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Bankruptcy

Personal Property



The bankruptcy code: an overview by chapters

- Chapter 1 – General provisions, definitions and rules of construction.
- Chapter 3 – Case administration.
- Chapter 5 – Creditors, the debtor and estate.
- Chapter 7 – Liquidation of assets.
- Chapter 9 – Adjustment of debts of a municipality.
- Chapter 11 - Reorganization.
- Chapter 12 – Adjustment of the debts of a family farmer.
- Chapter 13 – Adjustment of the debts of an individual with regular income.



Types of bankruptcy

Chapter 7

- Available for individuals and business entities.
- If the debtor is a business entity or sole proprietorship, business operations typically cease.
- A trustee collects the nonexempt property of the debtor, converts that property to cash, and distributes the cash to the creditors in the order of priority prescribed by the Bankruptcy Code.



Types of bankruptcy

Chapter 11

- Business reorganization or a liquidation of assets.
- In reorganization cases, typically, the debtor remains in control/possession of the bankruptcy estate and operates the business as “debtor in possession” (“DIP”).
- The DIP proposes a “plan of reorganization” to the court and creditors, which shows its proposed payment of creditors over a maximum 5 year period, beginning from the date of the filing of the bankruptcy case.
- If the plan is approved, as to debts provided for in the plan, the debtor has essentially entered into a new contractual arrangement for payment of these debts.
- To be approved, the plan must provide for payment of debts in accordance with the provisions of 11 U.S.C. § 1129.



Types of bankruptcy

Chapter 13

- Individual debtors or sole proprietorships operated by an individual.
- Debtor has a regular source of income sufficient to pay creditors, without the need to liquidate assets in the bankruptcy case.
- According to the terms of a court-approved “Chapter 13 Plan,” the debtor makes regular payments of a specified amount to the Chapter 13 trustee, who pays creditors in accordance with the treatment of such creditors provided for in the plan.
- Plan term is a minimum of 3 years.



Steps in a Bankruptcy

1. A debtor files a bankruptcy “petition” and provides “notice” of the filing of the bankruptcy to known creditors.
2. The filing of the petition triggers the creation of the “bankruptcy estate” and a corresponding “stay” of certain actions by creditors and others against the debtor and/or the property of the bankruptcy estate.
3. Creditors file “proofs of claims.”
4. The assets of the bankruptcy estate are liquidated and allowed claims are paid in order of “priority” from and to the extent of the proceeds of the liquidation.
5. Or, alternatively, allowed claims are paid, in order of priority, in accordance with a “plan of repayment or reorganization” that is approved by the court.
6. Unless certain exceptions apply, to the extent that creditors’ claims are not paid through liquidation or under the terms of a plan, the debtor receives a “discharge” from personal liability for these unpaid debts.



TERMINOLOGY...

- **Petition**
- **Petition Date**
- **Notice**
- **Bankruptcy Estate**
- **Automatic Stay**
- **Claims**
- **Proof of Claim**
- **Priority of Claims**
- **Bar Date/Allowed Claim**
- **Discharge/Exceptions to Discharge**



The Petition...

- Voluntary (all Chapters) v. Involuntary (Chapters 7 and 11)
 - (filed by at least three creditors with asserting claims that are non-contingent as to liability or amount) (11 U.S.C. §§ 301(a), 302 and 303)
- Joint petitions (11 U.S.C. § 302)
- The petition identifies the Chapter under which the debtor is filing and is accompanied by schedules listing the debtor's assets, liabilities, and known creditors.
- Where filed? Typically in the federal district where the individual or business entity resided or was domiciled for a specified period preceding the filing of the petition. *See 28, U.S.C. 1408.*



The Petition Date...

- Date on which the bankruptcy petition is filed with the court, which operates as the entry of an “order of relief” for the debtor.
- In both voluntary and involuntary cases, the petition date is the determinative date for a number of events that occur during the case or are triggered by the filing of the case (e.g., the imposition of the automatic stay, calculation of the date that claims must be filed to be deemed timely, the period during which a Chapter 11 Debtor is allowed to repay certain debts)



Notice of the Case...

- Actual notice v. constructive notice (both are binding on governmental entities)
- Form and content of formal notices (Chapter, petition date, notice of first setting of meeting of creditors, bar date)
- How to ensure your governmental entity receives notice
 - ✓ Designate an address for service of notices with the bankruptcy court clerk's office
 - ✓ Participate in "Electronic Bankruptcy Noticing" (provides notice by email transmission) (go to www.ebnuscourts.com for more information)
 - ✓ Establish internal procedures for reviewing and processing of notices of bankruptcy filings (both formal or informal) and all bankruptcy related correspondence



The Bankruptcy Estate...

- The filing of a petition creates the bankruptcy “estate.” 11 U.S.C. 541(a).
- The “estate” is comprised of the property described in Section 541(a)(1-7), which includes “all legal or equitable interests of the debtor in property as of the commencement of the case.”
- Property not included in the bankruptcy estate is listed in section 541(b). These exceptions are narrow. It is best to assume for the purposes of the automatic stay, that a property interest of the debtor is included in the estate.



