

COLLECTING TAXES AND OTHER CHARGES IN BANKRUPTCY

I. INTRODUCTION

Real and personal property taxes, as well as other governmental charges and transactions, receive varied treatment under the Bankruptcy Code. The treatment which these taxes and charges receive under the Bankruptcy Code may be different in some respects than that provided for by State law. An understanding of the status of taxes and charges within the framework of a bankruptcy proceeding is necessary to maximize their collectibility. In bankruptcy proceedings, more than any other type of Court proceeding, governmental units that do not actively pursue their claims will, in many cases, collect less than they might otherwise have collected.

II. AN OVERVIEW OF THE BANKRUPTCY PROCESS

A. Goals Behind the Bankruptcy Statute

The Bankruptcy Code is an attempt to provide for orderly determination of the types and amounts of claims against a debtor as of a particular date (the date of the filing of the bankruptcy Petition), and to provide for an equitable repayment of all or a portion of these claims out of the assets and/or cash flow of the debtor. This procedure seeks to avoid the normal debt collection process whereby the first creditor to obtain a judgment and levy on the assets of the debtor gets paid to the detriment of the remaining creditors.

B. History

Before the Bankruptcy Act the United States followed English law by imprisoning debtors who defaulted on their loans. Imprisoned debtors had no way of earning income to repay their debts and their families had to be supported by society. Gradually public opinion shifted from punishment to rehabilitation of debtors. In exchange for a turn over of the individual's assets to his or her creditors they were forgiven all debts. In addition, Individuals are granted what is known as a “fresh start”.

They are allowed to keep necessary assets such as their home and car with minimum equity in order to be employed and avoid burdening society. In 1978, the Bankruptcy code became law, modifying the rights of debtors and creditors. The Bankruptcy Code has been amended several times. On October 17, 2005, the Bankruptcy Abuse, Prevention and Consumer Protection Act of 2005 became effective further modifying the rights of creditors and the debtor.

C. Types of Bankruptcy Proceedings

The Bankruptcy Code is now available to businesses as well as individuals. Some asset values are maximized by a continuation of business operations rather than an auction sale. An assembly line or grain bin will generate less money after the disassembly and moving costs than if left in place to generate income. To reflect this business reality the Bankruptcy Code allows a business to continue its operations by restructuring its debts if more is paid to the creditors than would be realized upon liquidation.

1. Liquidation. Chapter 7 requires a liquidation of assets generally by auction or bankruptcy sale and is available to individuals and businesses. Chapter 7 provides for the orderly liquidation of assets for the benefit of creditors in return for a forgiveness of debts. Certain debts are not discharged however under Chapter 7. The most common non-dischargeable debts are:

- a. Taxes specified under Sec. 523 of the Code (includes certain real and personal property taxes).
- b. Money or property obtained by fraud.
- c. Debts not listed in the Bankruptcy Schedules (except in a no asset Chapter 7).
- d. Embezzlement by a fiduciary.
- e. Child support, alimony and divorce property settlements.
- f. Willful and malicious injury to person or property.
- g. Certain governmental fines.
- h. Student loans (including from private lenders).
- i. Damages for death or personal injury caused by drunk drivers.

Individuals may also retain some of their assets to obtain a “fresh start”. These assets are said to be “exempt” from claims of creditors. Debtors can elect to take “State” or “Federal” exemptions. The most common State exemptions are:

- a. Real estate owned by husband and wife as tenants by the entirety (except as to joint creditors).
- b. IRA's and pension plans.

Michigan places no limit on the value of exempt real estate, IRA's, or pensions an individual is allowed to keep.

The most common Federal exemptions for each debtor (spouses are two debtors) are:

- a. Equity in a home not to exceed \$22,975.00.
- b. Equity in a car not to exceed \$3,675.00.
- c. Household furniture, household goods, wearing apparel, appliances, books, etc. not to exceed \$12,250.00 in the aggregate nor \$575.00 for any one item.
- d. Jewelry of a value not exceeding \$1,550.00.
- e. An amount equal to \$1,225.00 plus up to \$11,500.00 of any amount not used for the full house equity exemption for any other item(s).
- f. Implements, professional books or tools of the debtor's trade or a trade of the debtor's dependent not to exceed \$2,300.00.
- g. Cash surrender value of life insurance not to exceed \$12,250.00.
- h. Income including alimony, support, social security, pension and welfare benefits to the extent necessary for the debtor's support.
- i. Payment for personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, not to exceed \$22,975.00.
- j. ERISA qualified 401K/Pension Plans (not property of the estate).

