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## Coates' Canons Blog: Bankruptcy, Registration Blocks, and The New Property Tax System for RMVs

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Article: <https://canons.sog.unc.edu/bankruptcy-registration-blocks-and-the-new-property-tax-system-for-rmvs/>

This entry was posted on July 17, 2013 and is filed under Finance & Tax, Property Taxes

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[UPDATED 8/24/16]

Big changes are on the horizon for all North Carolina drivers. Under the state's new "Tax and Tag Together" program (aka "H.B. 1779" among property tax geeks) that will launch in September, anyone who wishes to renew a vehicle registration or obtain a new registration will be required to pay local property taxes on the vehicle at the time of registration. Under the current property tax system, owners are billed for taxes on their vehicles about three months after registration. The hope is that the new system will greatly increase motor vehicle tax collection rates while at the same time making taxpayers' lives easier by combining the two transactions (registration and tax payment) into one.

The new system transfers most of the collection responsibility for property taxes on registered motor vehicles ("RMVs") from the counties to the N.C. Division of Motor Vehicles. But counties will still play an important role in the process, about which I'll be blogging and teaching over the next few months.

Today's post focuses on an issue that arose under the current RMV tax system but takes on even greater importance under the "Tax and Tag Together" program: can the DMV refuse to register a vehicle based on the owner's failure to pay RMV taxes if that owner is in bankruptcy?

For years the School of Government's answer—via me, Shea Denning and Bill Campbell, the Dean Smith/Coach K of N.C. property tax law—was a resounding, "No!"

We based that answer on the fact that federal bankruptcy law creates an automatic stay immediately upon the filing of a bankruptcy petition. The stay generally prohibits creditors from taking action to collect debts owed by the debtor while the bankruptcy is ongoing.

But the impending implementation of the "tax and tag together" system along with a recent opinion letter from the N.C. Attorney General's Office caused me to look more deeply into the issue. And now I'm reconsidering my standard answer to this recurring question.

My revised conclusion is that counties may block vehicle registrations for property taxes that arise *after* a bankruptcy filing, which are known as *post-petition* taxes. I still recommend against blocking registrations for taxes that arose before a bankruptcy filing, which are known as *pre-petition* taxes.

To explain my change of heart, we need to dive into the weeds of bankruptcy law. Readers who might first benefit from a quick overview of the topic can find one here.

### What does the automatic stay prohibit?

The automatic stay applies to every bankruptcy debtor under 11 U.S.C. 362 and creates a variety of prohibitions on creditors and third parties, two of which are particularly important for our purposes.

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The first is the prohibition against “the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title . . .” 11 U.S.C. 362(a)(1). In plain English, this provision essentially bars all efforts to collect debts that arose *prior* to the filing of the bankruptcy petition.

The second relevant prohibition is created by 11 U.S.C. 362(a)(3), which bans “any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate.” The term “estate” refers to property of the debtor that is under the control of the bankruptcy court. With limited exceptions, the bankruptcy estate includes *all* of the debtor’s property, including property owed to the debtor but held by other parties such as wages, bank accounts, and investments.

As a result, 362(a)(3) effectively bars a debt collection action that affects *any* property of the debtor. And because the provision makes no reference to pre- or post-petition debts, 362(a)(3) applies to collection efforts for all debts regardless of when they arose.

Read together, 11 U.S.C. 362(a)(1) and (3) prohibit two things: (i) “actions” to collect pre-petition debts and (ii) collection efforts for all debts (regardless of when they arose) if those efforts affect the property of the debtor.

### **What does this mean for registration blocks when the taxpayer is in bankruptcy?**

The answer depends on whether the registration is being blocked for pre-petition taxes or post-petition taxes.

For bankruptcy purposes, a North Carolina property tax obligation arises on the date the property is listed for taxes. *In re: Member’s Warehouse*, 991 F.2d 116 (4<sup>th</sup> Cir. 1991). For taxes on registered motor vehicles, the listing date is the date on which the owner renews an existing registration or applies for an initial registration. G.S. 105-330.2.