The Automatic stay...

- The filing of a voluntary or involuntary petition triggers the automatic stay under 11 U.S.C. § 362(a).
- This prohibits undertaking certain acts against the debtor and the property of the estate both during and after the conclusion of the case.
- For governmental units this generally prohibits the initiation of or continuation of forced collection activity against the debtor and the property of the estate (including lawsuits, administrative, proceedings, levies, executions on judgments, and, with certain exceptions, the perfection of liens).



The Automatic stay...

Statutory Exceptions to the Automatic Stay for Governmental Units

- Pertaining to taxes, under section 362(b)(9), a county can, without violating the stay,
 1. Audit a taxpayer to determine tax liability;
 2. Issue a notice of tax deficiency to a taxpayer;
 3. Make a demand for tax returns; or
 4. Make an assessment of any tax and demand payment
- Section 362(9) limits a county's ability to perfect a lien for taxes allowed to be assessed under this subsection.
- However, section 362(b)(18) authorizes a county to perfect a statutory lien for ad valorem property taxes without violating the stay.



For Example...

QUERY: After the filing of a Chapter 11 or 13 petition, does the debtor have a duty to file tax returns for post-petition periods and pay the related taxes as they come due?

YES... If the debtor fails to fulfill this duty, the county may file a motion to dismiss the case or, alternatively, to convert the case to a Chapter 7 liquidation. 11 U.S.C. 1112(b)(1) and (b)(4)(I); 11 U.S.C. 1307(c).

RETURNS DUE FOR PRE-PETITION PERIODS: In a Chapter 13, the debtor is required to file all missing tax returns for tax periods ending within 4 years of the case.

If the debtor fails to do this, the county may file a motion to compel the filing of the missing returns. 11 U.S.C. § 1308. The debtor's failure to comply with this duty is grounds for conversion or dismissal. Section 1307(e).



Claims...

For the purposes of a bankruptcy, a “claim” is broadly defined as

1. A right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
2. A right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

11 U.S.C. § 101(5)



Potential claims for counties...

From a county's perspective a right to payment might include the following outstanding liabilities:

- Taxes (sales and ad valorem taxes),
- Administrative penalties and fines,
- Regulatory fees,
- License fees,
- Assessments, and
- Civil penalties.



Classification of Claims...

- **Administrative Claims** (the right to payment arises after the filing of the bankruptcy petition)
- **Secured Claims** (the right to payment is secured by collateral in the bankruptcy estate)
- **Unsecured Priority Claims** (e.g., claims for certain types of taxes)
- **Unsecured Claims Non-priority Claims** (“general unsecured”)



Priority of CLAIMS...

Who gets paid first from the proceeds of the liquidation of assets or under a payment plan?

1. Administrative Claims
2. Secured Claims
3. Unsecured Priority Claims
4. General Unsecured Claims



Unsecured priority claims...

Although unsecured, some claims for pre-petition debt have special status under section 507(a)(8) of the Bankruptcy Code, including claims based on debt for

- Property taxes (507(a)(8)(B)),
- “Trust Fund” taxes (e.g., sales taxes) (507(a)(8)(C)),
- Excise taxes (e.g., business privilege and license taxes due for pre-petition transactions that occurred or for which a return was last due within three years of the petition date), and
- Income taxes (returns last due within three years of the petition date) (section 507(a)(8)(A)).

In Chapter 7, if funds are available, priority unsecured claims are paid before general, unsecured claims.



Better yet...

- In Chapter 11 and Chapter 13 cases, to be approved by the court, the debtor's plan to pay creditors must provide for payment in full of the government's priority claims, unless the creditor agrees to a different treatment. 11 U.S.C. § 1322(a)(2) and 1129(a)(9)(C).
- A Chapter 11 plan must provide for payment of interest on these claims, as well. *See, e.g., In re Southern States Motor Inns, Inc.*, 709 F.2d 647, 651 (11th Cir. 1983).



proof of claim...

- Filing with the court (or in some cases a claims agent) notice of the county's right to payment.
- The proof of claim designates the amount of the claim, the basis of the claim (the nature of the debt on which it is based), and the nature of the claim (secured, unsecured, priority).
- For claims based on debts that arose prior to the petition date, there is a link to a fillable pdf proof of claim form at www.uscourts.gov/FederalCourts/Bankruptcy.aspx
- Form of administrative proof of claim.



Bar Date/Allowed Claim...

Bar Date

- The last date on which a claim will be deemed “timely filed.”
- Claims filed by governmental entities are timely filed if filed within 180 days of the petition date.
- Treatment of late filed claims.

Allowed Claim

- Claims are deemed allowed unless objected to by the debtor or trustee. 11 U.S.C. § 502(a).
- Note, however, if the debtor’s plan of repayment or reorganization does not provide for payment of the claim, this essentially serves as an objection to the claim. Creditors are bound by the terms of these plans, if confirmed. If not provided for in the plan, a creditor’s claim is essentially “disallowed.”



Discharge...

