

14

BANKRUPTCY LAW

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14-1 OVERVIEW AND NOTICE

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“the Reform Act”)¹ and bankruptcy-related provisions in Titles 18 and 28 of the United States Code provide the statutory framework for our bankruptcy cases.

14-1.01 Definitions

Bankruptcy is a legal process giving an indebted person or business the opportunity of a “fresh start” while providing equal treatment to each class of creditor. There are five basic types of bankruptcies under the Bankruptcy Code.

14-1.01(a) Chapter 7

Chapter 7 (known as a liquidation bankruptcy) is the most common type of bankruptcy filing. Chapter 7 is available to individuals or businesses. In a Chapter 7 bankruptcy, the debtor’s liabilities far outweigh assets and the court distributes available non-exempt assets to creditors. There are two kinds of Chapter 7 bankruptcies.

14-1.01(a)(1) No Asset

The bankruptcy court’s form notice may designate the case as Chapter 7, no asset, which means that after exemptions, security interests, and administrative expenses, the debtor has nothing left that the court can distribute. The court notices will contain instructions not to file a proof of claim. Fortunately, unless the court specifically rules otherwise, most tax claims will not be discharged, and the debt can be collected once the bankruptcy closes (see section [14-6.03\(a\)](#)). Unfortunately, if the case involves a business, there will not be any entity left from which to collect. A court judgment post-discharge that purports to establish liability for a pre-petition debt that is discharged is void even if the debtor failed to schedule the debt, absent fraud. 11 U.S.C. § 524(a)(1); *Horizon Aviation Inc. v. Alexander*, 296 B.R. 380 (E.D. Va. 2003); *In re Presley*, 288 B.R. 732 (Bankr. W.D. Va. 2003).

¹ The Reform Act constituted a significant overhaul of the Bankruptcy Code, in many instances making it tougher for individuals to file for bankruptcy (in particular, to file under Chapter 7 as opposed to Chapter 13) and reducing some protections enjoyed by debtors in bankruptcy. As the Reform Act only applies to cases filed on or after October 17, 2005, and bankruptcy cases may linger in the courts for many years, many opinions from the years following the Reform Act will reference both pre-Reform Act and post-Reform Act practice.

14-1.01(a)(2) Asset

The other type of Chapter 7 filing is an asset case. Again, the debtor's liabilities far outweigh assets, but here there are sufficient non-exempt assets for the court to distribute to creditors. Many creditors will receive a small percentage of their actual claim.

14-1.01(b) Chapter 9

Chapter 9 applies to municipalities that go broke, which is beyond the scope of this work. However, for Virginia practitioners, it is worth noting that a municipal bankruptcy action was filed by the Alleghany Highlands Economic Development Authority. The court dismissed the petition upon finding that the authority was not specifically authorized under Virginia law to seek bankruptcy protection as required by 11 U.S.C. § 109(c)(2). The court found as insufficient statutory language designating the authority as a "body corporate" with power to "sue and be sued" and to "plead and implead." *In re Alleghany-Highlands Econ. Dev. Auth.*, 270 B.R. 647 (Bankr. W.D. Va. 2001). The bankruptcy court in the Eastern District of Michigan issued an extensive opinion addressing several municipal bankruptcy issues in its determination that the City of Detroit was eligible for bankruptcy protection. *In re City of Detroit*, 504 B.R. 191 (Bankr. E.D. Mich. 2013).

14-1.01(c) Chapter 11

Chapter 11 permits a business reorganization, allowing companies to postpone payments to creditors and to earn operating revenue while obtaining necessary goods and services. Individuals also may qualify for Chapter 11 relief. *Toibb v. Radloff*, 501 U.S. 157, 111 S. Ct. 2197 (1991). This most often occurs with real estate holdings. In a Chapter 11 case, a company will segregate creditors, then propose through a plan of reorganization how each class of creditor is to be paid. The plan may not pay all creditors in full.

This plan may be objected to by creditors. If the bankruptcy court accepts the plan, the debtor will file monthly statements of income and expenses, and the debtor will distribute payments to creditors as scheduled under the plan. Payments legally may be extended over many years. Tax claims, priority and secured, must be paid in regular cash installments not to exceed five years from the date the petition was filed and in a manner no less favorable than the most favored unsecured nonpriority claims other than convenience claims.² 11 U.S.C. § 1129(a)(9)(C). "Early discharge" (i.e., after plan confirmation but before all plan obligations are met) is not available to debtors upon substantial plan consummation. *In re Belcher*, 410 B.R. 206 (Bankr. W.D. Va. 2009).

One interesting aspect of Chapter 11 cases is the prevalence of "First Day Orders." Frequently, Chapter 11 debtors will file multiple "First Day Motions" alongside their bankruptcy petitions, seeking expedited hearings on a variety of matters. Although the majority of these First Day Motions are routine and inoffensive (e.g., motions to employ debtor's counsel, admit counsel pro hac vice, maintain bank accounts, pay employee wages, etc.), some are potentially problematic and can prejudice localities' rights if not opposed. For example, debtors frequently need to obtain financing to remain afloat during the pendency of the reorganization and will move for an order authorizing financing. Although such orders are not problematic per se, they frequently contain provisions granting the financing bank *superpriority* liens over all of the debtor's current and future property, real and personal, tangible and intangible. Unless objected to, these liens could potentially subordinate a locality's statutory liens. Another example of problematic first day orders are those that mandate continued utility services with nominal or inadequate deposits, leaving utility creditors little security against debtors who fail to pay their post-petition utility bills.

Accordingly, it is important that, when a locality receives notice of a bankruptcy, it reviews all first day motions and orders for any objectionable provisions. Although the orders

² Tax claims entitled to priority treatment can be paid over time not to exceed six years from the date of assessment.

may have already been entered by the time notice is received, these orders are frequently styled as “interim” orders and are of limited duration. A well-founded objection to the interim order and any future orders will place the court and debtor on notice of a locality’s first priority, secured claims, and the debtor will likely be willing to include language carving out the locality’s liens from future interim orders.

14-1.01(d) Chapter 12

Chapter 12 offers certain farmers special bankruptcy treatment. It is substantially similar to a Chapter 13 reorganization.³

14-1.01(e) Chapter 13

Chapter 13 offers a reorganization to individuals or sole proprietor businesses with up to \$465,275 unsecured debt and \$1,395,875 secured debt.⁴ 11 U.S.C. § 109(e). These eligibility limits are based on the amount of debt as of the petition date. *In re Knott*, No. 21-50423 (Bankr. W.D. Va. June 24, 2022). Similar to a Chapter 11 filing, Chapter 13 offers repayment to creditors through a plan of reorganization. Plan payments may last from three to five years, depending on the disposable income of the debtor. The plan may last for a shorter time if all of the allowed unsecured creditors are paid in full. 11 U.S.C. §§ 1322(d) and 1325(b).

A debtor cannot obtain a discharge from a Chapter 13 filing if the debtor has received a discharge from a Chapter 7, 11, or 12 proceeding within four years or if a debtor had received a discharge from a Chapter 13 proceeding within two years. 11 U.S.C. § 1328(f).

14-1.01(f) “Chapter 20”

“Chapter 20” is a colloquial reference to a Chapter 13 bankruptcy filed within four years of a Chapter 7 bankruptcy that concluded with a discharge. *Branigan v. Davis (In re Davis)*, 716 F.3d 331 (4th Cir. 2013). While a debtor may not obtain a discharge, the debtor may still wish to seek later relief under Chapter 13 in order to cure a default through a plan, or simply to seek protection of the bankruptcy court and the automatic stay while paying debts in an orderly fashion through a plan. *Branigan v. Bateman (In re Bateman)*, 515 F.3d 272 (4th Cir. 2008).

14-1.02 Formalities

14-1.02(a) Voluntary v. Involuntary Filings

Although a bankruptcy usually begins when the debtor files a petition for relief, a creditor under certain circumstances may force a debtor into involuntary bankruptcy. 11 U.S.C. § 303. There is little practical distinction between voluntary and involuntary filings.

14-1.02(b) Conversion

Bankruptcy law permits the debtor to convert from one type of bankruptcy to another.⁵ 11 U.S.C. §§ 706, 1112, and 1307. Any creditor can bring a motion to convert a repayment

³ However, most tax claims are nondischargeable for individual farmers, as with Chapter 11 reorganizations. 11 U.S.C. § 1228(a)(2). *But see* 11 U.S.C. § 1222(a)(2) (the reorganization plan must “provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507, unless the holder of a particular claim agrees to a different treatment of that claim”).

⁴ Under 11 U.S.C. § 104, these amounts are adjusted every three years, most recently in April 2022.

⁵ Importantly, 11 U.S.C. § 706 does not grant an absolute right to conversion. *See Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 127 S. Ct. 1105 (2007); *accord In re Holmes*, No. 07-05770-JW (Bankr. D.S.C. Mar. 19, 2008) (finding that there is no longer a one-time absolute right to conversion); *Mitrano v. United States (In re Mitrano)*, 472 B.R. 706 (E.D. Va. 2012) (a finding of bad faith can negate a debtor’s right to choose dismissal in lieu of conversion), *aff’d*, No. 12-2044 (4th Cir. Oct. 18, 2012); *In re Fletcher* (Bankr. E.D. Va. 2019) (attempt to convert Chapter 7 case to Chapter 13 case is void ab initio if debtor is not eligible to proceed under Chapter 13); *In re Wetter*, 620 B.R.

case into a Chapter 7 liquidation (or dismiss the bankruptcy entirely). The presumption is that the conversion or dismissal should be granted if the movant shows cause; the statute contains an expansive list of what constitutes cause. 11 U.S.C. §§ 1112(b)⁶ and 1307(c), (d). If the debtor has not filed tax returns by the time of the § 341 meeting, the meeting will be held open under § 1308. If after demand by a party, the debtor still fails to file a tax return, then the court, after notice and a hearing, must dismiss or convert the case under § 1307(e). See section 14-4.02(a).

Conversion may affect the priority of the debt.⁷ Claimants usually need not file a new proof of claim.⁸ Fed. R. Bankr. P. 1019(3). Claims that arise after the petition date and before the conversion date are subject to the automatic stay provisions. *In re Sheets*, No. 12-31723 (Bankr. E.D. Va. Sept. 29, 2014). If the debtor converts from a Chapter 13 to a Chapter 7, nondischargeable debts subject to the “super discharge” of § 1328(a) become nondischargeable. *In re Quick*, 152 B.R. 902 (Bankr. W.D. Va. 1992). Absent a bad faith filing, a debtor who converts to Chapter 7 is entitled to any post-petition earnings or acquisitions held but not yet distributed by the Chapter 13 trustee. *Harris v. Viegelahn*, 575 U.S. 510, 135 S. Ct. 1829 (2015). Section 1328(f) provides that there can be no Chapter 13 discharge if there has been a Chapter 7, 11, or 12 discharge within four years or a Chapter 13 discharge within two years.

Conversion affects which debts are discharged since under § 348(d), the conversion date controls to determine what is pre-petition for discharge purposes. Where a case is converted under § 1307, “the order for relief under this chapter” as used in Section 727(b) means the conversion of the case to Chapter 7. 11 U.S.C. § 348(b). Together, §§ 727 and 348(b) require the discharge of any non-exempt, non-dischargeable debt incurred before the conversion of the case to Chapter 7. *Rosenberg v. Corio (In re Corio)*, No. 07-5864 (D.N.J. Sept. 22, 2008), *aff’d*, 371 Fed. Appx. 352 (3rd Cir. 2010); *Fickling v. Flower, Medalie & Markowitz, Esqs. (In re Fickling)*, 361 F.3d 172 (2d Cir. 2004) (stating that all debts, other than those listed in § 523, arising between the filing of the petition and the conversion are dischargeable).

14-1.02(c) Venue Considerations

The debtor must file in the court where the debtor is domiciled, resides, or has its principal place of business or principal assets in the United States. 28 U.S.C. § 1408. Virginia is divided into two Bankruptcy Districts, Eastern and Western, with four courts in each District. A listing of the courts is available in section 14-7. If a debtor files outside Virginia, the courts differ widely on whether or not foreign creditors will be considered absent a personal appearance or employment of local counsel. All courts will allow an out-of-state creditor to

243 (Bankr. W.D. Va. 2020) (petition to convert from Chapter 7 to Chapter 11 denied where debtor “played fast and loose with the facts,” was “evasive and misleading” about his assets, and where conversion likely would not be in the best interests of the creditors).