These amounts change based upon inflation.

2. Reorganizations. Reorganizations are available to businesses (corporations, LLCs, partnership and sole proprietorships) under Chapter 11; farmers under Chapter 12; individual wage earners under Chapter 13 of the Bankruptcy Code and municipalities under Chapter 9. Essentially the individuals or businesses are allowed to keep their assets provided they pay their creditors more than the creditors would have received under a Chapter 7 liquidation and they agree to use all of their disposable income (income after paying reasonable

living expenses) to pay creditors. Generally in Chapter 11, Chapter 12 and Chapter 13 the debtor tenders a plan for the creditors' and court's consideration and if approved, the debts are modified in amount and/or manner of payment.

PRACTICE POINT - MANY REORGANIZATIONS MAKE ATTEMPT TO REDUCE THE ASSESSMENT ON PROPERTY TO MINIMIZE TAXES AND STRETCH OUT PAYMENTS. PROMPT ACTION MUST BE TAKEN TO DEFEND AGAINST THESE ACTIONS WHICH OTHERWISE WILL BE GRANTED BY DEFAULT. ALSO MAKE SURE THE DEBTOR IS ELIGIBLE FOR RELIEF UNDER THE BANKRUPTCY CHAPTER SELECTED. FOR EXAMPLE, UNDER CHAPTER 13, THE DEBTOR MUST BE AN INDIVIDUAL WITH REGULAR INCOME AND LESS THAN \$1,149,525.001 OF NON-CONTINGENT, LIQUIDATED, SECURED DEBTS AND LESS THAN \$383,175.00 OF NON-CONTINGENT, LIQUIDATED, UNSECURED DEBTS.

D. Bankruptcy Filings.

A bankruptcy may be filed voluntarily by the debtor, or involuntarily by creditors if the debtor is insolvent and generally failing to pay its bills as they are due. Once a filing has occurred the Bankruptcy Code prohibits any further collection efforts. This is called the “Automatic Stay”.

PRACTICE POINT - ONCE NOTIFIED OF A BANKRUPTCY FILING, MAKE SURE NO COLLECTION EFFORT IS MADE. THE COURT STRICTLY ENFORCES THE AUTOMATIC STAY AND MAY PUNISH TAXING AUTHORITIES IN CONTEMPT OF COURT THROUGH FINES FOR ANY INTENTIONAL VIOLATIONS. UNINTENTIONAL VIOLATIONS ARE SET ASIDE AS VOID.

Bankruptcy filings are very detailed and complex. A series of schedules are filed detailing all assets and liabilities. All creditors must be listed along with their complete mailing address to insure proper notification, otherwise (except in a no asset Chapter 7) the debt may not be discharged. Within 30 days of a bankruptcy filing all creditors receive a notice of a meeting of creditors with the debtor. Attendance at the meeting is not required, but does give the creditors an opportunity to ask a few questions of the debtor regarding the extent of his assets, and the treatment of their debts.

E. Classification of Claims.

The liabilities, or debts, are categorized by groups established under the Bankruptcy Code.

1. Secured Claims. A secured creditor is treated as secured to the extent of the value of its collateral. If a bank mortgage debt is greater than the value of the real estate, the bank's secured claim is limited to the value of the real estate and any excess debt is treated as an unsecured claim. Undersecured creditors (those whose debt exceeds the value of their collateral) are not entitled to a statutory or contract interest on the secured portion of their debt but are entitled to be paid the present value of their secured claim.

2. Priority Claims. Assets remaining after the payment of secured claims are distributed under the Code according to priorities established by the Bankruptcy Code and then if any assets remain to unsecured creditors in Chapter 7 cases. In reorganizations, priority debts must be provided for before lower priority debts are allowed to receive payment. The most common priorities are:

- a. Domestic Support Obligations (1a priority). Unsecured domestic support obligations owed to a spouse or dependant.
- b. Assigned Domestic Support Obligations (1b priority). Unsecured domestic support obligations assigned to a governmental unit by law or owed to a governmental unit.
- c. Certain Trustee Owed Administrative Claims (1c priority).
- d. Administrative claims (2nd priority). These liabilities arise during the bankruptcy and are deemed by the court to be beneficial and necessary for the preservation of the estate. (Attorneys fees for debtor, creditors committee, post-petition taxes and other post-petition debts).
- e. Involuntary case claims (3rd priority). Between petition and order for relief.
- f. Wage, salary and commission claims (4th priority). Limited to \$12,475.00 per individual earned within 180 days of bankruptcy for wages and salary and 12 months for commissions.
- g. Employee benefit plan claims (5th priority). Limited to \$12,475.00 per employee in the aggregate earned within 180 days of bankruptcy or the substitution of the debtor's business minus amounts actually paid.
- h. Deposits for purchase or lease of property (7th priority). Limited to \$2,775.00.
- i. Income and property tax claims (8th priority). (Pre-Petition tax claims).

1 These amounts change based upon inflation.

- j. Death or personal injury claims (10th priority). Resulting from the operation of a motor vehicle or vessel if the operation was unlawful because the debtor was intoxicated from using alcohol, drugs, or another substance.

These amounts change based upon inflation.

3. General Unsecured Claims. In a Chapter 7, any property remaining after payment to all priority claimants, in their order of priority, is distributed to the unsecured creditors on a pro rata basis.

PRACTICE POINT - THE PRIORITY GRANTED TO TAXING AUTHORITIES UNDER THE CODE DOES NOT GUARANTEE PAYMENT OF THE DEBT. BANKRUPTCY CASES MUST BE MONITORED AND ASSERTED CLAIMS ENFORCED TO MAXIMIZE COLLECTION. SECURED CLAIMS ARE ENTITLED TO ADEQUATE PROTECTION PAYMENTS WHICH THE CREDITOR MUST ASSERT TO COLLECT. IF YOU DON'T ASK FOR IT, YOU WON'T GET IT IN BANKRUPTCY.

F. Proofs of Claims.

In order to participate in any distribution from a Chapter 7 or Chapter 11 estate, the creditor must either be listed on the schedules or file a proof of claim. In a Chapter 13 case a proof of claim MUST be filed. In Chapter 7 and Chapter 13, proofs of claims must be filed within 90 days of the first meeting of creditors. Chapter 11 proofs of claim must be filed by a deadline established by order of the court. Once filed, your proof of claim is presumed to be correct and supersedes the classification and amount listed by the debtor in his schedules.

PRACTICE POINT - IN MOST SITUATIONS THE TAXING AUTHORITIES DON'T RECEIVE COPIES OF THE BANKRUPTCY SCHEDULES TO KNOW IF THEY ARE CORRECTLY LISTED. MOST BANKRUPTCY SCHEDULES ALSO DO NOT CORRECTLY CLASSIFY TAX CLAIMS BETWEEN SECURED AND PRIORITY. TIMELY FILING A CLAIM 90 DAYS FOLLOWING THE FIRST MEETING OF CREDITORS MAY, HOWEVER, BE TOO LATE TO ALLOW FOR EFFECTIVE INPUT INTO CHAPTER 7 AND 13 CASES. FOR THESE REASONS, WE RECOMMEND THAT YOU SET UP A PROCEDURE TO AUTOMATICALLY FILE A PROOF OF CLAIM IMMEDIATELY UPON LEARNING OF THE BANKRUPTCY FILING.

PRACTICE POINT - IT IS IMPORTANT TO THE COLLECTING TREASURER, TO THE EXTENT POSSIBLE, TO INFORM HIMSELF/HERSELF OF THE NEW BANKRUPTCIES THAT HAVE BEEN FILED. IN MANY JURISDICTIONS, LOCAL CREDIT BUREAUS WILL ISSUE A BULLETIN INCLUDING SUCH ITEMS AS RECENT JUDGMENTS OBTAINED AND NEW BANKRUPTCIES FILED. A SUBSCRIPTION TO THE LOCAL CREDIT BUREAU BULLETIN IS MORE THAN WORTH THE SUBSCRIPTION COSTS. IT IS A RELATIVELY EASY PROCESS FOR A TREASURER TO COMPARE THE NAME OF THE ENTITY LISTED ON THE CREDIT BUREAU BULLETIN AS RECENTLY HAVING FILED BANKRUPTCY WITH THE NAMES CONTAINED IN THE TAX ROLLS. A PROOF OF CLAIM MAY THEN PROMPTLY BE FILED TOGETHER WITH A REQUEST THAT THE TREASURER RECEIVE ALL NOTICES ISSUED IN THE BANKRUPTCY. COPIES OF SCHEDULES AND PLEADINGS ARE IMMEDIATELY AVAILABLE ONLINE FOR A NOMINAL PER PAGE CHARGE (ON PACER) BUT YOU MUST HAVE AN ACCOUNT SET UP AND A CHARGE CARD TO BE CHARGED.