- The whole point of a bankruptcy action is to afford an honest debtor relief from his debts (while providing some measure of fairness to his creditors), and allowing the debtor to have a “fresh start.”
- In most instances, if the debtor complies with the rules governing the bankruptcy, the debtor will receive a discharge of “personal liability” for certain debts that are not paid in the course of the bankruptcy case.
- There are limitations to this fresh start, in the form of “exceptions to discharge.”
- Furthermore, even if personal liability is discharged, statutory tax liens survive the bankruptcy and continue to attach to the debtor’s unencumbered pre-petition property.



Chapter 7 Discharge

Chapter 7 discharge is only available to “individual debtors.”

- No discharge is available if the debtor received a discharge in a Chapter 7 or Chapter 11 case within 8 years preceding the petition date or received a Chapter 13 discharge within 6 years of the petition date (with some exceptions). 11 U.S.C. § 727(a)(8) and (9).
- Unpaid prepetition debts for all priority taxes listed in section 507(a)(8) are never discharged in a Chapter 7. 11 U.S.C. 523(a)(1)(A).
- Also excepted, pre-petition tax debt for which a return was not filed; or if late, was filed within 2 years prior to the petition date (section 523(a)(1)(B)) *or* for which a fraudulent return was made or there was a willful attempt to evade or defeat the tax. Section 523(a)(1)(C).



Discharge in Chapter 11

... for Corporate Debtors upon Confirmation of Plan of Reorganization – 11 U.S.C. § 1141

- Broadest discharge available in Chapters under discussion today
- Confirmation of the plan discharges the corporate debtor from any debt that arose *before confirmation of the plan*
 - whether or not a proof of claim was filed or allowed,
 - whether or not the claim was provided for in the plan, and
 - whether or not the holder of the claim accepted the plan.
- If debtor fails to pay debts to a governmental unit as provided for in the plan, governmental unit may declare debtor in default and proceed with statutorily authorized collection activities.



Discharge in Chapter 11

Effect of Discharge for Corporate Debtors upon Confirmation of a Plan of Reorganization - 11 U.S.C. § 1141

Example: Corporate Debtor files Chapter 11 bankruptcy. The Corporation's plan of reorganization is confirmed. The Corporation has liability to the county for pre-petition sales and use taxes. The county timely filed a proof of claim for this debt. The plan does not provide for payment of this debt.

Result: Confirmation of the plan of reorganization discharged this debt.

What is the import of this?

- ✓ *Review the provisions of the plan and submit timely objections if it does not provide for proper treatment of the county's claims.*



Discharge in Chapter 11

Exceptions to Discharge for Corporate Debtors...

- Where the debt was incurred by debtor using fraudulent or false financial information. 11 U.S.C. § 523(a)(2)(A) and (B).
- Also excepted, pre-confirmation tax debts for which a fraudulent return was made or there was a willful attempt to evade or defeat the tax. Section 1141(d)(6).
- More generally, confirmation of the plan does not discharge a corporate debtor if the plan provides for liquidation of substantially all of the property of the estate and the debtor does not engage in business after the consummation of the plan. Section 1141(d)(3).



Discharge in Chapter 11

...for Individual Debtors

- With limited exceptions, individual debtors in a Chapter 11 do not receive a discharge until the court grants a discharge on completion of payments under the plan. Section 1141(d)(5)(A).
- Scope of the discharge (and related exceptions) for an individual is the same as for an individual in a Chapter 7 case. Section 1141(d)(2).



Discharge in Chapter 13

The Chapter 13 “Non-Hardship” or “Super” Discharge under 11 U.S.C. §1328(a)...

Much broader than a Chapter 7 discharge, but still does not discharge the following *pre-petition* tax debts:

- Trust fund taxes described in section 507(a)(8)(C) (e.g., sales and income wh taxes).
- A tax for which a return was not filed or, if late filed, was filed within 2 years prior to the petition date. Section 523(a)(1)(B).
- A tax for which a fraudulent return was made or there was a willful attempt to evade or defeat the tax. Section 523(a)(1)(C).



Discharge in Chapter 13

Example of exception to Chapter 13 non-hardship discharge:

An individual files a Chapter 13 bankruptcy. All payments are made in accordance with the individual's confirmed Chapter 13 plan and the individual receives a non-hardship discharge. At the time of this discharge, the debtor has outstanding liability to the county for local sales taxes for periods preceding the petition date.

Result: *The debtor's outstanding liability for these pre-petition sales taxes is excepted from her Chapter 13 discharge. The county may proceed with collection activities without violating the automatic stay.*



Other Bankruptcy Issues...

Dismissal of a Chapter 11 or Chapter 13 case “for cause”...

- Under 11 U.S.C. 1112(b)(1) or (b)(4)(I); 11 U.S.C. 1307(c), a Chapter 11 or Chapter 13 case may be dismissed for cause.
- This includes the failure to file post-petition returns and pay post-petition taxes.
- A Chapter 13 may also be dismissed on the motion of the county based on the debtor’s failure to file pre-petition tax returns in accordance with the provisions of 11 U.S.C. § 1308.



Questions?