⁶ See, e.g., *In re Hao*, 644 B.R. 339 (Bankr. E.D. Va. 2022) (case converted from Chapter 11 to Chapter 7 because there was bad faith on the part of the debtor in that he had not accurately and timely disclosed all of his assets; there was a continuing loss to/diminution of the bankruptcy estate as the debtor was incurring fees that he could not afford to pay; and there was no reasonable likelihood that the debtor would be able to make payments under the plan).

⁷ After the Reform Act, administrative expense debts incurred during a reorganization case became subordinate to secured tax claims and both these claims are subordinate to the administrative expenses incurred after the debtor converts to a liquidation case. 11 U.S.C. §. 724(b)(2). This change in the order of priority was intended to eliminate “perverse incentives, encouraging Chapter 11 debtors and their representatives to incur administrative expenses even where there was no real hope for a successful reorganization, to the detriment of secured tax creditors when Chapter 7 liquidation ultimately proved necessary.” *Stubbs & Perdue v. Angell (In Re Anderson)*, 811 F.3d 166 (4th Cir. 2016).

⁸ However, a claim for administrative expenses may need to be refiled after conversion. See *In re DeVries Grain & Fertilizer*, No. 92 C 20304 (N.D. Ill. Jan. 14, 1993).

file a proof of claim, 11 U.S.C. § 501; the difficulty arises when the debtor or trustee objects to an out-of-state creditor's claim, which requires much more involvement by creditor's counsel. Fed. R. Bankr. P. 3007. Debtors can be sanctioned for filing meritless objections to harass out-of-state claimants. Fed. R. Bankr. P. 9011.

14-1.02(d) Local Rules

Bankruptcy courts publish local rules that detail any special forms or procedures not otherwise included in bankruptcy law that must be followed to practice before that court. These are generally available free of charge at the [courts' websites](#). The [Eastern](#) and [Western](#) District Local Rules are linked on their respective websites.

14-1.02(e) Time Limits

Distinguishing between time limitations specified within Bankruptcy Code provisions and those established by Bankruptcy Rules, the Supreme Court held that the latter were not "jurisdictional" and that such claim-processing rules, even if unalterable on a party's application, could be forfeited if the party asserting the rule waited too long to raise the point. *Kontrick v. Ryan*, 540 U.S. 443, 124 S. Ct. 906 (2004) (rule raised after decision on merits).

14-1.03 Notice of Bankruptcy

If the debtor contacts the locality before the locality receives a notice from the court, locality creditors should get the location of the court and a case number (if the debtor cannot provide a case number, the bankruptcy petition may not have been filed yet). Creditors can verify the filing online or request the debtor to send them a copy of the petition with the case number stamped on it. Creditors should also request to be included in the creditors' matrix (the mailing list for the court), so as to receive future notices about the case.

14-1.03(a) Official Notice

If the debtor has filed for bankruptcy, the court will send all named creditors a Notice of Bankruptcy. This Notice should contain the information necessary to research and prepare a proof of claim, identifying what the debtor owes the locality.

Creditors can check online or call or visit the court to verify that the debtor has filed. There is a twenty-four hour toll-free automated number (1-866-222-8029) for checking case status, with a voice menu that will explain how to alphabetically look up a case over the telephone and find out if the debtor has filed for bankruptcy, the case number, the debtor's attorney, the last activity in the case, and other useful information. The Eastern and Western Districts of Virginia bankruptcy courts charge a nominal fee to download pleadings through the [PACER system](#).⁹

For consumer cases, §§ 342(c), (f) & (g) provide that the debtor must use the address and account number provided by the creditor on the latest bills or on file with the court, or the automatic stay protection may not apply, and the debt may not be included in the bankruptcy discharge. Section 342(f) also allows an entity to file with any bankruptcy court a notice of addresses to be used by all bankruptcy courts or by particular courts, to provide notice of all cases under Chapters 7 and 13 pending in the courts in which such entity is a creditor. In addition, the clerk, upon the locality's request, is required to maintain a list of the local government's address for service of request for determination of tax liability. 11 U.S.C. § 505(b)(1)(A).

⁹ Practitioners should note, however, that after they have filed a proof of claim or requested service in a particular case, they will receive electronic notice of each subsequent pleading filed in the case, along with a single-use URL links to allow them to download a free copy of the pleading from CM/ECF.

14-1.03(b) Effect of No Notice

In some cases, creditors will not receive timely notice of the debtor's bankruptcy. Often in such cases, the debtor has been discharged, or it is past the bar date for filing a proof of claim.

In Chapter 7 no-asset cases, debts omitted by the debtor in filing the schedules are generally subject to discharge, under a "no harm, no foul" rule.¹⁰ *Karras v. Hansen (In re Karras)*, 165 B.R. 636 (N.D. Ill. 1994); see also *In re Banks-Davis*, 148 B.R. 810 (Bankr. E.D. Va. 1992) (bankruptcy court retains jurisdiction to determine dischargeability even after close of Chapter 7 case). But see *Colonial Sur. Co. v. Weizman*, 564 F.3d 526 (1st Cir. 2009) (pursuant to §§ 521 and 523, the Chapter 7 no asset debtor's failure to list the claims, and listing the creditor, was a condition of discharge). Although notice is viewed as essential to protect the due process rights of creditors under § 342 and related case law, see *In re O'Sullivan*, 488 B.R. 510 (Bankr. D. Mass. 2013) ("While notice is essential to protecting the due process rights of creditors it need not be perfect."), if an unscheduled debt was not dischargeable or would not have been paid even if scheduled, lack of notice makes no difference. 11 U.S.C. § 523.

In reorganization cases, scheduling has made a difference. Initially, discharge would appear required if the plan of reorganization is confirmed without making provision for payment of the tax debts. 11 U.S.C. § 1141(d). *Collier on Bankruptcy* recognized this apparent disparity and discussed whether § 1141(d) acts to deprive a creditor of his right to file a proof of claim where the creditor has no notice of the bankruptcy. By examining pre-Bankruptcy Code law, *Collier* came to the conclusion that it would be a violation of constitutional due process to discharge the debt:

[A]n elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.

Collier on Bankruptcy § 1141.01(b) (citing *Mullane v. Cent. Hanover Bank & Tr. Co.*, 339 U.S. 306, 70 S. Ct. 652 (1950)). The post-Code cases cited in *Collier* reach the same conclusion: that a Chapter 11 discharge does not operate to bar the claim of a creditor who did not receive notice of the claim's bar date. See, e.g., *In re Spring Valley Farms, Inc.*, 863 F.2d 832 (11th Cir. 1989); *Dalton Dev. Project v. Unsecured Creditors Comm. (In re Unioil)*, 948 F.2d 678 (10th Cir. 1991); *Fein v. United States (In re Fein)*, 22 F.3d 631 (5th Cir. 1994); *Pettibone Corp. v. Payne*, 151 B.R. 166 (Bankr. N.D. Ill. 1993); see also *Dilg v. Greenburgh*, 151 B.R. 709 (Bankr. E.D. Pa. 1993) (Chapter 13 cases). Bankruptcy is intended to protect the debtor from the continuing costs of pre-bankruptcy acts, not to insulate the debtor from otherwise nondischargeable obligations. *In re Sure-Snap Corp.*, 983 F.2d 1015 (11th Cir. 1993).

Where the creditor had actual or constructive notice of the bankruptcy, even if not scheduled (and so no notice by the court), due process will likely be deemed satisfied and the debt may be discharged.¹¹ Under the Bankruptcy Code's exception to discharge in

¹⁰ A debtor who moves to reopen to list a debt long after discharge must show that the omission was innocent and, even so, can probably be countered by anything that makes it inequitable to grant such relief.

¹¹ See *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 130 S. Ct. 1367 (2010). Although the official notice was sent to a payment lockbox that likely was never seen by anyone but a payment clerk, the Court found that Rule 60(b)(4) does not provide a license for litigants to sleep on their rights. The court observed that the creditor had actual notice of the debtor's plan, its contents, and the bankruptcy court's subsequent confirmation of the plan. In addition, the creditor filed a proof of claim regarding the debtor's student loan debt, thereby submitting itself to the bankruptcy court's jurisdiction with respect to that claim. See also *Wells Fargo Bank v. AMH Roman Two NC, LLC*, 859

Chapter 13 cases, unscheduled debts will not be discharged unless the bankruptcy creditors had notice or actual knowledge in time to permit the timely filing of a proof of claim and failed to do so. 11 U.S.C. § 1328(a)(2) incorporating § 523(a)(3). In all cases, if the debt is secured, such as real estate taxes, the lien survives discharge and may be enforced in rem. *Harold & Williams Dev. Co. v. Crestar Bank (In re Harold & Williams Dev. Co.)*, 163 B.R. 77 (Bankr. E.D. Va. 1994).

If notice is received after the bar date for filing a proof of claim, confirmation of a plan of reorganization is not permitted unless priority taxes are to be paid in full. 11 U.S.C. §§ 1129(a)(9)(c) and 1322(a)(2); *see also Fein v. United States (In re Fein)*, 22 F.3d 631 (5th Cir. 1994). *But see United States v. Macher (In re Macher)*, 303 B.R. 798 (W.D. Va. 2003) (court has authority to order IRS to consider compromise of priority tax claim even if it does not have the power to order IRS to accept compromise; § 1129(a)(9) does not bar the confirmation of a reorganization plan that does not pay 100 percent of priority claims if the parties agree to a compromise).

14-1.03(c) First Meeting of Creditors

Every debtor must attend a meeting at which creditors may ask questions about assets and liabilities. 11 U.S.C. § 341. Usually, the meeting is held virtually by Zoom for chapter 7, 12, and 13 cases. Failure by the debtor to attend the virtual meeting, or to answer questions, is grounds for dismissal, *see In re Martin-Trigona*, 35 B.R. 596 (Bankr. S.D.N.Y. 1983) (noting cause for dismissal based on debtor's refusal to cooperate during meeting of creditors), though in practice courts rarely order dismissal unless the debtor misses several meetings. In a Chapter 11 case, the court may dispense with the meeting if a prepackaged plan has been approved pre-petition. 11 U.S.C. § 341(e). The meeting is considered "held" on the date the meeting is concluded. *In re Stewart*, 360 B.R. 132 (Bankr. E.D. Va. 2006). While a meeting may be adjourned, the trustee must state at the meeting the date and time to which it is adjourned and promptly file written notice; the meeting may not be continued to an unspecified date. Fed. R. Bankr. P. 2003(e); *Jenkins v. Simpson (In re Jenkins)*, 784 F.3d 230 (4th Cir. 2015) (but refusing to hold that a violation of the rule per se means the meeting has concluded).

14-2 THE AUTOMATIC STAY

14-2.01 Automatic Stay

Filing a petition in bankruptcy creates an automatic stay affecting all actions against the debtor. 11 U.S.C. § 362(a)(3) (prohibiting "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"). Assessing and billing debts and sending notices of tax deficiency in the normal course of operations are permissible actions. Other permitted actions are audits to determine tax liabilities and demands for tax returns. 11 U.S.C. § 362(b)(9)(A), (B), (C), (D). Additionally, actions to enforce a locality's police or regulatory power are not barred. 11 U.S.C. § 362(b)(4); *see Safety-Kleen, Inc. v. Wyche*, 274 F.3d 846 (4th Cir. 2001) (enforcement of environmental financial assurance requirements not barred by stay); *Perry v. Aidonis*, 2020 U.S. Dist. LEXIS 258132 (E.D. Va. 2020) (enforcement of local zoning ordinance and the Virginia Uniform Statewide Building Code is not barred by stay); *Value Am., Inc. v. Kamena*, 265 B.R. 717 (W.D. Va. 2001) (consumer protection enforcement action not barred by automatic stay but subject to being enjoined pursuant to § 105(a)). The stay prohibits only affirmative acts; the mere retention of property already held (e.g., vehicles previously impounded for unpaid parking tickets) is not prohibited. *City of Chicago v. Fulton*, 592 U.S. ___, 141 S. Ct. 585 (2021).

F.3d 295 (4th Cir. 2017) (bank "slept on its rights"; failure to follow procedural rules does not cause lack of jurisdiction).