III. TAXES IN BANKRUPTCY

A. Determination of the Status of Taxes in Bankruptcy

1. Secured Claims. The determination as to the status of any security interest or lien on real and personal property in bankruptcy is made as of the date of filing and using state law. However, liens for real and personal property taxes can be attached even after bankruptcy is filed through an exception to the automatic stay.

a. Tax Day. Lien Date. Michigan compiled laws Chapter 211 establishes tax procedure and the status of all real and personal property tax claims in the State of Michigan. Pursuant to state law, the true cash value, situs and taxability (exemption) of all real and personal property taxes are determined as of December 31 of the year prior to the year for which the taxes are assessed. This date is known as “tax day”.

b. Lien Date for Real and Personal Property. The lien date for real and personal property is December 1 of the tax year unless varied by Chapter MCL 211.40 and 211.40a.

c. Jeopardy Assessment. Michigan tax law allows a collecting treasurer who believes that personal property taxes are in jeopardy of not being collected to accelerate both the due date and lien attachment date. Pursuant to MCLA §211.691 et seq., the Treasurer may file a Jeopardy Assessment Affidavit with the local Register of Deeds, thereby accelerating both the due date and lien date of the taxes.

2. Priority Claims. The priority granted to an unsecured claim (one without a lien or security interest granted to it) is determined by reference to the Bankruptcy Code. Under the Bankruptcy Code, some unsecured claims are granted priority over other unsecured claims. Those claims which accrue (are assessed) after the filing date of bankruptcy, including real and personal property taxes are granted a second priority administrative claim status. Unsecured taxes which accrue prior to the filing of the Bankruptcy Petition are granted an eighth priority status.

B. Treatment of Taxes in Bankruptcy.

1. Secured Tax Claims. Those tax claims for which the tax lien has attached in Chapter 11, Chapter 12 or Chapter 13 cases may be paid over time, pursuant to a Plan filed by the debtor. Interest must be paid on these taxes. They should be paid in a Chapter 11 within five (5) years of the date of the order for relief but debtors sometimes try to string them out longer because they are “secured” and not being treated as “priority”.

2. Administrative (Second Priority) Tax Claims. Administrative tax claims must be paid as they come due in Chapter 11 cases based upon an Order that is entered at the beginning of every Chapter 11 case. This Order indicates that all claims which accrue after the date of the Petition must be paid when due. The failure to make these payments is grounds for ordering the debtor's case converted to a Chapter 7 bankruptcy liquidation case.

3. Priority (Eighth Priority) Tax Claims. Tax claims which are pre-petition, unsecured claims entitled to an eighth-priority, pursuant to the Bankruptcy Code, may be paid in installments. In Chapter 11 and Chapter 12 cases, interest must be paid. In Chapter 13 cases, these taxes may be paid over time without interest. They must, however, be paid in full. As a result, most debtors will seek to pay their priority tax claims over time.

4. Treatment of Tax Claims in Chapter 7 Liquidation Cases. Section 724(b) of the Bankruptcy Code gives the Chapter 7 Bankruptcy Trustee special powers with regard to secured tax claims. The Bankruptcy Trustee may avoid pre-petition secured tax claims and use the lien amount, for the payment of administrative claims and other priority claims which would be paid before an eighth-priority tax claim. As a result, the taxing authority, in some cases, after conversion to Chapter 7, will find that its secured tax claim has been used to pay the fees and expenses of the administration of the bankruptcy, wage and deposit creditors, and other first through seventh priority creditors with nothing left to pay the taxes. Conversion to Chapter 7, after having been in a Chapter 11, Chapter 12 or Chapter 13, is often bad news for the tax creditor.

C. “Adequate Protection” and the Tax Creditor.

In a Chapter 11, Chapter 12 or Chapter 13 bankruptcy case, prior to Confirmation, the debtor will remain in possession of the collateral of a secured creditor. For tax creditors and loan creditors, this means that the taxpayer/customer will remain in possession of the real or personal property to which the tax lien/security interest attaches. This means that the real and personal property granted as security to a bank or municipality for a loan or subject to tax liens will continue to be used by possibly lessening its value or because of the increasing debt or tax amount impairing the bank or taxing creditor’s security. It is the debtor’s obligation, if the secured creditor requests, to provide “adequate

protection” to the secured creditor whose collateral position is being impaired by the debtor’s continued possession of the property.

