

# TACS FACTS<sup>SM</sup>

*A Resource for Treasurers on Developments and Trends in Collection and Bankruptcy and Other Areas  
From Taxing Authority Consulting Services, P.C. (TACS)*

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## **IMPROVING YOUR RECOVERY IN BANKRUPTCY**

*By Jeffrey Scharf, Taxing Authority Consulting Services, P.C.*

Many Treasurers' Offices have seen an upsurge in the number of bankruptcy filings that they have been receiving. This increase in filing means an increased bankruptcy case workload for the locality, as more cases need to be reviewed, more claims filed, and more discharge determinations need to be made. This is made more difficult as many localities do not have a lot of experience dealing with bankruptcy matters and handling bankruptcy cases is difficult, especially if you do not have to do so on a regular basis. This article will focus on a few key steps or actions that a locality can take to improve its recovery from the pending bankruptcy cases and smooth the handling of such cases.

One of the key requirements to any court based action is to make sure that there is someone in the locality, be it in the Treasurer's Office or the Local Government Attorney, who understands the substantive rules and procedures for classification of claims, claim filing, discharge, etc. and knows how to actually file the necessary documents to advocate for prompt and full payment of the locality's taxes. While these rules/determinations are beyond the scope of this article, it is a critical piece that is necessary for a locality to be able to fully participate in the case.

### Exceptions to the Automatic Stay

One way in which a locality can improve their recovery from bankrupt debtors is through a full understanding of the "automatic stay". The automatic stay arises when the bankruptcy case is filed and generally prohibits any actions that would change the positions of the parties from the way it was on the date the bankruptcy was filed. For example, the stay prohibits filing lawsuits, issuing liens and most collection action. The key to understanding the stay, though, is that it is NOT a blanket prohibition of contact and action with regard to the debtor and there are, in fact, exceptions to the stay that may be critical for the locality to use to protect its interests.

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## IMPROVING YOUR RECOVERY IN BANKRUPTCY *continued from page 1*

*The filing of a petition under...this title..., does not operate as a stay—*  
*(9) under subsection (a), of—*

- (A) an audit by a governmental unit to determine tax liability;*
- (B) the issuance to the debtor by a governmental unit of a notice of tax deficiency;*
- (C) a demand for tax returns; or*
- (D) the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment... **11 U.S.C. §362 (in part).***

So a locality can continue to take limited actions against a bankruptcy debtor including conducting audits or demanding tax returns by the Commissioner of Revenue. The Treasurer is also permitted to issue a notice of tax deficiency (that is, a statement of a balance due) or issue a notice and demand for payment of a new assessment (billing).

### Responsible Officer Assessments

Another area in which a locality may continue to take action is with regard to responsible officer assessments. Virginia law provides that under certain circumstances; like for trust taxes (§58.1-3906) or real estate taxes (§58.1-3965(F)); that a responsible officer of a corporation, partnership or LLC may be held liable for those taxes.

*Any corporate, partnership or limited liability company officer who willfully fails to pay, collect, or truthfully account for and pay over any local admission, transient occupancy, food and beverage, or daily rental property tax administered by the commissioner of revenue or other authorized officer, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable for a penalty of the amount of the tax evaded or not paid, collected, or accounted for and paid over, to be assessed and collected in the same manner as such taxes are assessed and collected. **Code of Virginia §58.1-3906.***

If a corporation owing such debt filed for bankruptcy protection, the Treasurer may still pursue the corporate officer. The bankruptcy automatic stay only applies to the corporate debtor. The trust tax or real estate tax liability can still be assessed against the responsible officer and collection action taken against them personally. This action not only provides a secondary means for collection, but also provides leverage for the locality in the corporate bankruptcy case.

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*“The key to your recovery is to have someone with sufficient knowledge of the substantive laws to follow the case step by step and jump through the necessary “hoops” to get paid. It is critical to always file your claims and to actively review and properly pursue collectible debts after notice of dismissal or discharge is received.”*

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### Filing Claims

In bankruptcy cases, in which a claim is required to be filed, it is absolutely critical that the locality timely file their claim. In many instances, the Court will set a “bar date”, effectively a claims filing deadline, by which claims need to be filed. In order to be paid out of a bankruptcy case, the locality must file a claim.

*A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor...objects. **11 U.S.C. § 502.***

While the claim filing rules can be quite complex, it is the only way to assert that a debt is owed against the bankruptcy estate. And since the claim is deemed allowed unless objected to, it still makes sense to file even if your claim would be late, particularly in Chapter 7 cases where late priority (often taxes) claims are still entitled to be paid.

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### Dismissal and Discharge

These are the two means by which a bankruptcy case is most frequently concluded and it is important to understand the difference. When a case is dismissed, it is generally because the debtor has failed to adhere to the rules or procedures necessary to complete the case. As such, when a case is dismissed, the automatic stay ends and it is as if the debtor never filed bankruptcy. The Treasurer can immediately resume collection action on the entire amount owed.