The automatic stay becomes effective when the debtor files the petition with the bankruptcy court.¹² Notice of filing may be constructive, as when an agency of a local government, but not its attorney, is told of the bankruptcy. Case law suggests actual or constructive notice is required before the court will punish a violation of the stay. See *NationsBank v. Bush (In re Bush)*, 169 B.R. 34 (W.D. Va. 1994) (reversing award of damages upon finding no evidence creditor received notice of bankruptcy filing prior to violating automatic stay).

Section 362(b)(1) provides that the filing of bankruptcy does not operate as a stay of criminal proceedings against the debtor. The Fourth Circuit has found this true even if the criminal proceeding's purpose is to collect a debt. See *In re Simonini*, No. 02-2021 (4th Cir. July 1, 2003) (unpubl.) (no authority to issue injunction pursuant to § 105(a) to stop criminal proceeding even though underlying purpose was debt collection); see also *United States v. Colasuonno*, 697 F.3d 164 (2d Cir. 2012) (finding that proceedings to enforce a probationary sentence constitute the continuation of a criminal action or proceeding against the debtor and thus fall within the specific exception to the automatic stay); *Gruntz v. Los Angeles Cnty. (In re Gruntz)*, 202 F.3d 1074 (9th Cir. 2000) (finding that Bankruptcy Code does not stay criminal proceeding against debtor).

The automatic stay has certain limits. If a prior case filed by an individual is pending within one year and is dismissed (except a case refiled under a chapter other than a Chapter 7 after a 707(b) dismissal), then the automatic stay in the second case expires thirty days after filing. A party in interest may file a motion to extend the stay as to all or some creditors but has the burden to establish good faith. 11 U.S.C. § 362(c)(3); see *In re Brown*, No. 12-34822 (Bankr. E.D. Va. May 28, 2013) (foreclosure did not violate stay). No stay goes into effect in a case filed by an individual if two or more cases pending within one year preceding the filing are dismissed (other than after a dismissal under § 707(b)). A court may impose the stay upon request of a party in interest within thirty days of the filing if the later filing is established as in good faith. 11 U.S.C. § 362(c)(4); *In re Garrett*, No. 08-31324-KRH (Bankr. E.D. Va. May 23, 2008). The limits on application of the automatic stay in serial filings apply only when the second (or third) case is filed again in Chapter 7. The limits are irrelevant if the case is initially filed in Chapter 13, even if the debtor later seeks to convert to Chapter 7. However, the court may deny the conversion if it appears the debtor was acting in bad faith.

In addition, for small businesses, the automatic stay does not apply if the debtor (or another entity that has acquired substantially all the assets) was subject to a bankruptcy dismissal or confirmation within two years preceding the current filing. This provision does not apply if an involuntary petition is filed without the collusion of the debtor or if a feasible non-liquidating plan is likely. 11 U.S.C. § 362(n)(2).

Further, an individual may not be a debtor in any chapter of the Code within 180 days of the debtor's voluntary dismissal of a bankruptcy case following the filing of a request for relief from the automatic stay. 11 U.S.C. § 109(g)(2); see, e.g., *In re Brown*, 534 B.R. 673 (Bankr. E.D. Va. 2015) (discussing whether there can be a waiver to this provision).

Recognizing a split in authority on the applicability of § 350 to adversary proceedings, a federal district court held that it was not an abuse of discretion for a bankruptcy court to refuse to reopen an adversary proceeding in which it had found a

¹² The stay is valid even if it is subsequently determined that the debtor was ineligible to file for bankruptcy. Under certain circumstances, however, the stay can be annulled for cause and then lifted retroactively. 11 U.S.C. § 362(d); *Shaw v. Ehrlich*, 294 B.R. 260 (W.D. Va. 2003) (debtor ineligible to file under Chapter 13 because exceeded allowed debt ceiling of § 109(e); stay annulled because equities favored validating judgment entered in state court the day the petition was filed), *aff'd*, *Wiencko v. Ehrlich*, No. 03-2128 (4th Cir. May 24, 2004).

violation of the stay. *U.S. Dep't of Agric. v. Sexton*, 529 B.R. 667 (W.D. Va. 2015). Section 350 states a "case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause."

14-2.02 Co-Debtor Stay

The automatic stay ordinarily does not extend to non-debtor parties except for co-debtors' consumer debts in Chapter 13 cases. 11 U.S.C. § 1301; see *In re Sowers*, 164 B.R. 256 (Bankr. E.D. Va. 1994) (holding that collection activities against debtor's employer for failure to honor pre-petition garnishment summons did not violate automatic stay). But see *In re Cornus Montessori, LLC*, No. 21-10213-KHK (Bankr. E.D. Va. Apr. 16, 2021) (finding unusual circumstances, including significant co-mingling of finances and identity of interests, warranted protecting debtor's wife from collection efforts by landlord). For example, a partner's own property is available for collection, even where the partnership is in bankruptcy. *In re Southside Lawn & Garden/Suffolk Yard Guard*, 115 B.R. 79 (Bankr. E.D. Va. 1990). Significantly, a tax lien on a co-debtor's bank account for unpaid personal property taxes was found not to violate the Chapter 13 co-debtor's stay because personal property taxes are not "consumer debts." See *In re Stovall*, 209 B.R. 849 (Bankr. E.D. Va. 1997).

Property jointly owned by a bankrupt debtor and a non-bankrupt co-debtor will be protected by the stay. But see *Morris v. Zabu Holding Co. (In re Morris)*, 385 B.R. 823 (E.D. Va. 2008), where the court balanced the equities and retroactively annulled the co-debtor stay to protect an innocent third party who, without knowledge of the co-debtor stay violation, purchased at foreclosure a debtor and co-debtor's tenants-by-the-entirety home. See also *In re Stovall*, 209 B.R. 849 (Bankr. E.D. Va. 1997) (tax lien on co-debtor's bank account for unpaid personal property taxes not a violation of Chapter 13 co-debtor automatic stay because personal property tax is not "consumer debt"); *IRS v. Westberry (In re Westberry)*, 215 F.3d 589 (6th Cir. 2000) (finding co-debtor stay inapplicable because tax debt owed IRS is not "consumer debt"). If the debtor only has an interest in the property, the asset must be essential to the debtor's reorganization for the stay to withstand a request for relief. See *A.H. Robins Co. v. Piccinin*, 788 F.2d 994 (4th Cir. 1986). But see *Solidus Networks, Inc. v. Excel Innovations, Inc. (In re Excel Innovations, Inc.)*, 502 F.3d 1086 (6th Cir. 2007) (holding that action that may diminish important asset of debtor's liability insurance policy subject to stay).

14-2.03 Prohibited Collection Action

The automatic stay acts as an injunction to prevent all active collection methods against property of the debtor's estate. Property of the estate is broadly defined by the Bankruptcy Code, see 11 U.S.C. § 541, to include even conditional, future, speculative, and equitable interests. *Vanderheyden v. Peninsula Airport Comm'n*, No. 4:12cv46 (E.D. Va. Jan. 2, 2013) (property of the estate includes causes of actions even before they become active, such as EEOC charges and the underlying facts which might support an employment discrimination claim); *In re Anders*, 151 B.R. 543 (Bankr. D. Nev. 1993) (conditional, future, speculative, or equitable nature of interest does not prevent it from becoming property of the bankruptcy estate). Unless state law transfers the full ownership of property seized by a creditor pre-petition, leaving the debtor no interest, the property remains protected by the stay. *In re West Aire, Inc.*, 131 B.R. 871 (Bankr. D. Nev. 1991) (citing *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 103 S. Ct. 2309 (1983)). Some collection practices to avoid are discussed below.

14-2.03(a) Court Action

Federal law forbids filing a lawsuit against someone in bankruptcy without a prior order of the bankruptcy court. If the lawsuit is filed but not reduced to judgment, the case must be dismissed (without prejudice), nonsuited, or if the court will permit, stayed. If a judgment is taken, it may not be docketed.

For example, in *In re Baum*, 15 B.R. 538 (Bankr. E.D. Va. 1981), when a bank obtained a judgment and filed a garnishment, the debtor filed for bankruptcy. The court pointed out that payment over of funds by the court or retention of those funds by the bank after filing was a violation of the automatic stay. Any payments made under the garnishment within ninety days of the bankruptcy filing were a preference and could be turned over to the trustee. The court noted that the bank may be subject to contempt if it did not dismiss the garnishment. For a detailed discussion about the court clerk's obligation to immediately release garnishment funds, including whether the court clerk should release the funds to the debtor or the trustee, see *In re Lebrun*, No. 95-10124 (E.D. Va. May 23, 1995). In contrast to *Lebrun*, the court in *Partridge v. Meyer, Goergen & Marrs (In re Partridge)*, 263 B.R. 755 (Bankr. E.D. Va. 2001), found that the defendant did not violate the automatic stay when it refused to return wages garnished before filing for bankruptcy, notwithstanding the post-petition return date on the garnishment summons.

When garnishment is sought during the period between dismissal and reinstatement of the petition after vacation of the dismissal, the relation back of the automatic stay depends on the equities, i.e., a weighing of the results of the creditor's reliance on the dismissal order against the debtor's level of fault in causing the dismissal and in pursuing reinstatement. *Tree Mount Ltd. v. Jennings*, No. 96-25888 (Bankr. E.D. Va. Apr. 24, 1997). In *Grady v. Kim*, No. L20705 (Loudoun Cnty. Cir. Ct. Nov. 2, 1998), the court held that a motion for judgment filed in violation of the automatic stay was voidable, not void, but it could be reinstated by the bankruptcy court by granting the creditor retroactive relief from stay.

In *Skillforce Inc. v. Hafer*, 509 B.R. 523 (E.D. Va. 2014), the court held that a state court status hearing on stayed debtor's interrogatories violated the automatic stay. Although the state court sua sponte set the status hearing, the federal court held the creditor had an affirmative obligation to cancel the status hearing or discontinue the debtor's interrogatories.

In *Gilchrist v. General Electric Capital Corp.*, 262 F.3d 295 (4th Cir. 2001), the Fourth Circuit held that the automatic stay applied to a receivership proceeding instituted prior to an involuntary bankruptcy proceeding.

14-2.03(b) Liens

Generally, no new liens may be placed against property in the bankrupt's estate. 11 U.S.C. § 362(a)(4). However, a previously docketed lien need not be released. *In re Trammel*, 63 B.R. 878 (Bankr. E.D. Va. 1986). Also, statutory liens may be created and perfected for ad valorem property taxes (including other special taxes or assessments on real property whether ad valorem or not) that come due after the filing of the petition. See 11 U.S.C. § 362(b)(18). Otherwise, the automatic stay bars the creation of a lien in property acquired post-petition even if all statutory steps necessary to perfect the lien were taken pre-petition. *United States v. Gold (In re Avis)*, 178 F.3d 718 (4th Cir. 1999) (stay intended to bar perfection of post-petition federal tax liens); see also *Birney v. Smith (In re Birney)*, 200 F.3d 225 (4th Cir. 1999) (same); *Krippendorf v. Campbell (In re Campbell)*, 187 B.R. 521 (Bankr. W.D. Va. 1995) (neither judgment nor IRS tax liens obtained pre-petition and recorded against property to be inherited can attach to property inherited post-petition; property immediately becomes part of estate and automatic stay prohibits lien attachment). This is important, because federal IRS tax liens generally do not trump prior perfected liens, so if the federal lien has not been created and perfected prior to the bankruptcy, it will not have priority over prior perfected liens.

Importantly, however, the automatic stay does not bar steps taken "to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b)." 11 U.S.C. § 362(b)(3); see *Branch Banking Co. v. Constr. Supervision Servs. (In re Constr.*

Supervision Servs.), 753 F.3d 124 (4th Cir. 2014). Under § 546(b), the bankruptcy trustee's rights and powers are subject to generally applicable laws that "permit perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection." 11 U.S.C. § 546(b); *Constr. Supervision Servs., supra*. Thus, to the extent a creditor has an interest in property of the estate that, if perfected, would be effective against an entity who acquired an interest in the property prior to the perfection, the creditor may take steps to perfect its lien without violating the automatic stay.

