
Coates' Canons Blog: Local Tax Collectors Sing the Bankruptcy Blues

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Consumer bankruptcy filings rose nearly 37% nationwide in the first half of 2009 as compared with the same time period one year ago. Second quarter bankruptcy statistics for North Carolina are not yet available, but first quarter 2009 filings across the state were up 24% from first quarter 2008.

None of this is good news for local tax collectors and budget officials. The automatic stay that immediately arises after a bankruptcy filing bars *any* effort to collect taxes beyond sending a bill to the taxpayer and accepting voluntary payments. Regardless of the type of bankruptcy involved, all collections efforts must halt until the bankruptcy court either discharges the taxpayer or dismisses the filing.

The automatic stay applies to new collection efforts as well as those that began before the taxpayer filed for bankruptcy. If a tax office has an ongoing wage garnishment for the collection of property taxes, it must discontinue that garnishment while the bankruptcy is pending. If the tax office has obtained a foreclosure judgment and is about to sell the taxpayer's real property, the sale must be postponed until the bankruptcy is discharged or dismissed.

That said, a bankruptcy filing does not mean that all unpaid local taxes are lost forever. It is true that older motor vehicle taxes and other personal property taxes that are not liens on real property are unlikely to be collectible after a bankruptcy filing. But most other taxes can be collected eventually, just not while the bankruptcy is pending.

In general, taxpayers who file for bankruptcy remain personally liable (in other words, subject to bank account attachment and wage garnishment) for taxes that arose during the bankruptcy or within one year prior to filing. And, regardless of when they arose, real property tax liens are always enforceable post-bankruptcy, which means that the ultimate property tax collection remedy—foreclosure—is unaffected by a bankruptcy filing. (But be sure to object if the court proposes a “Section 363 sale” of the real property free and clear of all liens.)

For a detailed analysis of what a local government may and should do to collect taxes after a bankruptcy filing, please see this terrific bulletin by my SOG colleague Shea Riggsbee Denning and Robert E. Price, Jr., staff attorney for the U.S. Bankruptcy Administrator, Middle District, N.C.

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