
Coates' Canons Blog: Tax Collection on Surrendered Property

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What does it mean for local government tax collectors when debtors surrender property in bankruptcy proceedings?

Great question! Let's see what the band Cheap Trick has to say on this topic:

Mommy's alright, Daddy's alright, they just seem a little weird,

Surrender, surrender, but don't give yourself away, ay, ay, ay

Hmm. That chorus is catchy but not very helpful. Perhaps we should look to federal bankruptcy law instead of pop music to answer this question.

Bankruptcy law can be immensely complicated, and I am far from an expert. Happily we don't need to dive too deeply into the U.S. Code to figure out what happens when property is surrendered in a bankruptcy proceeding. But if you'd like a quick overview of bankruptcy law before we go forward, take a look at this post. Masochists who desire the full details of how bankruptcy affects local tax collection should read chapter 16 of my property tax collection book.

When a debtor files a bankruptcy petition in federal court, an *automatic stay* immediately arises and protects the debtor's property from debt collection actions by any of the debtor's creditors. For example, assume that the debtor owns a house that is subject to a mortgage. While the bankruptcy is pending, the mortgage holder would be prohibited from foreclosing on that house unless the court first gave permission.

If a debtor *surrenders* a particular piece of property, then that property is removed from the automatic stay and creditors are free to take collection actions against that property. For example, if a debtor surrenders her house in a bankruptcy proceeding then a creditor that held a mortgage on that house would be free to foreclose without waiting for the bankruptcy proceeding to end.

I'm simplifying this process a bit, as additional action by a creditor may be needed to formally lift the automatic stay on the surrendered property. But for our purposes, my use of the term "surrender" describes a situation in which the bankruptcy estate no longer has an interest in the property and creditors are free to take action against it.

Here's the important point: surrendering property does not transfer title or ownership of that property from the debtor to a creditor or to any other party. Surrender merely opens the door for a creditor to take action to obtain ownership of the surrendered property; it does not force a creditor to take such action. See *In re Cormier*, 434 B.R. 222, 229-33 (Bankr. D. Mass. 2010).

Assume Tommy TarHeel files for bankruptcy in early 2014 while owning a house at 123 Main Street. The house is subject to a mortgage held by Big Bank. Tommy consults with his attorney and chooses to surrender the house at 123 Main St. so that the bank can take title to house in satisfaction of the mortgage debt.

After the surrender, who owns the house? Tommy does, unless and until Big Bank enforces its right under the mortgage to take ownership. If Big Bank never does so, Tommy will continue to be the record owner of the house.

Many debtors are surprised to learn that they still own the property surrendered in bankruptcy and that they are still responsible for any post-bankruptcy obligations relating to that property. See *In re Koeller*, 170 B.R. 1019 (Bankr. W.D. Mo. 1994) and *Cormier*, cited above.

Back to Tommy. Assume that Big Bank never enforces its mortgage rights. Tommy moves out of the house, believing that he no longer owns it. The bankruptcy ends and the 2015 tax bill becomes delinquent. Whom may the county hold personally responsible for those delinquent taxes? Tommy, not Big Bank, because Tommy is still the record owner of the house.

Sometimes after property is surrendered it's ignored by everybody. The debtor assumes that he no longer owns it and the creditors take no action to possess it. Weeds and trash accumulate, the structure deteriorates, and local governments may be forced to incur nuisance abatement or demolition costs on the property. Just like taxes, these obligations will be the responsibility of the record owner—in our example, Tommy and not Big Bank.

The local government could foreclose on the property to satisfy delinquent taxes and the other costs owed on the property. But if the property isn't valuable enough to satisfy those debts, the better collection action will be targeting Tommy's personal property: his car, his bank account, his wages, or anything else of value that the local government can locate.

Tommy will be furious and claim that Big Bank should be held responsible. Sadly for Tommy, local government tax collectors couldn't go after Big Bank even if they wanted to. Big Bank has no responsibility for obligations on 123 Main Street if it never took action to transfer the property into its name.

And so, with apologies to music fans everywhere, I end with a riff on Cheap Trick:

The bank gets off free; the debtor's all mad, it does seem a little weird;

Surrender, surrender, you know it doesn't transfer title away, ay, ay . . .

[Many thanks to my SOG colleague Christopher Tyner for his excellent research on this topic.]

Links

- canons.sog.unc.edu/wp-content/uploads/2014/09/cheap_trick.jpg
- canons.sog.unc.edu/?p=3944
- www.sog.unc.edu/publications/books/fundamentals-property-tax-collection-law-north-carolina