For local government purposes, this exception may prove useful in the utility lien context. Pursuant to Va. Code § 15.2-2118, certain localities may enact ordinances providing that charges for water and sewer service constitute liens on real estate served by the waterline and sewer. Under Va. Code § 15.2-2120, such liens are enforceable in the same manner as taxes (i.e., prior to any other liens and encumbrances, Va. Code § 58.1-3340) once docketed with the court. Because the statutory water and sewer lien constitutes a locality's interest in the property of the estate that, once docketed (perfected), is effective against an entity that acquired its interest prior to perfection, these liens may be docketed post-petition without violating the automatic stay.

14-2.03(c) Sale of Real Estate

The injunction of the automatic stay extends to the tax sale of real estate, including bill in equity, Va. Code § 58.1-3965 et seq., and escheat proceedings, § 55.1-2400 et seq. However, Bankruptcy Proc. Rule 9011(a) sanctions were warranted against a debtor and attorney for filing a Chapter 11 petition solely to delay a tax foreclosure sale of property. *Cnty. of Chesterfield v. Tamojira, Inc. (In re Tamojira, Inc.)*, 197 B.R. 815 (Bankr. E.D. Va. 1995). A court may grant in rem relief from the stay if the purpose of the bankruptcy filing was to delay, hinder, or defraud creditors, or if the property was the subject of multiple bankruptcy filings. If the order granting relief is recorded, the automatic stay does not apply to the property in any subsequent bankruptcy filing for two years absent a hearing and good cause shown. 11 U.S.C. §§ 362(d)(4) and 362(b)(20).

Bankruptcy case law consistently has found a "statutory right of redemption" (such as that given to the owner of a parcel sold to satisfy delinquent taxes, Va. Code § 58.1-3974, of property of the estate under the protection of the automatic stay. *In re Saylors*, 869 F.2d 1434 (11th Cir. 1989). Cases involving Chapter 13 debtors hold that when a redemption period had not yet expired when the bankruptcy was filed, the debtor maintains an interest in the property, even where foreclosure proceedings had begun. *In re Bradley*, 75 B.R. 198 (Bankr. W.D. Va. 1987). This interest is considered property of the estate. *In re O'Neal*, 142 B.R. 411 (Bankr. D. Or. 1992).

However, the debtor does not acquire any greater rights than before filing for bankruptcy. *Old Stone Bank v. Tycon I Bldg. Ltd. P'ship*, 946 F.2d 271 (4th Cir. 1991). Additionally, the time period specified for redemption is not extended by virtue of the bankruptcy filing. *In re Martinson*, 26 B.R. 648 (D.N.D. 1983), *rev'd on other grounds*, 731 F.2d 543 (8th Cir. 1984). The automatic stay does not stop the redemption time from running out, after which the debtor ceases to have a protected interest in the property. *In re Thom, Inc.*, 95 B.R. 261 (Bankr. D. Me. 1989).

Cases permitting the right of redemption to expire involve foreclosures where the sale had already occurred but the debtor still retained a statutory right of redemption. *In re Cooke*, 127 B.R. 784 (Bankr. W.D.N.C. 1991); *In re Glenn*, 760 F.2d 1428 (6th Cir. 1985). Where the debtor's right of redemption exists prior to sale, the automatic stay should prevent sale of the property, even after the right of redemption has expired. See *In re Josephs*, 93 B.R. 151 (N.D. Ill. 1988), where the court found the automatic stay prevented the state foreclosure sale process where the judicial sale did not occur until after the redemption period expired and the debtor filed for bankruptcy during the redemption period. *In City of Roanoke v. Whitlow (In re Whitlow)*, 410 B.R. 220 (Bankr. W.D. Va. 2009), the

debtor filed for Chapter 13 protection two days after a judicial sale of debtor's property at auction but before the sale was "confirmed" by the circuit court as required by Va. Code § 8.01-96. The bankruptcy court held the "right of redemption" expired at the time of the sale. If the state circuit court failed to "confirm" the sale (e.g., because of buyer default), the debtor's right of redemption would become extant and property of the estate. Therefore, the bankruptcy court modified the automatic stay so that the locality could seek confirmation in circuit court.

A foreclosure sale performed in accordance with state law will not be set aside as a fraudulent conveyance. See *BFP v. Resolution Tr. Corp.*, 511 U.S. 531, 114 S. Ct. 1757 (1994) (finding that foreclosure sale price constituted "reasonably equivalent value" and therefore nonjudicial foreclosure sale not fraudulent conveyance under 11 U.S.C. § 548(a)(2)); *Washington v. Cnty. of King William (In re Washington)*, 232 B.R. 340 (Bankr. E.D. Va. 1999) (extending *BFP* holding to judicial tax sale conducted in accordance with Virginia law). In single-asset Chapter 11 reorganizations, the stay may be lifted if the debtor fails to make payment to secured creditors. 11 U.S.C. § 362(d)(3)(B).

14-2.03(d) Setoff and Recoupment

Setoff often is used to collect debts where a debtor is due a payment from local government. Va. Code § 58.1-3133. Although the *right* to setoff is preserved, 11 U.S.C. § 553, exercise of that right is limited to mutual, see *In re Ricketts Constr. Co., Inc.*, 441 B.R. 512 (Bankr. W.D. Va. 2010) (mutuality did not exist when city had claim against debtor and owed debtor's surety for overpayment on a separate transaction), pre-petition obligations, with "mutual" meaning the same parties, not the same transaction. See *In re IML Freight, Inc.* 65 B.R. 788 (Bankr. D. Utah 1986) (no requirement that debt and claim arise from the same transaction); *Braniff Airways v. Exxon Co., U.S.A.*, 814 F.2d 1030 (5th Cir. 1987) (only requirements for setoff are that debts and claims be mutual and pre-petition). Because the bankrupt estate is a different entity than the debtor, there can be no setoff right between pre- and post-petition debts. See *Mine Serv. Co. v. James River Coal Co. (In re James River Coal Co.)*, 534 B.R. 666 (Bankr. E.D. Va. 2015) (no mutuality when company holds tax refund as agent for debtor and no offset when refunds received post-petition); *Braniff Airways, supra* (mutuality element is lacking if party attempts to setoff a pre-petition debt against a post-petition claim). But see *Gordon Sel-Way, Inc. v. United States (In re Gordon Sel-Way, Inc.)*, 270 F.3d 280 (6th Cir. 2001) (IRS may set off debtor's tax refund claim against pre-petition tax penalty obligations that were improperly subrogated during a Chapter 11 reorganization). Mere "netting" of overpayments against underpayments has been held to be an accounting method rather than a setoff, and so not a violation of the automatic stay. *Pettibone Corp. v. United States*, 34 F.3d 536 (7th Cir. 1994). In *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 116 S. Ct. 286 (1995), the United States Supreme Court held that a creditor bank's administrative freeze of a Chapter 13 debtor's checking account pending resolution of a right of setoff did not violate the automatic stay. The bank account was merely a promise to pay, and the freeze was merely a refusal to perform that promise. The Court did not rule, however, on how long an administrative freeze is permitted without seeking relief from the automatic stay. Often creditors can administratively freeze an account for a few months in Chapter 7 cases and then apply the setoff after discharge to nondischargeable taxes. However, the court in *In re Wicks*, 215 B.R. 316 (E.D.N.Y. 1997), found an administrative freeze of four months was too long, and the credit union thus violated the automatic stay.

In *Tavener v. United States (In re Vance)*, 298 B.R. 262 (Bankr. E.D. Va. 2003), the bankruptcy court distinguished recoupment from the right of setoff. The court stated that recoupment was an equitable doctrine frequently called a "nonstatutory exception to the automatic stay." The case involved the federal government's garnishing of its employee's wages because of an unintentional overpayment of a military housing subsidy. The court stated, first, that to avoid the automatic stay, the source of the claim must be a contract, not a governmental entitlement program. Second, both debts must arise out of

the same contract. The court upheld the garnishment as a legitimate recoupment because the government's obligation to pay wages and the housing subsidy arose out of the same military enlistment contract. *See also Thompson v. Bd. of Trs. (In re Thompson)*, 182 B.R. 140 (Bankr. E.D. Va. 1995) (distinguishing between setoff and recoupment); *New York State Elec. & Gas v. McMahon*, 129 F.3d 93 (2nd Cir. 1997) (utility did not violate automatic stay by applying pre-petition service deposit to reduce amount owed; use of deposit was recoupment rather than setoff); *Williams v. Kinser*, 64 Va. Cir. 128 (Fairfax Cnty. 2004) (state law case distinguishing between setoff and recoupment; setoff is subject to statute of limitations as an affirmative action, recoupment is not).

To allow exercise of setoff rights, the automatic stay must be lifted. 11 U.S.C. § 362(d); *In re Conti*, 50 B.R. 142, 149 (Bankr. E.D. Va. 1985); *see also In re Wood*, 993 F.3d 245 (4th Cir. 2021) (government was entitled to set off debtors' tax overpayment against their Housing and Urban Development debt, but should have first sought relief from automatic stay); *In re Hookup, LLC*, No. 12-33202-KRH (Bankr. E.D. Va. Oct. 15, 2012) (setoff of post-petition claim violates automatic stay). An alternative is to pursue setoff after the debtor is discharged. Some Chapter 7 cases have found that the setoff right is preserved even if not provided for through a proof of claim. *See, e.g., In re G.S. Omni Corp.*, 835 F.2d 1317 (10th Cir. 1987) (until discharge is ordered, creditor need not file a proof of claim as a prerequisite to asserting a right to setoff); *Neal v. Golden Knights*, No. 4:95cv170 (E.D. Va. Apr. 8, 1996) (upholding bankruptcy court's allowance of setoff despite failure to file proof of claim); *In re Handy*, 41 B.R. 172 (Bankr. E.D. Va. 1984) (no waiver of right to setoff based on failure to seek relief to obtain setoff). However, in reorganization cases, creditors need to preserve their setoff rights in the proofs of claim or in the Plan, or those rights may be lost. *United States ex rel. IRS v. Norton*, 717 F.2d 767 (3rd Cir. 1983) (IRS failed to object to plan that did not include IRS setoff; court found IRS bound by plan and lost right to setoff); *In re Crabtree*, 76 B.R. 208 (Bankr. M.D. Fla. 1987) (creditor whose pre-petition claim allowed and not dealt with by confirmed plan has no right to setoff); *In re Warden*, 36 B.R. 968 (Bankr. D. Utah 1984) (confirmation of Chapter 13 plan, where neither plan nor order of confirmation provides for setoff, extinguishes right to setoff). In *In re Grannan*, 277 B.R. 673 (Bankr. E.D. Va. 2002), the court stated that a creditor waives the right of setoff when 1) funds against which the setoff could be made are released before the right of setoff is asserted in court or otherwise, or 2) affirmative steps are taken that are inconsistent with a prior assertion of the right of setoff. *See also In re Ricketts Constr. Co., Inc.*, 441 B.R. 512 (Bankr. W.D. Va. 2010) (explaining creditor's waiver of setoff). But *see United States v. Fleet Bank (In re Calore Express Co.)*, 288 F.3d 22 (1st Cir. 2002), where the government's silence during the bankruptcy case may not have constituted a waiver of its right to setoff General Service Administration debt against the debtor's IRS obligation.

It may be argued, pursuant to 11 U.S.C. § 506(a), that a claim entitled to setoff may be treated as a secured claim, entitled to adequate protection per § 362(d)(1). Under this reasoning, if a debtor with outstanding taxes is owed a refund on another tax account, a locality may claim the tax up to the amount of the refund as a secured claim on its proof of claim. If the debtor fails to provide adequate protection, the locality may initiate an action to lift the stay and set off the debt. Under the same reasoning, where the setoff amount a locality holds is greater than its claim, the locality should be entitled to interest in reorganization cases. *In re Rozel Indus.*, 120 B.R. 944 (Bankr. N.D. Ill. 1990) (allowing accrued interest through the date of setoff in the amount subject to setoff).

