

BANKRUPTCY: CAN YOU COLLECT OR NOT?

Connecticut Tax Collectors' Association

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Federal law governs the procedure by which the assets of an insolvent person or business are distributed amongst creditors. A bankruptcy court supervises the proportionate repayment of pre-petition debts (arising before the case was filed), and also ensures that post-petition debts, especially “administrative expenses” like ongoing taxes, are kept current. The three primary types are:

- Chapter 7 Liquidation: a trustee sells any nonexempt assets to pay the debtor’s creditors
- Chapter 11 Reorganization: the debtor, usually a business, proposes a plan to repay debts over five years or less
- Chapter 13 Wage-earner’s plan: a trustee manages an individual’s plan to repay debts over five years or less using anticipated earnings

A “proof of claim” is the creditor’s itemization of amounts owed which must be filed early in the case unless (typically in Chapter 7) the creditors are instructed not to do so. (If it says that, you really shouldn’t – it will just be thrown away.) Itemized breakdowns, statutory citations, and other details and printouts should be provided for all principal, interest, fees, and other charges. The municipality should list all debts owed to any of its departments of any nature, not just unpaid taxes. File it with the bankruptcy court, and send copies to the bankruptcy trustee and anyone else who has filed an appearance in the case. The parties are often invited to a “creditors’ meeting” to give them the opportunity to question the debtor under oath about his assets and debts, but attendance is optional (and uncommon unless the debtor disputes the debt).

Debts are prioritized by type, and the lowest are unlikely to be paid much or anything. Delinquencies which have been liened (like real estate, water or sewer charges when a continuance certificate has been recorded, and personal property

taxes when a UCC-1 has been filed) are classified as “secured” and among the highest in priority. Taxes which are not liened (like motor vehicle, or personal property when no UCC-1 has been filed) but were last payable without interest less than one year before the bankruptcy started are lower but called “priority.” Most other municipal debts are unsecured, nonpriority claims. These three categories are mutually exclusive; **never classify the same tax as both “secured” and “priority”** on a proof of claim form.

The “automatic stay” makes it contempt of court for a creditor to do nearly anything to attempt to collect a debt against the debtor personally or any property relevant to the bankruptcy until after any dismissal. For example, during a taxpayer’s bankruptcy a municipality cannot:

- demand payment or threaten any collection effort
- refuse a DMV release
- revoke or deny a permit due to nonpayment
- garnish wages or bank accounts
- submit adverse credit bureau reports
- allow a marshal or collection agency to continue collection efforts
- start or continue litigation or a tax sale

Despite the automatic stay, the tax collector can (and usually should):

- send a regular tax bill that does not demand payment
- file lien continuance certificates
- assign tax liens to third parties
- file a Collector’s Deed for a pre-petition tax sale (except that if the bankruptcy was commenced less than 60 days before the redemption deadline, the deed recording must wait until 60 days afterward)
- accept unsolicited voluntary payments from the debtor (although a bankruptcy trustee might be able to force the town to refund it later)
- ask banks, escrow agents, and junior encumbrancers to pay the taxes
- warn the debtor’s lawyer that post-petition taxes are not being paid
- enforce normal police and regulatory powers against the debtor
- demand 1-2 months bond or prepayment of municipal utilities services

On this last point, 11 U.S.C. § 366 allows the municipality to discontinue utility service during the bankruptcy if the debtor fails to provide this “adequate assurance of payment.”

Creditors can ask the bankruptcy court to convert a case from a Chapter 11 or 13 into a Chapter 7, or dismiss the case completely, if the debtor violates the plan or does not keep post-petition debts current. If a debtor files bankruptcy multiple times, be sure not to confuse the docket numbers assigned to each and to file new paperwork in the right case.

Bankruptcy laws also give tax collectors a few tools against “serial filers.” For example, if an individual debtor allows his case to be dismissed twice within a year for failing to meet deadlines or file paperwork, third and subsequent bankruptcy filings will have no automatic stay at all, unless the debtor persuades the court he is acting in good faith.