Adequate protection is assurance that the secured creditor’s position will not erode during the time the debtor is in bankruptcy. A creditor's secured position can erode in two ways: (1) while the collateral remains approximately the same value, the debt becomes larger, due to accruing interest and threatens to exceed the value of the collateral; and (2) through a decrease or depreciation in the value of the collateral, the debt threatens to exceed the value of the collateral. As a result of these possibilities, the Bankruptcy Code requires that the debtor protect the secured creditor against the loss of its secured position. This protection may be granted by (1) making payments to the secured creditor (e.g., a payment equal to accruing interest and depreciation caused by use); (2) through the granting of liens on additional collateral so that even with a decrease in the value of the current collateral, or an increase in the amount of the loan and interest, the creditor will be protected; (3) by proving to the Court that the value of the value of the collateral is sufficiently in excess of the amount of the loan that the creditor is in no danger (the “equity cushion” argument) and/or; (4) by granting to the secured creditor a special bankruptcy priority in the event that it is not fully paid out of the collateral. The exact protection afforded to the secured creditor is usually a matter of negotiation between the debtor and the individual creditor. The secured creditor will attempt to obtain as many of these types of protection as its negotiating position will allow.

The priority granted for the failure of protection under an Adequate Protection Agreement will be paid out of unencumbered assets of the debtor ahead of administrative claims. As a result, in cases where the taxes owed are sufficiently large to warrant the time and expense involved in negotiating and drafting Adequate Protection Agreements, taxing authorities may be able to use the special priority to avoid losing its tax claim to administrative expenses in a case that is converted to a Chapter 7

bankruptcy case. Use of Adequate Protection Agreements may also accelerate payment of the taxes. If there is a big equity cushion adequate protection may not be approved.

D. Pressure Points and Pitfalls for Governmental Creditors

1. Sales of assets in Bankruptcy Court. The sale of the debtor's real or personal property in Bankruptcy Court provides the taxing authority with both an opportunity (pressure point) and a possible pitfall. Many times an objection to a sale of property in a Chapter 11 case will result in a settlement being reached with the debtor and the secured creditor (the bank) allowing the taxes to be immediately paid out of the sale proceeds. On the other hand, the failure to appear and object to a proposed bankruptcy sale which is silent as to tax payment provisions oftentimes result in no payment to the tax creditor. Most sale notices simply state that the property is being sold free and clear of all liens [including the tax lien] with all liens to attach to the sale proceeds in the same rank and order as they existed on the property sold. While this may sound as though it will result in payment of the taxes when the money is distributed, that is not necessarily the case. After the sale is consummated and the bank is paid, the case will likely be converted to one under Chapter 7 of the Bankruptcy Code, and the Trustee will step forward and use Section 724(b) of the Bankruptcy Code to pay administrative and priority claimants before the tax lien is satisfied.

ANY NOTICE OF SALE THAT YOU RECEIVE FROM THE BANKRUPTCY COURT SHOULD BE REVIEWED CAREFULLY AND IF IT DOES NOT EXPLICITLY PROVIDE FOR THE IMMEDIATE PAYMENT OF THE TAXES OUT OF THE PROCEEDS OF THE SALE, AN OBJECTION TO THE SALE SHOULD BE FILED.

2. Adequate Protection Agreements. Adequate Protection Agreements in favor of the secured tax creditor which provide for a super priority claim under section 507(b) of the Bankruptcy Code can help to blunt the problem of conversion to Chapter 7. Adequate Protection Agreements with other secured creditors should be reviewed closely. Many

Adequate Protection Agreements with banks will indicate that the bank is being given an additional lien on the property which is superior to all other liens in exchange for its allowance of the debtor to continue in possession of the collateral. This type of lien would seem to grant the bank a lien in bankruptcy which is superior to tax liens.

AN OBJECTION TO THIS TYPE OF ADEQUATE PROTECTION ARRANGEMENT SHOULD BE FILED SO THAT THIS DOES NOT OCCUR.

A lender will also seek to have a priority claim which is superior to all other priorities if adequate protection fails. This grants the bank a priority in unencumbered property of the debtor which will be superior to the eighth priority granted for the taxes. The taxing authority, by having its own adequate protection arrangement with the debtor, can reduce the risk of higher priorities affecting its right to payment.