Money deducted from a debtor's Virginia income tax refund or lottery winnings under the State's Setoff Debt Collections program, Va. Code § 58.1-520 et seq., does not violate the automatic stay if the claim was filed pre-petition and the time for contesting the setoff under Va. Code § 58.1-525 has passed. The placement of the claim transfers the interest in those funds, which were withheld from the debtor pre-petition, to the creditor locality. Although the claim may not be matched and the funds not forwarded by the State until

post-petition, the transfer does not create any new ownership interest. *In re Oliver*, 186 B.R. 403 (Bankr. E.D. Va. 1995) (“If attachment is effective upon service under applicable law, ‘nothing more is required to transfer ownership . . .’ to the creditor.”) (quoting *In re Eisenbarger*, 160 B.R. 542 (Bankr. E.D. Va. 1993)). The State merely is transferring administratively funds already belonging to a locality, which does not violate the automatic stay.¹³ *Small v. Hennepin Cnty.*, 18 B.R. 318 (Bankr. D. Minn. 1982).

Addressing a divide among the bankruptcy courts and as a matter of first impression in the Fourth Circuit, the court held in *Copely v. United States*, 959 F.3d 118 (4th Cir. 2020), that federal income tax overpayments setoff against nontax federal liabilities do not violate the automatic stay. Because § 553 provides that no provision of Title 11 “affect[s]” a creditor’s right to offset a mutual, pre-petition debt with a bankruptcy debtor, the government’s right to offset the overpayment prevails.

Actions taken through “setoff” are specifically excluded from the scope of Code provisions relating to preferential transfers. Rather than being covered under the general preference rules of § 547, setoff is treated under § 553(b), which provides that a setoff can be recovered only to the extent that the insufficiency on the date of the setoff is less than the insufficiency as of the beginning of the preference period. *In re Comer* (*Comer v. U.S. Soc. Sec. Admin.*), 386 B.R. 607 (Bankr. W.D. Va. 2008).

14-2.03(e) Security Agreements

Security agreements remain enforceable. A bond or letter of credit to ensure payment, as for a cigarette tax or a plan of development, may be cashed upon default. *See In re Page*, 18 B.R. 713 (D.D.C. 1982) (allowing letter of credit to be cashed according to its terms). The courts consider a letter of credit or bond to be an independent obligation, as insured by a party outside of the bankruptcy. *In re Prime Motor Inns*, 130 B.R. 610 (S.D. Fla. 1991) (letter of credit is separate contract, with which bankruptcy court did not have jurisdiction to interfere); *see also In re Air Conditioning, Inc.*, 845 F.2d 293 (11th Cir. 1988) (letter of credit is an undertaking between issuing bank and beneficiary, and is independent of the relationship between the bank and the account party). Be aware that the court may consider payment of a security interest to be a voidable preference. If the security is not honored, the creditor’s recourse is against the non-bankrupt third party, and so is not subject to the stay. *Cf. Willis v. Celotex Corp.*, 978 F.2d 146 (4th Cir. 1992) (finding appeal bond was not property of the estate but extending automatic stay where the bond was essential to the debtor’s Chapter 11 reorganization).

14-2.03(f) Distress, Levy, and Third-Party Liens

Distress or levy is forbidden by the automatic stay. Any outstanding lien, garnishment, fieri facias, or seizure pursuant to distress or levy should be dismissed or called back from the sheriff. Any tangible property being held must be released back to the debtor or trustee. *United States v. Whiting Pools* (*In re Whiting Pools*), 462 U.S. 198, 103 S. Ct. 2309 (1983) (requiring turnover of property seized by IRS). However, if a lien was issued before the debtor filed, where the lien attaches to funds that were earned or available pre-petition, that lien does not have to be returned. *In re Eisenbarger*, 160 B.R. 542 (Bankr. E.D. Va. 1993). The difference is that tangible property, other than cash, has an uncertain value. At sale, some equity of the debtor, protected by the stay, could be compromised. With cash,

¹³ For a contrary result, *see Camacho v. United States*, 190 B.R. 895 (D. Alaska 1995), which held a setoff debt claim made prior to the filing of a petition did not divest the estate of the refund claimed. The debtor continued to have some residual rights in the funds subject to setoff, such as the right to have a setoff hearing. As such, the property could continue as property of the estate. It is important to note, however, that the state’s setoff debt collections program purges each year’s claims at the end of the calendar year, requiring the claims to be resubmitted to be matched for the following calendar year. Because resubmission of the claim while the debtor has filed for bankruptcy violates the automatic stay, locality creditors must be cognizant of bankruptcy filing dates when accepting matched funds.

because the locality has attached through lien or levy only the amount to which the locality is entitled, it is converted to "the locality's" money at the time of the receipt of the attachment.

A debtor proved by a preponderance of the evidence that the IRS willfully violated the automatic stay by showing that the IRS was aware of sufficient indicia of debtor's ownership of property sold in a tax sale to satisfy a third party's delinquency. *Hanna Coal Co. v. IRS*, 218 B.R. 825 (W.D. Va. 1997).

When the debtor is an individual, the stay terminates as to secured personal or leased property if the debtor fails to timely file a statement of intent to surrender or retain the property or assume the lease and timely take actions to perform such intentions. The trustee can file a motion to keep the property in the estate. 11 U.S.C. § 362(h).

14-2.03(g) Permits or Licenses

A locality cannot refuse to issue permits, licenses, or vehicle decals to, deny or terminate the employment of, or otherwise discriminate against a debtor on the basis that the debtor has filed for bankruptcy. 11 U.S.C. § 525. If the fee for the permit/license/decal is due upon application (not assessed like a tax), the debtor should pay it as an administrative expense. 11 U.S.C. § 503(b)(1). Also, the debtor must comply with yearly licensing requirements. 28 U.S.C. §§ 959 and 960. However, a license or decal cannot be held for pre-petition accounts. 11 U.S.C. § 525.

Bankruptcy does not exempt a debtor from complying with applicable police or regulatory requirements. 11 U.S.C. § 362(b)(4); *Spookyworld Inc. v. Town of Berlin*, 346 F.3d 1 (1st Cir. 2003) (building code enforcement action closing debtor's sole asset, an amusement park, not stayed); *In re Synergy Dev. Corp.*, 140 B.R. 958 (Bankr. S.D.N.Y. 1992) (automatic stay does not apply to pre-petition settlement entered pursuant to enforcement of consumer protection statute). A locality cannot, however, circumvent § 525's prohibition on the denial of licenses or permits by stating that the obligation to pay is a regulatory condition, not a debt per se. *FCC v. NextWave Personal Commc'ns, Inc.*, 537 U.S. 293, 123 S. Ct. 832 (2003) (regardless of regulatory motive, cancellation of licenses violated § 525(a)).

14-2.03(h) Assessment and Billing of Debts

The audit and assessment of taxes, and notice to the debtor of outstanding obligations, is allowed as long as collection action is avoided. 11 U.S.C. § 362(b)(9). See *In re Pullmann*, 319 B.R. 443 (Bankr. E.D. Va. 2004) (IRS had right to assess trust-fund penalty). For debts arising after the bankruptcy filing, notice is important to keep the debtor (and the court) aware of new obligations, especially if the debtor has a payment plan. Also, new debts may be an administrative expense and should be paid when due. Any bills or delinquent notices should be sent to the debtor as usual, with, if feasible, a copy to the trustees (both the case trustee, if any, and the United States trustee). The U.S. Trustee might file a motion to convert or dismiss a case due to unpaid post-petition taxes.

14-2.04 Violations of the Stay

Judging by prior case law, courts seem inclined to award compensatory damages and attorney's fees only for clear, intentional violations of the Bankruptcy Code, such as garnishing a bankruptcy debtor. Section 362(k) provides that an individual injured by any willful violation of the stay can recover actual damages, including costs and attorney's fees, and, in appropriate circumstances, may recover punitive damages. See generally *Houck v. Substitute Tr. Servs., Inc.*, 791 F.3d 473 (4th Cir. 2015) (§ 362(k) provides a private cause of action for violation of the stay); see, e.g., *Davis v. IRS*, 136 B.R. 414 (E.D. Va. 1992) (awarding attorney's fees and compensatory damages based on IRS garnishment of debtor and attachment of tax refund). In *Edwards v. B&E Transport, LLC*, 607 B.R. 532 (Bankr. W.D. Va. 2019), the defendant creditor had financed the bankruptcy debtor's loan for

purchase of a Harley Davidson motorcycle. After receiving the Notice of Bankruptcy, the creditor repossessed the motorcycle, which was the debtor's only mode of transportation, and demanded full payment of the remaining loan amount. The creditor did not seek relief from the automatic stay and refused to return the motorcycle, even after the court confirmed the Chapter 13 plan that provided for the remaining balance of the loan to be paid in full plus interest. Under such circumstances, the court awarded compensatory damages in the amount of the full purchase price of the motorcycle, costs to insure the motorcycle, and lost wages caused by the lack of transportation, as well as \$25,000 in punitive damages and attorney's fees. *See also In re Payne*, No. 20-30524 (Bankr. E.D. Va. Mar. 22, 2021) (court awarded attorney's fees, compensation for emotional distress, and punitive damages when respondents intentionally and willfully continued to pursue divorce case in violation of automatic stay).

Unintentional or inadvertent violations, where an administrative error was made and where the locality promptly stops or reverses the action, are not likely to result in sanctions. *In re Conti*, 42 B.R. 122 (Bankr. E.D. Va. 1984) (awarding attorney's fees but not compensatory damages based on inadvertent violation of stay). For consumer cases, §§ 342(c), (f), and (g) now provide that the debtor must use the address and account number provided by the creditor on the latest bills or on file with the court, or the automatic stay protection may not apply and no monetary penalty can be imposed.

14-2.05 Lifting the Stay

The automatic stay terminates upon dismissal of a bankruptcy case, discharge in a Chapter 7 case, confirmation of the plan of reorganization in a Chapter 11 case, and completion of plan payments in a Chapter 12 or 13 case, or by court order granting relief from stay.¹⁴ 11 U.S.C. § 362(d) and Fed. R. Bankr. P. 4001. The stay is automatically terminated sixty days after the filing of a request for relief from stay unless extended by agreement of all parties in interest or by the court for good cause. 11 U.S.C. § 362(e)(2).

A party in interest wishing to have the stay lifted to sell property must show the court either that the sale will pay for necessary current expenses or that creditors will benefit. A creditor wanting to lift the stay must show a superior interest in the property to be sold, such as a security agreement, and that the property to be sold is not essential to the debtor's reorganization. Examples would include a foreclosure by a bank or a repossession of a car by a finance company. A locality may also file for relief from the stay to get the court's approval to perfect its lien before demolishing a debtor's condemned property. *See In re Cornell*, No. 01-60036-DOT (Bankr. E.D. Va. 2003) (locality's motion for relief from stay). Unless the debtor deposits thirty days' rent with the court along with a certificate that non-bankruptcy law allows the debtor to cure the default, a residential tenant eviction may continue if the lessor has obtained a judgment prior to the filing of the petition or the lessor seeks possession based on endangerment of property or illegal use of controlled substances at the property. 11 U.S.C. § 362(b)(22), (23), and (m).

A motion lifting the stay may not be advantageous since it usually requires a time-consuming adversary court action within the bankruptcy, as debtors often are reluctant to lose the broad protection afforded by the stay. An adversary action also allows the court to examine the basis of the underlying debt, because the court has the power to determine

¹⁴ A bankruptcy court's order unreservedly denying relief from the automatic stay constitutes a final, immediately appealable order under § 158(a). *Ritzen Group, Inc. v. Jackson Masonry, LLC*, 589 U.S. ___, 140 S. Ct. 582 (2020). The crucial question is whether the order "disposes of a procedural unit anterior to, and separate from, claim-resolution proceedings." *Cf. Bullard v. Blue Hills Bank*, 575 U.S. 496, 135 S. Ct. 1686 (2015) (order denying confirmation of a debtor's proposed repayment plan is not a final order that the debtor can immediately appeal).

dischargeability.¹⁵ 11 U.S.C. § 505(a)(1). The granting of relief from the automatic stay does not necessarily decide the validity of the debt or the rights of the parties so that collateral estoppel may not apply in subsequent court actions. *In re Lee*, No. 09-16342-RGM (Bankr. E.D. Va. Jan. 27, 2010) (noting that validity of lien not generally litigated in hearing on motion for relief from automatic stay).