Pre-petition debts include all taxes assessed before the case was filed, since even transferring or destroying the property after the assessment would not prevent the debtor from having to pay the tax when it is later billed. In re Columbia Gas, 37 F.3d 982 (3rd Cir. 1994). This means a tax collector receiving a bankruptcy petition filed between October 1 and July 1 should include the not-yet-due tax in a proof of claim, rather than assuming it will be paid as an administrative expense. (Use the date the case was originally filed, not the date it may have been converted from one chapter to another.) When the amount is finalized after the mill rate is known, the claim should be amended to reflect the full amount. Relatedly, never exclude not-yet-due installments of any tax, because plan confirmation may extinguish the lien for the entire annual amount. In re Northern New England Telephone Operations, 795 F.3d 343 (2d Cir. 2015). Also insist on including a line in the plan that says something like, “All taxes and other amounts assessed post-petition will constitute administrative expenses to be paid when due,” in order to protect those liens as well.

Read the proposed plan very, very carefully. If the debtor or his attorney misstate the amount of money owed, the interest rate accruing on it, the proper fees and charges, the allowable time frame for repaying it, the municipality’s priority over other creditors, or anything else, you or the town attorney should immediately contact the debtor or debtor’s attorney to request an amendment. If they refuse, you should file a written objection with the court. Once a plan is confirmed – and if no one objects, it likely will be – it is nearly impossible to change later.

Persons who were not listed as co-debtors are not protected by the stay or discharged. Therefore, collection efforts can continue normally against a joint owner of tax-delinquent property who did not join in the bankruptcy filing as long as the effort would not remove the property itself from the bankruptcy estate. For

example, a wife can be denied a vehicle registration for a tax-delinquent car jointly owned with her husband who filed bankruptcy alone, but only her half-interest in their tax-delinquent house could be foreclosed and auctioned. However, a person's "DBA" or "trade name" is legally the *same* person, so the stay protects both – unlike a valid LLC or corporation owned by that person. Also, the tax collector can continue to accept payments from third parties, such as a mortgage bank paying taxes from an escrow account.

Tax collectors never find they receive payments which exactly equal the actual balance due over the course of a plan. This is because the trustee's amortization schedule is run on different software, is thrown off by a single missed or short payment, and otherwise won't match the town's automated calculations. If the tax collector receives too much money, the difference should be returned to the trustee (for distribution to other creditors). If the balance listed on a check stub is less than the town's records show, the tax collector should notify the trustee's office. Connecticut's Chapter 13 trustee has suggested that each tax collector should send an updated statement for each account to her office on an annual basis so that any ongoing balance discrepancies can be investigated.

After a liquidation or successful plan, the bankruptcy court issues a "discharge" which forever prohibits any effort to collect the debts against the person. Liens for secured taxes (like real estate and sewer) survive a Chapter 7 discharge, so a tax sale or foreclosure against the delinquent property itself (as opposed to efforts against the person's money or other property) remains possible. Unsecured taxes (like motor vehicles, and personal property delinquencies beyond the equipment's value) which came due without penalty more than one year before the bankruptcy was filed are uncollectable after discharge.

- Example: Debtor files Chapter 7 on July 31, 2017 and is later discharged. His July 1, 2016 motor vehicle bill can still be demanded and DMV release denied, because it could have been paid without interest less than one year before he filed bankruptcy. His motor vehicle bills from earlier years, however, are discharged.
- Example: Debtor files Chapter 7 on August 5, 2017 and is later discharged. His July 1, 2016 motor vehicle bill and all older ones are discharged, and a tax collector risks contempt of court by demanding payment or refusing to sign a DMV release.

Creditors are not technically bound to a bankruptcy stay or discharge of which they were never notified, with some exceptions. Most importantly, creditors are bound to a “no asset” Chapter 7 discharge regardless of notice, since participation in the bankruptcy would not have changed its outcome. A creditor may also ask to be added to a Chapter 11 or 13 filing so as to be included in the plan. If a municipality is omitted from the notices, any violation of the stay while the bankruptcy is pending is inadvertent and will not be punished although the action taken will probably still be declared void. However, once the municipality learns of the bankruptcy through any means, violating the stay becomes intentional.

DISCUSSION QUESTIONS

Taxpayer files bankruptcy on Dec. 1, 2018. Should the proof of claim include:

- (a) All installments of his 2016 Grand List RE? MV?
- (b) All installments of his 2017 Grand List RE? MV?
- (c) Only the July 2018 installment of his 2017 Grand List RE? MV?
- (d) All installments of his 2018 Grand List RE? MV?
- (e) His unpaid 2017 dog license fee?