Under both the current and the new RMV tax systems, if the taxpayer renews a registration or applies for an initial registration before filing for bankruptcy then the RMV taxes relating to that registration will be pre-petition. If the renewal or initial registration occurs after a bankruptcy filing, then the related taxes will be post-petition.

Under the current RMV tax system, the taxes at issue will often be *pre*-petition due to the lag time between the tax obligation arising and the placement of a registration block many months later.

For example, assume Billy BlueDevil renews his registration on July 10, 2013. If the taxpayer files for bankruptcy at any point after this date, the taxes relating to that vehicle for 2013-214 will be pre-petition regardless of the fact that the tax collector cannot request a block on the taxpayer’s registration for unpaid taxes until months later.

However, under the new RMV tax system taxes will be payable on the same day the vehicle is registered. This means that the taxes almost always will be paid before a bankruptcy filing occurs (in which case we don’t need to worry about the automatic stay) or they will arise after a filing and will be *post*-petition.

There will be only one situation under the new “tax and tag together” system in which RMV taxes might be pre-petition (and therefore not eligible for a registration block): when a taxpayer files bankruptcy after buying a vehicle (usually from a dealer) and obtaining a limited registration plate but before a “regular” full-year registration is obtained.

When purchasing a vehicle from a dealer the taxpayer has the option of obtaining a limited registration for the new vehicle (good for 60 days) without paying any RMV taxes. G.S. 20-79.1A. To obtain a “regular” registration for the rest of the registration year the taxpayer will be required to pay the full year of taxes on the vehicle. Those taxes arose at the time the limited registration was issued, however. If the taxpayer files bankruptcy at any point after purchasing the vehicle, the taxes relating to the initial vehicle registration will be pre-petition. For the reasons discussed below, the DMV could not later require the taxpayer to pay the property taxes on the vehicle prior to obtaining a full registration .

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With that in mind, let's analyze how bankruptcy law affects blocks for pre-petition taxes as compared to those for post-petition taxes.

#### *Registration Blocks for Pre-Petition Taxes*

These blocks likely violate the automatic stay. Here's why:

11 U.S.C. 362(a)(1) prohibits all actions or proceedings to collect pre-petition debt. The consensus among the few courts that have wrestled with this issue is that the placement of a block on the issuance of any type of a license or a registration—or the refusal to take steps to remove a block put in place prior to the bankruptcy filing—is an action under 362(a)(1) and therefore violates the automatic stay.

For example, see *Jessamey v. Town of Saugus*, 330 B.R. 80 (Bankr.D.Mass 2005)(refusal to lift driver's license and registration block based on failure to pay pre-petition taxes violates automatic stay); *Bertuccio v. Cal. State Contractors License Board*, 414 B.R. 604 (Bankr.N.D.Cal. 2008)(state had affirmative duty to restate contractor's license which was suspended prior to bankruptcy filing for contractor's failure to pay taxes).

Assuming that North Carolina bankruptcy courts would adopt similar reasoning, a tax collector should not create a registration block for taxes that arise prior to the filing of a bankruptcy petition. If a block is already in place at the time of the bankruptcy filing, the tax collector should ask the DMV to remove that block.

Among the several exceptions to the automatic stay is one for efforts by a government to enforce its "police and regulatory power." 11 U.S.C. 362(b)(4). If the registration block for unpaid taxes were considered a regulatory action and not a debt collection action, it would fall outside of the automatic stay and would be permissible regardless of when the taxes arose.

That said, I don't think this exception applies. Ever since the U.S. Supreme Court's decision in *Perez v. Campbell*, 402 U.S. 637 (1971), courts have refused to apply the police and regulatory exception to actions by governments that are motivated by a "pecuniary interest" of the government rather than by public safety and health concerns. In other words, if the action in question is aimed primarily at helping the government collect a debt then that action is prohibited by the automatic stay.