3. Post Filing Financing Arrangements. Occasionally, a debtor will advise the court that it needs to obtain a loan after it has filed bankruptcy so as to preserve and enhance its chances of a successful reorganization. Any such loan must be approved by the Bankruptcy Court. If approved by the Bankruptcy Court, this loan will be given a special priority which is again higher than the tax priority granted by the Bankruptcy Code. In post-petition financing arrangements, additional liens are often also granted.

ANY POST-PETITION FINANCING ARRANGEMENTS SHOULD BE REVIEWED CAREFULLY TO MAKE SURE THAT THEY DO NOT JUMP THE LENDER'S LIENS AHEAD OF THE TAX CLAIMS.

4. Motions to Convert to Chapter 7. Motions to convert to Chapter 7 are particularly troublesome. As stated previously, Section 724(b) of the Bankruptcy Code allows the Trustee to take the dollars claimed in the tax claim and use them to pay administrative expenses and other priority claims which are senior to the tax priority (eighth priority). Administrative expenses include any unpaid expense incurred by the debtor after the filing of

the Petition. Examples of this type of expense are Trustee's fees, the debtor's attorney fees, attorney fees of the creditors committee, accountant's fees, and even charges for goods and services which are provided to the debtor after bankruptcy is filed but didn't get paid. Other priority claims such as wage claims, child support, etc. would also be paid prior to the taxes. After conversion, the tax creditor may be faced with most of what it would otherwise have been paid being used to pay administrative expenses and other priority claims.

5. Motions for Relief from the Automatic Stay. A secured creditor, for various reasons, including the lack of "adequate protection," can ask the Bankruptcy Court to grant it relief from the automatic stay and allow it to foreclose its lien. When such a motion is granted, normal state law lien and collection rules apply.

The bank's liens under state law are subordinate to subsequent tax liens. As a result, once relief from the automatic stay is granted, the status of the taxes is analyzed under state law. Once the bank obtains possession of the property, it must pay all taxes together with all accrued interest and administration fees or risk losing the property to the taxing authority. Personal property may be seized from the bank by the Treasurer to satisfy the tax liens and real property may be foreclosed by tax sale divesting the bank and/or any purchaser from the bank outside of bankruptcy from title. As a result, once the bank has obtained possession of the property, it should voluntarily pay the real and personal property taxes. If, however, the bank purchases the property, pursuant to a sale in bankruptcy, free and clear of all liens with the liens attaching to the proceeds, the bank obtains clear title to the property free of all taxes.

6. The Passage of Time and New Unpaid Taxes. Particularly in multiyear Chapter 7 cases (but also in Chapter 11's and 12's to a lesser degree) if the taxes are building up because new years' taxes are not being paid it is time to seek relief from stay. The non-payment of more than one year of taxes may assist with getting the motion granted.

E. Challenging the Amount of Taxes in Bankruptcy Court

The Bankruptcy Code allows a debtor or any appointed Trustee to challenge the amount and/or validity of any taxes owed by the debtor. The Bankruptcy Code allows such a challenge even though the appeal deadlines under state law have passed. As a result, even though the debtor did not go to the Board of Review and did not appeal to the Michigan Tax Tribunal before the June 30 deadline, the debtor or Trustee in bankruptcy still has the right to challenge the taxes in Bankruptcy Court. The Bankruptcy Court must apply state tax law in making its determination as to the amount and validity of the tax. As a result, the Bankruptcy Judge can determine the true cash value of the property on tax day, apply the appropriate number of tax mills to that value and determine the appropriate tax. The Bankruptcy Court could also determine the right to any exemption granted under state law.

If the debtor has already appealed to the state agency empowered to make a decision regarding the tax, and a final decision has been made by that agency, the Bankruptcy Court may not modify that decision. As a result, if the debtor appeals to the Michigan Tax Tribunal and the Michigan Tax Tribunal makes a final decision, the Bankruptcy Court cannot overturn that decision.

The Bankruptcy court is likely to be a more favorable forum for the debtor than the Michigan Tax Tribunal would be.