Taxpayer proposes a plan. Should you object if:

- (a) The RE is classified as “priority”?
- (b) The MV is to be repaid with 0.5% per month interest?
- (c) It says nothing about post-petition W/S installments?
- (d) The creditor’s meeting hasn’t happened yet?
- (e) The figures would pay the town **too much** money?

Taxpayer is discharged Sept. 1, 2019. Can you refuse a DMV clearance if:

- (a) The bankruptcy has not yet been closed?
- (b) The 2016 Grand List MV is unpaid?
- (c) The 2017 Grand List MV is unpaid?
- (d) The 2018 Grand List MV is unpaid?
- (e) His wife, who jointly owns the car and wasn’t part of the bankruptcy, asks?

CONNECTICUT MUNICIPAL TAX CLAIMS IN BANKRUPTCY

Connecticut Tax Collectors Association – Adam J. Cohen, General Counsel

PETITION DATE

CLOSURE DATE

bankruptcy case pending

1 year

REALLY OLD TAX

Assessed prepetition, and interest-free deadline was 1 year or more before case was filed.

1. Include in Proof of Claim as either secured or nonpriority.
2. Should be paid per Plan.
3. If nonpriority, gone forever after discharge; but if dismissed instead, can pursue normally after closure.

DURING-THE-CASE TAX

Assessed while case is pending and also comes due while case is pending.

1. File supplemental Proof of Claim as either secured or priority (not both) before Plan is confirmed.
2. Should be paid per the Plan. If assessed after Plan is confirmed, treat as administrative claim although interest might not be collectable.

NOT-SO OLD TAX

Assessed prepetition, but interest-free deadline was less than 1 year before case was filed.

1. Include in Proof of Claim as either secured or priority (not both).
2. Should be paid per Plan.
3. Collect normally after discharge/dismissal and closure.

DUE-LATER TAX

Assessed while case is pending but comes due after discharge/dismissal.

1. Do not include in Proof of Claim.
2. Just wait; collect normally after discharge/dismissal and closure.

ALMOST DUE TAX

Assessed prepetition, but comes due while case is pending.

Handle exactly the same as “Not-So Old Tax.”

TOTALLY NEW TAX

Both assessed and comes due after discharge/dismissal.

1. Collect normally after discharge/dismissal and closure.
2. If debtor files bankruptcy again, may be able to get stay relief to resume collection.

- secured = RE, W/S, PP if UCC-1 filed, and other taxes properly secured by a lien
- priority = MV or PP with no UCC-1 filing if interest-free deadline less than 1 yr ago
- nonpriority = MV or PP with no UCC-1 filing if interest-free deadline 1 yr or more, and other unliened gov’t claims
- assessed = the grand list assessment when liability is fixed, which is almost always October 1 in Connecticut
- interest-free deadline = last day to pay with no penalty, usually August 1 (or next business day) in Connecticut
- nonrecourse = foreclosure or sale of taxed property itself, but no pursuit of debtor’s other assets

EXCERPTS FROM A FEW ESSENTIAL BANKRUPTCY LAWS

11 U.S.C. § 108. Extension of time

(b) ... if applicable nonbankruptcy law ... fixes a period within which the debtor ... may ... cure a default, or perform any other similar act, and such period has not expired before the date of the filing of the petition, the [debtor] may only ... cure ... before the later of— (1) the end of such period ... or (2) 60 days after the [petition].

11 U.S.C. § 362. Automatic stay

(a) ... a petition ... operates as a stay, applicable to all entities, of—

(1) the commencement or continuation ... of a judicial, administrative, or other action or proceeding against the debtor ... or to recover a claim against the debtor that arose before the commencement of the case under this title;

.

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title....

.

(b) The filing of a petition ... does not operate as a stay [of]—

.

(9)(B) the issuance to the debtor by a governmental unit of a notice of tax deficiency;

.

(9)(D) the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment....

.

(18) ... the creation or perfection of a statutory lien for an ad valorem property tax, or a special tax or special assessment on real property whether or not ad valorem, imposed by a governmental unit, if such tax or assessment comes due after the date of the filing of the petition....

.

