than 77.5 percent of the individual petitioners in the bankruptcy sample had a negative net worth compared with 12.6 percent in the general population outside of bankruptcy

- Overall, the data show that almost 30 percent of all petitioners in the bankruptcy sample reported owing some kind of tax debts. The data further indicate that individual entrepreneurs reportedly owed tax debts more often than small business entities. The table also suggests that individual small business owners from California and Texas most often reported tax debts, while individual small business owners from Tennessee reported tax debts least often.

Scope and Methodology

The database for this project is a nationally representative sample of 1,903 bankruptcy schedules filed by petitioners (both individuals and entities)

in five federal judicial districts between October 17, 2005, and October 16, 2006 (California, Tennessee, Pennsylvania, Illinois, Texas). The time period was selected to coincide with the new federal bankruptcy legislation that became effective on October 17, 2005 (Bankruptcy Code, 11 U.S.C. §§ 523(a), 1322(a)(2), 1141(d) (1978), as amended by Bankruptcy Abuse Prevention and Consumer Protection Act of 2005). The bankruptcy schedules were accessed through the PACER system. Access to this database was granted by the clerks of the courts of the various judicial districts. The sample included consumers, individual business owners (i.e., sole proprietors), and business entities (i.e., corporations, LLCs, etc).

This report was peer reviewed consistent with the Office of Advocacy's data quality guidelines. More information on this process can be obtained by contacting the director of economic research at advocacy@sba.gov or (202) 205-6533.

Comments from Advocacy

This study is an important addition to small business research, analyzing the link between bankruptcy petitioners and taxes.

Ordering Information

The full text of this report and summaries of other studies performed under contract with the U.S. Small Business Administration's Office of Advocacy are available on the Internet at www.sba.gov/advo/research. Copies are available for purchase from:

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