14-3 BARS TO SUIT

14-3.01 Sovereign Immunity

The Supreme Court has held that in ratifying the Bankruptcy Clause of the U.S. Constitution, the states acquiesced in a subordination of whatever sovereign immunity they might otherwise have asserted in proceedings necessary to effectuate the in rem jurisdiction of the bankruptcy courts. *Central Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 126 S. Ct. 990 (2006) (5-4). In *Katz*, the majority made clear that the Bankruptcy Clause itself manifests the consent of the states to be sued and thus states have no sovereign immunity from any bankruptcy proceedings. *But see Davis v. W. Va. State Tax Dep't (In re Patriot Coal)*, 562 B.R. 632 (Bankr. E.D. Va. 2016) (sovereign immunity can apply if bankruptcy proceeding seeks to determine right to tax refunds from state under state law). Moreover, the Supreme Court stated expressly in *Board of Trustees v. Garrett*, 531 U.S. 356, 121 S. Ct. 955 (2001), that the Eleventh Amendment does not extend its immunity to units of local government. In *Northern Insurance Co. of New York v. Chatham County*, 547 U.S. 189, 126 S. Ct. 1689 (2006), the Court held there was no "residual" sovereign immunity applicable to counties that permits a broader interpretation of acting as an "arm of the State" than under Eleventh Amendment jurisprudence. *See also Lake Country Estates, Inc. v. Tahoe Reg'l Planning Agency*, 440 U.S. 391, 99 S. Ct. 1171 (1979) (reiterating that Eleventh Amendment does not afford protection to counties and municipalities).

14-3.02 Rooker-Feldman and Abstention

A bankruptcy court may be barred from determining issues that have been the subject of state court litigation under the *Rooker-Feldman* doctrine,¹⁶ which prevents federal courts from acting as a court of appeals from state court decisions. The Supreme Court, however, confined the application of the doctrine to narrow circumstances in *Exxon Mobil Corp. v. Saudi Basic Industries Corp.*, 544 U.S. 280, 125 S. Ct. 1517 (2005), holding that the doctrine applies only to cases brought by state-court losers complaining of injuries caused by state-court judgments rendered before the district court proceedings commenced and inviting district court review and rejection of those judgments. *Rooker-Feldman* does not override or supplant preclusion doctrine or augment comity or abstention doctrines that allow federal courts to stay or dismiss proceedings in deference to state-court actions. Properly invoked concurrent jurisdiction does not vanish if a state court reaches judgment on the same or related question while the case remains sub judice in a federal court. While the Court did not specifically address bankruptcy issues in *Exxon Mobil*, the tone of the opinion was that the *Rooker-Feldman* doctrine had limited application.

In *Safety-Kleen, Inc. v. Wyche*, 274 F.3d 846 (4th Cir. 2001), the *Rooker-Feldman* doctrine did not bar the plaintiff Chapter 11 debtor's adversary proceeding against defendant state agency seeking to prevent the agency from closing its commercial hazardous waste landfill. The court reasoned that Safety-Kleen's claims did not require the federal court to review any issues "actually decided" by or "inextricably intertwined" with the permit issues decided by the South Carolina Court of Appeals. *Id.* However, in *Cody Inc. v. Orange County (In re Cody, Inc.)*, 281 B.R. 182 (S.D.N.Y. 2002), *aff'd on other grounds*, 338 F.3d 89 (2d Cir. 2003), the district court found that tax exemption issues were of a

¹⁵ Under the Code, the bankruptcy court cannot determine the amount or legality of a tax if the state statute of limitations has run. 11 U.S.C. § 505(a)(2)(C).

¹⁶ The doctrine takes its name from *Rooker v. Fidelity Trust Co.*, 263 U.S. 413, 44 S. Ct. 149 (1923) and *D.C. Court of Appeals v. Feldman*, 460 U.S. 462, 103 S. Ct. 1303 (1983).

quintessential state law character and should be decided by the state and thus abstention under *Rooker-Feldman* was warranted. See also *Bridgewater Operating Corp. v. Feldstein*, 346 F.3d 27 (2d Cir. 2003), where a claim under the Racketeer Influenced and Corrupt Organizations (RICO) Act was found duplicative of prior unsuccessful attempts in state and federal court to obtain possession of real estate and the claim was barred by *Rooker-Feldman*.

In *Metromedia Fiber Network, Inc. v. Various State & Local Taxing Authorities (In re Metromedia Fiber Network, Inc.)*, 299 B.R. 251 (Bankr. S.D.N.Y. 2003), the court granted the non-state defendants' motions to abstain under 28 U.S.C. § 1334(c)(1), reasoning that ad valorem property taxation is governed by local law, that there is compelling local interest in "uniformity of assessment" in fairly allocating the local tax burden and that imposition by the bankruptcy court of a standardized valuation methodology would entail a high risk of conflict with many, if not all, of the differing local tax laws, as applied by the numerous local tax authorities involved. Lacking any allegation of unlawful discrimination or other official misconduct in violation of local law, the court refused to exercise the power granted under § 505. See also *In re Elantic Telecom Inc.*, No. 04-36897-DOT (Bankr. E.D. Va. Dec. 2, 2005) (citing *Metromedia*, the court agreed with the Virginia tax authorities that the debtor's valuation challenge to local telecommunication taxes was a local issue better resolved by state procedures).

14-4 PROOF OF CLAIM

14-4.01 Filing the Proof of Claim

The proof of claim is a document filed with the bankruptcy court to establish a creditor's right to the debtor's money. The court will establish a cutoff for filing the proof of claim (usually within three months of the debtor's filing, unless extended by court order). Under § 502(b)(9), governmental entities may file claims up to 180 days after the petition is filed.

Virginia bankruptcy courts require that attorneys file proofs of claims electronically, either through the Court's ECF password-protected system, through the court's website (which does not require a password), or by filing on a disc in Adobe Acrobat format. However, the Richmond District strongly recommends that creditors file proofs of claims through CM/ECF or the court's website and discourages creditors from sending in claims on a disc.

Pursuant to Rule 1019(3), if the bankruptcy case later converts, as from a Chapter 11 or 13 to a Chapter 7, the proof of claim does not need to be refiled.

In Chapter 7 no-asset cases, the court normally advises not to file a proof of claim. If assets are discovered, the court will send a subsequent notice advising creditors to file a claim.

A class proof of claim can be filed, but it is conditional until the bankruptcy court determines pursuant to a Rule 9014 motion that the class action process is superior to the bankruptcy claims resolution process. *Gentry v. Siegel*, 668 F.3d 83 (4th Cir. 2012).

14-4.01(a) Attachments

A claim based on a tax is a statutory claim and is not "based on a writing"; thus a taxing authority is not required to attach any supporting documentation to its proof of claim for the claim to be presumptively valid. *In re Los Angeles Int'l Airport Hotel Assocs.*, 106 F.3d 1479 (9th Cir. 1997). Localities should, however, include an accounting listing the tax or debt, penalties, and interest. Interest should be through the date the debtor filed for bankruptcy (to qualify later interest for post-petition status). If the claim is based on a writing, some account of the debt should be attached to the proof of claim. Fed. R. Bankr. P. 3001(c); see, e.g., *In re Reed*, 624 B.R. 155 (Bankr. E.D. Va. 2020) (claim based on

service contract for renovation work must include copy of contract; invoice and interest accrual spreadsheet not sufficient to establish prima facie validity).

14-4.01(b) Acknowledgment of Claim

Once a proof of claim is electronically filed, the claimant will receive a Notice of Electronic Claims Filing, which is an acknowledgment from the bankruptcy court, showing receipt of the proof of claim and the parties who have received a copy. Under § 342(f), notice can also be requested in all Chapter 7 and 13 cases. See section [14-1.03\(a\)](#). With electronic filing, all filed claims can be viewed online and downloaded.

14-4.02 Debt Categories

There are four broad categories of debt in bankruptcy. The first level, which should always be paid, consists of administrative expenses. These expenses include attorney's and accountant's fees, newly assessed taxes, and other expenses necessary to keep the debtor going. The second level, which also is paid, often with interest, consists of secured debts, where the creditor has filed and perfected a security interest in property held by the debtor.¹⁷ The third level, which is paid if there is enough money, is priority claims, found in § 507 and includes recently incurred tax debts discussed below. The final level consists of unsecured claims, which rarely are paid, and then only as a percentage of the claim.

It is important to distinguish between pre-petition and post-petition claims. Pre-petition claims are debts that first come due before the filing date of the bankruptcy. Post-petition debts are any debts actually incurred by the trustee or debtor-in-possession while administering the estate. Debts incurred by the estate are administrative expenses. 11 U.S.C. § 503(b)(1)(B).

A corporation's debt in Chapter 11 arising before confirmation of the plan of reorganization and not provided for by the plan is discharged. 11 U.S.C. § 1141(d)(1). However, pursuant to § 1141(d)(2), confirmation of a plan of reorganization does not discharge an individual debtor from priority tax debt. This seems at odds with the requirement that the debtor or trustee pay all post-petition but pre-confirmation taxes. 28 U.S.C. §§ 959 and 960.¹⁸ This issue has not been resolved by the courts. Under § 1141(d)(6)(B), plan confirmation will not operate to discharge any tax for which the debtor made a fraudulent return or willfully attempted to evade or defeat the tax.

The debtor in a reorganization should promptly pay taxes that become due after the debtor's plan is confirmed. 28 U.S.C. §§ 959 and 960. If a reorganized debtor fails to pay taxes pursuant to a plan of reorganization or incurred post-petition, the creditor may pursue certain collection actions, depending on what remains in the bankruptcy estate after confirmation.¹⁹ Under § 1116, in cases involving small businesses, the trustee or debtor in

¹⁷ Note that the Fourth Circuit, based on Maryland law, held that an unrecorded deed of trust had priority over a subsequent federal tax lien pursuant to the common law doctrine of equitable conversion, holding that 26 U.S.C. § 6323(h)(1)(A) incorporates Maryland law insofar as it protects equitable security interests against subsequent judgment-creditor liens. *In Re: Restivo Auto Body, Inc.*, 772 F.3d 168 (4th Cir. 2014). Because Virginia also recognizes the doctrine of equitable conversion, *City of Manassas v. Bd. of Supervisors of Prince William County*, 250 Va. 126, 458 S.E.2d 568 (1995), the Fourth Circuit's holding in *Restivo Auto Body, Inc.* may be equally applicable in Virginia jurisdictions.

¹⁸ As amended, these sections require officers and agents conducting any business under court authority to pay all taxes when due unless the property is abandoned in a Chapter 11 case or in a Chapter 7 case if the estate has insufficient funds to pay in full all administrative expenses with the same priority as the taxes.

¹⁹ For a thorough discussion of this complicated area of the law, see *In re Reynard*, 250 B.R. 241 (Bankr. E.D. Va. 2000) (post-confirmation collection activities in Chapter 13 and the extent of the post-confirmation estate); *In re Schechter*, No. 10-72175-FJS (Bankr. E.D. Va. Aug. 16, 2012) (post-confirmation collection activities in Chapter 13); *U.S. Dep't of Air Force v. Carolina Parachute Corp.*,

possession is required to timely file all tax returns and timely pay all uncontested administrative taxes. In all Chapter 11 cases, failure to pay taxes due post-petition constitutes grounds to convert or dismiss the case. The court must commence a hearing on a motion to dismiss or convert within thirty days of filing and decide the matter fifteen days thereafter. 11 U.S.C. § 1112.

14-4.02(a) Tax Claims

"The very existence of government is contingent upon the successful collection of taxes. The County's receipt of taxes enables it to achieve its objectives and perform the functions of government." *In re Parr Meadows Racing Ass'n*, 92 B.R. 30, 34 (E.D.N.Y. 1988), *aff'd in part and rev'd in part*, 880 F.2d 1540 (2d Cir. 1989); *see also* 11 U.S.C. § 362(b)(18).

For Chapter 13 cases, before the date of the creditors' meeting, the debtor must file with the appropriate tax authorities all tax returns for all taxable periods during the four-year period ending on the date of the filing of the petition. If the debtor fails to file the returns, a party or trustee may request the court to dismiss the case or convert it to Chapter 7. A claim by a governmental unit pursuant to § 1308 is timely if the claim is filed on or before the date that is sixty days after the date on which the return was filed as required. 11 U.S.C. §§ 1308, 1307(e), 502(b)(9).

The priority tax status period of tax liens is tolled during the period of a previous bankruptcy proceeding. 11 U.S.C. § 507(a)(8)(A)(ii)(II). Virginia Code §§ 8.01-229(D) and 58.1-3940(D) also permit limitations periods to be tolled during the pendency of a bankruptcy case.