Our state's registration block seems to be motivated entirely by pecuniary interests—tax collection—rather than by public health and safety interests. The block has no relationship to the vehicle owner's driving or criminal history; it is based solely on a financial obligation unrelated to the safety of our state's highways. "If the law looks like a revenue collection measure and operates like a revenue collection measure, the chances are excellent when all is said and done, it is indeed a revenue collection measure." *Hoffman v. Clark*, 65 B.R. 985 (Bankr.D.R.I. 1986)(holding that a state law requiring payment of delinquent taxes prior to transfer of liquor license was not covered by the "police and regulatory" exception to the automatic stay).

In *Perez*, the Court struck down Arizona's suspension of bankruptcy debtors' drivers' licenses based solely on the non-payment of pre-petition judgments based on the negligent operation of their motor vehicles. Knowing that the collection of a legal judgment relating to negligent driving wasn't enough to trigger the police and regulatory power exception, it seems reasonable to conclude that the collection of property taxes also falls outside of that exception.

If the arguments above don't convince you that blocks for pre-petition taxes are illegal, consider 11 U.S.C. 525(a). That statute bans "discrimination" by a government in the issuance of licenses or permits based on a debtor's failure to pay a debt that is dischargeable in bankruptcy. RMV taxes that became delinquent more than a year prior to a bankruptcy filing are generally dischargeable in bankruptcy. If a local government refused to remove a registration block for an old RMV tax, I think that action would violate both the automatic stay and 11 U.S.C. 525(a).

#### *Registration Blocks for Post-Petition Taxes*

These blocks are likely permissible under bankruptcy law.

The issue turns on whether a registration block is an "act to obtain possession of property of the estate or of property from

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the estate or to exercise control over property of the estate” and therefore barred by 11 U.S.C. 362(a)(3).

Happily for tax collectors, courts generally agree that motor vehicle registrations (along with driver’s licenses) are privileges and not property. This means that the refusal to issue a vehicle registration for failure to pay post-petition obligations is not an act that affects the property of the debtor and therefore does not violate the automatic stay. See for example *Geiger v. Pennsylvania*, 143 B.R. 30 (E.D.Pa. 1992)(refusal to reinstate driver’s license for failure to pay a post-petition debt did not violate automatic stay because driver’s license was not property of the debtor); *In re: Thomas*, 2007 WL 1079980 (Bankr.N.D.Cal.)(government could require payment of post-petition parking fines before permitting bankruptcy debtor to renew motor vehicle registration).

### **The Bottom Line**

When a county learns that a taxpayer has filed a bankruptcy petition, it should refrain from placing a new registration block on that taxpayer for pre-petition taxes and it should remove any existing registration blocks on that taxpayer.

The county is free to place registration blocks on taxpayers in bankruptcy for post-petition taxes. Taxes relating to registration renewals or issuances after a bankruptcy petition is filed are considered post-petition. Under the new “Tag and Tax” system nearly all unpaid RMV taxes will be post-petition, except those arising from the issuance of a limited registration. As a result, the DMV generally can require payment of RMV taxes at the time of registration regardless of whether the taxpayer has filed for bankruptcy.

### **Links**

- [www.ncdot.gov/dmv/vehicle/tagtax/](http://www.ncdot.gov/dmv/vehicle/tagtax/)
- [canons.sog.unc.edu/wp-content/uploads/2013/06/Advisory-Letter-to-CommissionerForte-RE-Bankruptcy-Issue-2-26\\_1.pdf](http://canons.sog.unc.edu/wp-content/uploads/2013/06/Advisory-Letter-to-CommissionerForte-RE-Bankruptcy-Issue-2-26_1.pdf)
- [canons.sog.unc.edu/?p=3944](http://canons.sog.unc.edu/?p=3944)
- [www.law.cornell.edu/uscode/text/11/362](http://www.law.cornell.edu/uscode/text/11/362)
- [www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-330.2](http://www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-330.2)
- [www.law.cornell.edu/uscode/text/11/525](http://www.law.cornell.edu/uscode/text/11/525)