F. Tax Foreclosure and Bankruptcy.

1. The Automatic Stay. In the event that a Treasurer is in the tax forfeiture and foreclosure process on a property and the owner of that property files for protection under the Bankruptcy Code, the automatic stay prohibits continuation of the process. As a result the taxing authority, without relief from the automatic stay, may not take additional steps or actions required including posting service of notice, forfeiture, foreclosure hearing, etc. without relief from the automatic stay. While the taxing authority may not take additional steps it is not required to go back to the beginning of the process in order to complete the process once the

automatic stay has been lifted. As a result, if forfeiture has already occurred, the taxing authority may pick up at the foreclosure of taxes without going back to the forfeiture step for any tax years that forfeiture has occurred. For the tax years that have not gone through the process, of course, the Treasurer will have to complete the full process. Given the timing in the state statute for these items it may, or may not be, just as easy to begin the process over. It depends on the timing on which relief from stay is granted and the status of forfeiture and foreclosure with regard to a particular year of taxes. If the process is completed and the March 31 redemption period has run before the bankruptcy is filed, then the property is not an asset of the estate and the Treasurer may go ahead with the sale.

2. When the Automatic Stay is of Limited Application. The Bankruptcy Code only allows an extension of time for the longer of (1) the end of any redemption period or (2) 60 days after the order for relief with regard to real property taxes which have already been through the full foreclosure process (except the redemption period). This process (except for the redemption period) ends on the date the judgment of foreclosure is entered by the court. After that date all that is left to do is for the redemption period (typically to March 31 of that year) to be completed. As a result, if the debtor files for bankruptcy on March 31 of that year the debtor would have an additional 60 days to redeem. If the debtor were to file bankruptcy after the redemption period had run that year then there would be no extension of time. As set forth above, the extension only occurs if the debtor still has an interest in the property which ends when the redemption period ends.

G. Other Types of Governmental Claims in Bankruptcy

1. Public Utility Charges

a. Water and Sewer Service Charges. Pursuant to MCLA §123.161, et seq., these charges are a lien on the real estate to which the service is provided and are

subordinate only to tax claims against the real estate. As a result, these claims are superior to any bank lien claims.

b. Municipal Power Plant Electricity Charges. If a municipally owned electric utility was built using revenue bonds, and the rate or service charges are used to repay the bonds, pursuant to the MCLA §141.121, the service charges are a lien on the real estate to which the service is provided.

2. Economic Development, Small Business and Other Types of Municipal Loans.

These loans are treated the same as all other loans to the debtor. As a result, the rank and status of any liens granted by the debtor to secure the loans will be determined by the security agreement, UCC financing statements and/or mortgage granted to the municipality as security for the loan and state law.

3. Executory Contracts. Executory contracts are contracts which are not yet completely performed. Under the Bankruptcy Code, the debtor has the right to elect whether or not to accept or reject these contracts. If rejected, the contract is terminated and the governmental unit would have either an unsecured or administrative claim (or both) for the amounts owed prior to rejection. In the event that the debtor wants to continue to have the benefit of this contract (assume the contract), the debtor must cure any defaults under the contract within a reasonable time after the contract is assumed and provide assurance of future performance. In other words, the debtor may not take the benefits of the continuation of the contract without also paying any amounts due and curing any other defaults under the contract. Some examples of typical types of executory contracts with governmental entities are as follows: (1) cable television franchises, (2) long-term municipal convention center management/ commission arrangements, (3) cable television - pole use agreements, (4) construction contracts, (5) airport leases, (6) municipal building leases.

H. Inter-Governmental Agreements and the Collection of Taxes

Governmental agencies in the State of Michigan can enter into inter-governmental agreements whereby services or types of functions or activities of governmental units are consolidated under a single governmental unit. If desired by the governmental units involved, the collection of taxes for entities who have filed for protection under the Bankruptcy Code could be consolidated under a single unit of government. As a result, townships, villages and even small cities that might not have the staff, resources and/or expertise to oversee the collection of taxes for entities in bankruptcy might, through an inter-governmental agreement, transfer those responsibilities to the county in which the township, village or city is located. Both the transferring governmental unit and the governmental unit receiving the duties must agree to the transfer. This transfer is accomplished by written agreement approved by both units of government. A consolidation of bankruptcy tax collection work in the hands of persons with greater bankruptcy familiarity and/or staff resources can help increase bankruptcy collections and also provide for greater cost effectiveness in the collecting process.

I. Final Thought

In the Bankruptcy Court, more than any other court, active litigants are more likely to obtain payment than an entity that passively files a Proof of Claim and waits to be paid.