By contrast, when a case is discharged, it means that the debtor has successfully concluded their bankruptcy obligations and that certain of their debts are wiped out (discharged). While we will not belabor the substantive discharge rules here, it is important that someone in the locality understand them and is able to apply them to the debts owed in concluded bankruptcy cases.

Despite what their bankruptcy attorney told the debtor, many taxes are NOT discharged in bankruptcy. It is up to the Treasurer to make that determination and to write off the bills that are discharged and to resume collection on those debts were non-dischargeable and which remain collectible.

*A discharge under...this title does not discharge an individual debtor from any debt- for a tax or a customs duty—*

*(A) of the kind and for the periods specified in section 507(a)(3) or 507 (a)(8) of this title, whether or not a claim for such tax was filed or allowed;*

*(B) with respect to which a return, or equivalent report or notice, if required—*

*(i) was not filed or given; or*

*(ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or*

*(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax; § 523.*

There are several ways to get additional revenue out of the bankruptcy process. Bankruptcy should not be a black hole in which all debts are classified “hands off” and then routinely written off at the conclusion of the bankruptcy case. The key to your recovery is to have someone with sufficient knowledge of the substantive laws to follow the case step by step and jump through the necessary “hoops” to get paid. It is critical to always file your claims and to actively review and properly pursue collectible debts after notice of dismissal or discharge is received. ♦

# tacs

## WHO IS TACS?

Taxing Authority Consulting Services, P.C. is a Virginia law firm formed to meet the needs of treasurers and local tax officials.

Jeffrey Scharf, Mark Ames and John Rife are dedicated to serving the needs of local taxing authorities.

TACS' focus is on tax collection, assessment and bankruptcy issues faced by governments. TACS can provide assistance to your locality to help increase your revenue.

Please contact us at (804) 649-2445 or by e-mail to [info@taxva.com](mailto:info@taxva.com) to discuss your collection needs or for more information about the firm.





## Answer to Frequently Asked Questions:

Q: We have a customer with an outstanding personal property tax bill. This person has filed Chapter 7 bankruptcy protection. We have stopped all collections procedures and also not adding any additional penalty and interest from the date of filing. What do we do with this bill once the debtor is discharged. Can we resume our normal collection procedures on the outstanding personal property tax?

A: There is no easy answer. Much depends on the timing of the bankruptcy, when the tax was due and a few other factors to determine if it is discharged or not. The basic rule is (1) If a required return was not filed, the tax is not discharged per Bankruptcy Code §523(a)(1)(B); (2) In Chapter 7 cases personal property taxes owed by individuals are not discharged if they are "last payable without penalty after one year before the filing of the petition" [11 U.S.C. §523(a)(1)(A) referencing §507(a)(8)]. I find that the easiest way to conceptualize this is to draw a time line, and go back one year from the petition filing date. Any tax that was due after that is entitled to priority and therefore non-dischargeable.

So if the debtor filed bankruptcy on May 15, 2011, you would look back one year (to May 15, 2010) and then determine that any tax "last payable without penalty" (basically the due date) after May 15, 2010 is not discharged. The discharged bills can be written off immediately and you are able to resume collection on the non-dischargeable bills.

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Q: My Commissioner of Revenue will only adjust taxes going back for three years. I thought I heard something that allows them to go back five years so the entire amount can come off the books. Is this true?

A: There is a statute that permits the Commissioner of Revenue to make adjustments to personal property taxes for the full 5 years the tax is collectible "provided the taxpayer can demonstrate by clear factual evidence that he was not subject to the tax for the year in question". Code of Virginia §58.1-3980 (B).♦

## Italy "dog and cat tax" muzzled after uproar

*Reuters – May 2012*

ROME (Reuters) - A proposal to levy a tax on cats and dogs that stunned Italy on Friday turned out to be all bark and no bite after a wave of popular anger saw it withdrawn on the same day it was made public.

Italy was abuzz for hours after local media reported that a parliamentary commission had proposed a tax on domestic "animals of affection" to raise revenue for debt-strapped cities and towns.

Protests were voiced by everyone from animal rights groups - who said it would prompt more people to abandon animals - to politicians who called it everything from "grotesque" to "surreal" to "idiotic" to "shameful". There was so much reaction - all of it incredulous - that one Italian agency ran nearly 40 news items on the proposal in less than four hours.

The proposal was withdrawn by early Friday evening however, and it seemed everyone on the commission where it was discussed was denying its paternity. "The only thing that's left to tax are wives and children," said parliamentarian Domenico Scilipoti.

Italy, like many other countries across the euro zone, is struggling to revive its economy and reduce its public debt, a predicament that has prompted the country's lawmakers to try to dream up new revenue-raising measures.

## "TACS"ing Thoughts

"There is just one thing I can promise you about the outer space program: Your tax dollar will go farther."

--Werner Von Braun



*Taxing Authority Consulting Services, welcomes and encourages your contributions to TACS FACTS to help us keep your fellow tax professionals informed on news, trends and latest developments of interest to treasurers and finance officers throughout Virginia. Please send your comments, thoughts or story ideas to us at [publications@taxva.com](mailto:publications@taxva.com) or feel free to call us at (804) 649-2445 and let us know what you'd like to see.*