(c)(2) the stay ... continues until the earliest of—

(A) the time the case is closed; (B) the time the case is dismissed; or (C) ... the time a discharge is granted or denied....

(3) ... if a single or joint case of [an individual] debtor was pending within the preceding 1-year period but was dismissed... (A) the stay ... shall terminate with respect to the debtor on the 30th day after the filing of the later case; ... and

(4) (A) (i) ... if 2 or more single or joint cases of [an individual] debtor were pending within the previous year but were dismissed ... the stay ... shall not go into effect upon the filing of the later case....

11 U.S.C. § 502. Allowance of claims or interests

(i) A claim that does not arise until after the commencement of the case for a tax entitled to priority under section 507(a)(8) of this title shall be determined ... the same as if such claim had arisen before the date of the filing of the petition.

11 U.S.C. § 503. Allowance of administrative expenses

- (b) After notice and a hearing, there shall be allowed administrative expenses ... including ... (1) (B) any tax—
 - (i) incurred by the estate, whether secured or unsecured, including property taxes for which liability is in rem, in personam, or both, except a tax of a kind specified in section 507(a)(8) of this title....

11 U.S.C. § 505. Determination of tax liability

- (a) (1) ... the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax [unless] (2) ... such amount or legality was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under this title; [or] the applicable period for contesting or redetermining that amount under any law (other than a bankruptcy law) has expired.

11 U.S.C. § 507. Priorities

- (a) The following expenses and claims have priority in the following order:
 -
 - (8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for ... (B) a property tax incurred before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition....

11 U.S.C. § 511. Rate of interest on tax claims

- (a) If any provision of this title requires the payment of interest on a tax claim or on an administrative expense tax, or the payment of interest to enable a creditor to receive the present value of the allowed amount of a tax claim, the rate of interest shall be the rate determined under applicable nonbankruptcy law.

11 U.S.C. § 523. Exceptions to discharge

- (a) A discharge ... does not discharge an individual debtor from any debt—
 - (1) for a tax ... (A) of the kind and for the periods specified in section ... 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed....
 -
 - (3) neither listed nor scheduled [in a case other than a no-asset Chapter 7] ... in time to permit— (A) ... timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing....

11 U.S.C. § 524. Effect of discharge

- (a) A discharge ... (2) operates as an injunction against the commencement or continuation of an action ... or an act, to collect, recover or offset any such debt as a personal liability of the debtor....
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- (f) Nothing contained in ... this section prevents a debtor from voluntarily repaying any debt.

11 U.S.C. § 727. Discharge

(a) The court shall grant the debtor a [Chapter 7] discharge, unless—

. . . .

(8) the debtor has been granted a discharge under [Chapter 7 or 11] in a case commenced within 8 years before the date of the filing of the petition;

(9) the debtor has been granted a discharge under [Chapter 13] in a case commenced within six years before the date of the filing of the petition, unless payments under the plan in such case totaled at least—

(A) 100 percent of the allowed unsecured claims in such case; or

(B) (i) 70 percent of such claims; and (ii) the plan was proposed by the debtor in good faith, and was the debtor's best effort...

11 U.S.C. § 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

. . . .

(9) (C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim regular installment payments in cash—

(i) of a total value, as of the effective date of the plan, equal to the allowed amount of such claim [and] (ii) over a period ending not later than 5 years after the date of the order for relief....

. . . .

(d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes.... In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

11 U.S.C. § 1328. Discharge

(f) ... the court shall not grant a [Chapter 13] discharge ... if the debtor has received a discharge—

(1) in a case filed under chapter 7, 11, or 12 of this title during the 4-year period preceding the date of the order for relief under this chapter, or

(2) in a case filed under chapter 13 of this title during the 2-year period preceding the date of such order.

28 U.S.C. § 960. Tax liability

(b) A tax ... shall be paid on or before the due date of the tax under applicable nonbankruptcy law, unless (2) payment of the tax is excused under a specific provision of title 11.

(c) In a case pending under chapter 7 ... payment of a tax may be deferred until final distribution is made ... if ... (2) before the due date of the tax, an order of the court makes a finding of probable insufficiency of funds of the estate to pay in full the administrative expenses allowed under section 503(b) of title 11 that have the same priority in distribution under section 726(b) of title 11 as the priority of that tax.