As a general rule, taxes that are incurred after the debtor files the petition in bankruptcy are administrative expenses. Recently incurred taxes with liability attaching before filing are an eighth priority claim. 11 U.S.C. § 507(a)(8); *In re R.J. Reynolds-Patrick Cnty. Mem'l Hosp.*, 305 B.R. 243 (Bankr. W.D. Va. 2003) (priority tax claim retains priority character in serial Chapter 11 proceedings; court rejected debtor's assertion that discharge of tax debt upon confirmation of plan in first proceeding meant that the debt should be classified as general unsecured debt in second proceeding). However, there are a number of exceptions to this rule.²⁰

14-4.02(a)(1) Real Estate Taxes

Real estate taxes and special assessments, such as sidewalk, curb, and gutter assessments, *see, e.g.*, Va. Code §§ 15.2-2605, 15.2-2411, and 15.2-2119, which are treated under Virginia law as liens against real property, should be treated as secured claims because of the statutory lien. Va. Code § 58.1-3340; *see In re Stanford*, 826 F.2d 353 (5th Cir. 1987).

907 F.2d 1469 (4th Cir. 1990) (In Chapter 11 proceeding, "since Confirmation of the Plan has the dual effect of revesting the debtor with title to its property and discharging the debtor from all dischargeable debts, there can be no further application of the automatic stay after confirmation.").

²⁰ For example, the Supreme Court, with four Justices dissenting, held that a post-petition federal income tax is not incurred by a Chapter 12 (farm) bankrupt estate; the debtor, not the estate, is generally liable for taxes. *Hall v. United States*, 566 U.S. 506, 132 S. Ct. 1882 (2012). The Court in its opinion stated that there is also no separately taxable estate in a Chapter 13 case. The Court observed that § 1305(a)(1), which gives holders of post-petition claims the option of collecting post-petition taxes within the bankruptcy case, would be superfluous if post-petition tax liabilities were automatically collectible inside the bankruptcy. Although the Court's opinion spoke specifically to federal income taxes, it could be applied to personal and real property taxes in Chapter 12 and Chapter 13 bankruptcies. Since there is no separate taxable estate in Chapter 12 and 13 cases, the bankruptcy estate is not liable for real and personal property taxes incurred during the pendency of the bankruptcy, and such taxes are not administrative expenses. Although courts have yet to further clarify this issue, localities can still file post-petition tax claims in Chapter 13 actions under 11 U.S.C. § 1305(a)(1).

An exception to the automatic stay allows the perfection of statutory liens.²¹ 11 U.S.C. § 362(b)(18). Secured tax liens survive discharge, *In re Trammel*, 63 B.R. 878 (Bankr. E.D. Va. 1986), and in reorganization bankruptcies should be paid interest. Importantly, the local interest rate controls, but the Chapter 11 Plan can alter it unless the locality timely objects. 11 U.S.C. § 511.

14-4.02(a)(2) Personal Property Taxes

Personal property taxes may qualify as a general secured claim, a priority unsecured claim, a general unsecured claim, or a combination of these three classifications. *In re Meyers*, No. 06-11348-SSM (Bankr. E.D. Va. Nov. 16, 2007) (upholding treatment of debt by plan as both priority unsecured in part and general unsecured in part, despite qualification of debt as secured under Virginia law). Since interest is payable on secured claims, it is preferable to file as secured if the debtor has equity in the property. The claim may be designated as “secured to the extent of the debtor’s equity and otherwise 507 tax priority,” if the priority can be claimed.

Taxes for which a distress or seizure warrant has been executed should be secured debts under Virginia law. Va. Code § 58.1-3942. If the property is specifically assessed, a statutory lien may apply, elevating the personal property debt to secured status. Va. Code §§ 58.1-3941 and 58.1-3942; *see also* 1982-83 Op. Va. Att’y. Gen. 618. A lien for personal property tax exists whether or not the locality has seized the property. Va. Code § 58.1-3942.²²

Personal property taxes are a priority debt if the tax was incurred before the case was filed and the tax was due and payable without penalty not more than a year before the debtor filed for bankruptcy. 11 U.S.C. § 507(A)(8)(B). A property tax is incurred when, according to the applicable state or local law, liability for the debt arises.²³ As an example, suppose the debtor files for bankruptcy on December 7, 2015, and the tax due date is December 5. The 2015 tax is a property tax incurred before the commencement of the case, as the tax was assessed January 1, 2015, which is before December 7, 2015. The tax was last payable without penalty on December 5, 2015. Because one year before the date of the filing of the petition would be December 7, 2014, and the tax was last payable without penalty after that date, the 2015 tax qualifies under § 507(a)(8)(B) as a priority, and is nondischargeable under § 523(a)(1)(A). Any 2014, 2013, 2012 or 2011 taxes are not priority taxes. If the debtor had filed on December 4, 2015, both 2014 and 2015 taxes would have been priority.²⁴

14-4.02(a)(3) Gross Receipts Taxes

A gross receipts tax, such as a business license tax, is a priority if the tax return was due not more than three years before the debtor filed for bankruptcy, or if the tax was assessed within 240 days of the bankruptcy. 11 U.S.C. § 507(a)(8)(A). For example, if the debtor filed for bankruptcy on April 1, 2015, and the due date of the business license tax return

²¹ Virginia Code §§ 58.1-3281 and 58.1-3340 provide that real estate taxes are assessed and become a lien on January 1st.

²² A bankruptcy court in *City of Martinsville v. Tultex Corp.*, 250 B.R. 560 (Bankr. W.D. Va. 2000), held that specific assessment alone does not create a lien; the property must be distrained before the superpriority lien becomes effective. In reaction to the *Tultex* decision, the Virginia Treasurers Association succeeded in having Va. Code § 58.1-3942 amended to read as above. The amendment was declared to reflect existing law.

²³ In Virginia, January 1 is the date when ad valorem taxes are “incurred.” Va. Code § 58.1-3515 (personal property).

²⁴ See *In re Aime*, No. 07-12388-SSM (Bankr. E.D. Va. Jan. 11, 2010), for a judicial discussion of this situation. The case involves Fauquier County personal property taxes and the court concluded that it had no power to prohibit collection of a non-dischargeable tax simply because the payment would impose a financial hardship on the debtor.

was March 30, 2015, the taxes would be unsecured and nonpriority for tax years 2011 and 2012 and would be priority debts for 2013, 2014 and 2015. If an extension of time to file was granted, the "last due" date similarly would be extended. 11 U.S.C. § 507(a)(8)(A)(i).

14-4.02(a)(4) Trust Fund Taxes

Certain types of taxes, such as meals taxes, admissions taxes, telecommunication taxes, and transient occupancy taxes, are collected and held in trust by the taxpayer until remitted to the treasurer.²⁵ 11 U.S.C. §§ 507(b)(8)(c) and 346(h); *Ill. Dep't of Revenue v. Hayslett/Judy Oil, Inc.*, 426 F.3d 899 (7th Cir. 2005). Because these taxes are not the property of the taxpayer, the funds should not be part of the bankruptcy estate.

Because the debtor does not own an equitable interest in the property he holds in trust for another, that interest is not 'property of the estate.' Nor is such an equitable interest 'property of the debtor'

Begier v. IRS, 496 U.S. 53, 110 S. Ct. 2258 (1990).

Unfortunately, taxpayers in bankruptcy often have spent these funds or have mixed them with other funds in the bankruptcy. Courts, including the Supreme Court in *Begier*, have found that if the debtor made voluntary payment of the trust taxes, there was no avoidable preference under 11 U.S.C. § 547(b) and the payment did not need to be returned. *Wellington Foods*, 165 B.R. 719 (Bankr. S.D. Ga. 1994). *But cf. Wendy's Food Sys.*, 133 B.R. 917 (Bankr. S.D. Ohio 1991) (allowing avoidance as preferential payments certain payments made from accounts containing sales tax funds commingled with other funds). Otherwise, a locality needs to show that the debtor had enough money in the bank to satisfy the trust fund tax obligation (not an easy task!) so that the locality can file an administrative claim for payment. Trust funds may be traced even if commingled into a general account using a "lowest intermediate balance" rule. *In re Dameron*, 155 F.3d 718 (4th Cir. 1998).

No third-party lien or security interest can attach to funds representing such taxes. *In re Koppinger*, 113 B.R. 588 (Bankr. D.N.D. 1990). If the court does not order payment of the amount requested, a suggested solution is to request adequate protection, in the form of a deposit from the debtor, as for a utility charge. 11 U.S.C. § 361.

14-4.02(a)(5) Recordation/Stamp Taxes

In Chapter 11 cases, a locality cannot impose any taxes paid by the debtor to record a security or instrument of transfer (such as a deed) if provided under the terms of a confirmed plan of reorganization. 11 U.S.C. § 1146(a); *see also In re Jacoby-Bender*, 758 F.2d 840 (2nd Cir. 1985) (delivery of deed transferring building exempt from stamp taxes). But see § 960, which facially conflicts with § 1146(c). In *NVR Homes Inc. v. Clerks of the Circuit Court*, 189 F.3d 442 (4th Cir. 1999), the court of appeals held the recordation taxation exemption applies to post-confirmation transfers only. The U.S. Supreme Court in *Florida Department of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 128 S. Ct. 2326 (2008), adopted the Fourth Circuit's rationale and found that the debtor's asset sale under § 363(b)(1) was not conducted "in accordance with" any plan confirmed under Chapter 11. The Court rejected the debtor's theory that § 1146 of the Bankruptcy Code is a remedial statute that should be construed liberally.

The Fourth Circuit indirectly addressed the application of § 1146(c) [now subsection (a)] to third party transfers in *Maryland v. Antonelli Creditors' Liquidating Trust*, 123 F.3d

²⁵ A tax may be both an excise tax and a trust fund tax (i.e., one that falls under § 507(a)(8)(C)). If a tax is structured so that the debtor is required to collect it from others and hold it for payment to the state, it does not matter that the tax being collected might also be viewed as an excise tax. To the extent that it also qualifies as a trust fund tax, the tax remains a priority, no matter how old it is.

777 (4th Cir. 1997), in holding that Chapter 11 reorganization provided for the transfer of property to a liquidating trust, and provided that transfers from the trust to third parties were exempt from stamp or recordation taxes under § 1146(c). After holding that the state and local governments were procedurally barred from challenging the court's construction of § 1146(c), the Fourth Circuit, in a similarly based jurisdictional challenge, held the transfer and recordation taxes exemption provided for in § 1146(c) can apply to third-party purchasers if such an exemption were provided for in the plan of reorganization. The court distinguished *In re Eastmet Corp.*, 907 F.2d 1487 (4th Cir. 1990), as third-party transfers that were not an essential part of the plan.

14-4.02(b) Fees and Other Charges

Pre-petition fees owed to governmental units, such as library fines or permit fees, generally are treated as unsecured claims and are discharged at the end of the bankruptcy. However, parking fines and other regulatory fees may be considered a "fine, penalty, or forfeiture" payable to a governmental unit and not dischargeable. 11 U.S.C. § 523(a)(7).

14-4.02(b)(1) Utility Charges

A locality may by ordinance provide that utility charges, such as water and sewer fees, become liens against property. See Va. Code §§ 15.2-2605, 15.2-2118, 15.2-2119, 15.2-2120, and 15.2-5139; *In re Sheldahl, Inc.*, 298 B.R. 874 (Bankr. D. Minn. 2003) (lien for water and sewer services automatically perfected). Because such liens are created statutorily, there is no violation of the automatic stay. 11 U.S.C. § 362(b)(18). Thus, if the debtor owns the real estate served by the utility, the claim should be filed as secured; otherwise, utility services charges should be filed as unsecured non-priority debts. Recorded utility liens have priority over prior recorded deeds of trust in foreclosure, *In re Foreclosure of 3215 Hunters Mill Drive*, Nos. CH 92CJ1112 - CH92CJ1115 (Henrico Cnty. Cir. Ct. Dec. 10, 1992); 1992 Op. Va. Att'y Gen. Va. 63, and although the charges may be discharged in bankruptcy as a personal obligation of debtor, the lien will remain collectible in rem. *In re Trammel*, 63 B.R. 878 (Bankr. E.D. Va. 1986). But see 11 U.S.C. § 545(2) (lien avoidance). However, if perfection of the lien is required under the applicable enabling statute, and the lien was not perfected pre-petition, the lien may be lost, since the trustee or debtor-in-possession is treated as a bona fide purchaser. 11 U.S.C. § 545(2). Under § 545(2), a trustee is not deemed a bona fide purchaser for tax or similar liens, and an argument could be made that water and sewer liens are similar to a tax lien.

The automatic stay prevents shutoff of service for nonpayment only if the trustee or the debtor within twenty days after order of relief (thirty days for a Chapter 11) provides "adequate assurance" (a deposit) of post-petition payment, and a pre-petition deposit may be used to set off utility debts without notice or order of the court.²⁶ 11 U.S.C. § 366(b) and (c). The Bankruptcy Code, 11 U.S.C. § 363(e), permits the court upon request of an "entity" (including governmental units, § 101(15)) to provide conditions for the use by the trustee of property of the entity.²⁷ Often, a debtor faced with making a substantial deposit will pay the arrearage rather than providing adequate assurance.

²⁶ See also *In re Parks*, No. 07-18341 (Bankr. N.D. Ohio May 6, 2008), for the proposition that if the debtor broke into a meter that had been shut off or diverted power from a different meter, the utility may be able to demand restitution for the broken meter before restoring service.

²⁷ The question of whether adequate protection is retroactive to the filing date is unresolved. Compare *In re Ritz-Carlton Inc.*, 98 B.R. 170 (S.D.N.Y. 1989) (general rule is that for adequate protection purposes a secured creditor's position as of the petition date is entitled to adequate protection against deterioration) with *In re Best Prods. Co.*, 138 B.R. 155 (Bankr. S.D.N.Y. 1992) (distinguishing *Ritz-Carlton* and holding secured creditor is only entitled to adequate protection from time such protection sought).

14-4.02(b)(2) Bad-Check Charges

Bad-check fees generally are not paid in bankruptcy, unless fraudulent, criminal intent by the debtor is proved. *Clarkson v. Elibuyuk (In re Elibuyuk)*, 163 B.R. 75 (Bankr. E.D. Va. 1993). Increasingly common are debtors who bounce checks as they file for bankruptcy. Although the underlying debt remains collectible as described above, the fees associated with the uncollectible check (under Va. Code §§ 15.2-105 or 58.1-12) are unsecured. However, in some instances a creditor may be able to argue that as the bad-check fee is a fine or penalty, it should be nondischargeable. 11 U.S.C. § 523(a)(7).

14-4.02(b)(3) Federal Tax Lien Priority

Federal taxes and liens enjoy no special status in bankruptcy compared with state or local taxes. For payment priority, the general rule remains "first in time is the first in right." *United States ex rel. IRS v. McDermott*, 507 U.S. 447, 113 S. Ct. 1526 (1993). Certain local taxes, including real estate taxes, Va. Code § 58.1-3340, and taxes secured by distraint against a motor vehicle, Va. Code § 58.1-3942, enjoy priority even over previously filed IRS tax liens. 26 U.S.C. § 6323(b).

14-4.03 Penalties

Certain penalties are a priority debt if they are not punitive but represent an actual pecuniary loss. 11 U.S.C. § 507(a)(8)(G). Note that if the penalty does *not* represent actual pecuniary loss, the penalty may be nondischargeable under § 523(a)(7). Virginia Code § 58.1-3916 provides that late filing and late payment penalties, "when so assessed shall become part of the tax" and therefore represents pecuniary loss if uncollected.

However, the bankruptcy court in Alexandria has held that pre-petition tax penalties are unsecured debts. *In re Manchester Lakes Assocs.*, 117 B.R. 221 (Bankr. E.D. Va. 1990). In the opinion, Judge Bostetter ruled that tax penalties are nonpecuniary losses as a flat percentage not connected to the costs of collection and that other creditors should not be punished for the debtor's wrongdoing. Consequently, the court subordinated penalties to the claims of other unsecured creditors. 11 U.S.C. § 510(c); *see also In re Virtual Network Servs. Corp.*, 902 F.2d 1246 (7th Cir. 1990) (upholding the equitable subordination of IRS non-pecuniary loss tax penalty claims).²⁸ Although addressing pre-petition taxes, the court's decision is dubious in light of the reasoning of *United States v. Noland*, 517 U.S. 535, 116 S. Ct. 1524 (1996), addressing the authority of the court under § 5109(c) to subordinate post-petition penalties.

Post-petition penalties are an administrative expense. 11 U.S.C. § 503(b)(1)(C); *see United States v. Friendship Coll.*, 737 F.2d 430 (4th Cir. 1984) (Bankruptcy Code accords first priority treatment to penalties on taxes which are first priority administrative expenses); *In re Putnam*, 131 B.R. 52 (Bankr. W.D. Va. 1991) (post-petition penalties and interest on tax claims are non-dischargeable and remain personal liability of the debtor). In *United States v. Noland*, 517 U.S. 535, 116 S. Ct. 1524 (1996), the United States Supreme Court held that a bankruptcy court may not on a categorical basis equitably subordinate post-petition, non-compensatory IRS tax penalties. The bankruptcy court had held that, based on the relative equities and the Code's preference for compensating actual losses, tax penalties should be subordinated to unsecured creditors' claims pursuant to the court's authority under § 510(c). The Supreme Court held that such categorical subordination was in derogation of Congress's scheme of priorities under §§ 503(b)(1) and 507(a)(2), which provide that such penalties are administrative expenses.

²⁸ But compare *In re Divine*, 127 B.R. 625 (Bankr. D. Minn. 1991), where the court would not subordinate secured IRS penalties to unsecured debts absent inequitable conduct. The underlying taxes also should not be subject to subordination. *In re F.W. Koenecke & Sons, Inc.*, 533 F.2d 1020 (7th Cir. 1976) ("all the people of the State are benefited when taxes which are lawfully owing are collected").

A tax penalty is not avoidable under the Bankruptcy Code or state fraudulent transfer statutes because it is not a voluntary exchange between debtor and creditor; rather, the IRS is an involuntary creditor by operation of statute and no value is given in exchange. *In re Yahweh Ctr., Inc.*, 27 F.4th 960 (2022) (applying North Carolina fraudulent transfer statute) (citing *In re Southeast Waffles, LLC*, 702 F.3d 850 (6th Cir. 2012), applying Tennessee fraudulent transfer statute). Thus, the debtor cannot invoke § 544(b)(1) to nullify tax penalties and recover tax penalty payments already made.

14-4.04 Interest

Whenever the payment of interest is provided for on a tax claim or administrative expense, the rate of interest is whatever it would have been under applicable nonbankruptcy law. 11 U.S.C. § 511; *In re Davis*, 352 B.R. 651 (Bankr. N.D. Texas Aug. 30, 2006) (§ 511 applies to assignees of tax lien). Bankruptcy courts permit pre-petition interest with the same priority as the underlying claim. 11 U.S.C. § 507(a)(8)(G); *In re Garcia*, 955 F.2d 16 (5th Cir. 1992) (finding that pre-petition interest shares equal priority with underlying tax debt). Pre-petition interest stops accruing as of the date of filing. 11 U.S.C. § 502(b)(2); *In re Foertsch*, 167 B.R. 555 (Bankr. D.N.D. 1994) (as a general rule, Bankruptcy Code does not permit interest to accrue on creditor claims after filing of bankruptcy petition).

Interest also is due on administrative claims. “[T]he prior case law, the statutory authority, the legislative history, and the public policy surrounding Section 503 clearly indicate that interest on post-petition taxes is an administrative expense.” *In re Stainless Processing Co.*, 98 B.R. 913 (Bankr. N.D. Ill. 1989); see also *United States v. Friendship Coll.*, 737 F.2d 430 (4th Cir. 1984).

In *Ron Pair*, the Supreme Court ruled that post-petition interest should be paid to oversecured creditors. *United States v. Ron Pair Enters.*, 489 U.S. 235, 109 S. Ct. 1026 (1989). But see *Nat’l Energy & Gas Transmission, Inc. v. Liberty Elec. Power, LLC (In re Nat’l Energy & Gas Transmission, Inc.)*, 492 F.3d 297 (4th Cir. 2007) (distinguishing *Ron Pair* and finding that § 502(b)(2) barred collection of post-petition interest) and § 502(b)(2).²⁹ Most courts following this case have held that for Chapter 7 cases, no interest is paid on pre-petition debts, but the court may allow post-petition interest on a nondischargeable tax debt. *United States v. Benson*, 88 B.R. 210 (W.D. Mo. 1988) (collecting cases). Every circuit has permitted §§ 503(b) and 726(a)(1) claims first priority for interest on post-petition tax obligations in Chapter 7 cases. See, e.g., *United States v. Yellin (In re Weinstein)*, 272 F.3d 39 (1st Cir. 2001) (interest on post-petition taxes incurred by a bankruptcy estate are first priority). In Chapter 11 or 13 cases, interest is paid after the debtor’s plan of reorganization is confirmed.³⁰

In *In re Kirkland*, 600 F.3d 310 (4th Cir. 2010), the Fourth Circuit held that a debtor’s obligation to pay post-petition interest on the outstanding balance of a student loan (unsecured contractual and statutory debt) arose independently from her Chapter 13 bankruptcy petition and thus the post-petition interest could not have been included in the proof of claim. However, once the bankruptcy estate closed, the debtor remained personally liable for all post-petition interest.

A Chapter 11 debtor may pay priority taxes (and secured claims which would otherwise be priority claims but for the secured status) over time.³¹ However, because the debtor is receiving what is essentially a loan from the local government during that time, the generally accepted construction of § 1129 provides for payment of interest during the

²⁹ For the Rule in Chapter 13 cases, see 11 U.S.C. § 1322(e).

³⁰ By implication, § 1124 requires post-petition interest to all claimants, even if unimpaired by the debtor’s plan.

³¹ Not to extend beyond five years after the petition date. 11 U.S.C. § 1129(a)(9)(C).

period of repayment. *In re Birdneck Apartment Associates II L.P.*, 156 B.R. 499 (Bankr. E.D. Va. 1993). A locality should object to plan confirmation if the debtor proposes to pay the locality less than the statutory rate of interest.

14-4.05 Post-Petition Debts

Taxes “incurred by the estate, whether secured or unsecured, including property taxes for which liability is in rem, in personam, or both,” after the debtor files for bankruptcy are administrative expenses. 11 U.S.C. § 503(b)(1)(B); *In re Callahan*, 304 B.R. 743 (W.D. Va. 2004) (commencement of a Chapter 7 case by a corporation or partnership does not create a separate taxable entity from the debtor itself and post-petition tax obligations of debtor are administrative expenses of estate). Under 28 U.S.C. § 959(b), “a trustee . . . including a debtor in possession, shall manage and operate the property in his possession . . . according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.” Therefore, the debtor or trustee must file tax returns and pay taxes as the tax becomes due. The trustee or debtor in possession is subject to all applicable Federal, state, and local taxes. 28 U.S.C. § 960; *In re Samuel Chapman, Inc.*, 394 F.2d 340 (2d Cir. 1968) (applying 28 U.S.C. § 960); *see also In re Lauriat’s Inc.*, 219 B.R. 648 (Bankr. D. Mass. 1998) (applying 28 U.S.C. § 959 and denying motion for exemption from state law) and *In re White Crane Trading Co.*, 170 B.R. 694 (Bankr. E.D. Cal. 1994) (§ 959(b) requires that debtor comply with state’s going out of business laws). For a general discussion of this issue, see “Right of Taxing Authorities to Collect Postpetition Interest on Tax Claim in Bankruptcy or Related Proceeding,” 13 A.L.R. Fed. 877.

If a debtor fails to file a required post-petition tax return or to obtain an extension, the taxing authority may request that the court convert or dismiss the case. If the debtor does not file the required return or obtain the extension within ninety days after a request is filed by the taxing authority, the court shall convert or dismiss the case, whichever is in the best interests of creditors and the estate. 11 U.S.C. § 521(j).

14-4.05(a) Post-Petition Taxes Due the Year of Filing

Administrative expense priority is available for taxes “incurred by the estate” after the bankruptcy petition date. The Fourth Circuit Court of Appeals has joined the Second Circuit, Third Circuit, Fifth Circuit, and many district courts in holding that the tax valuation date (January 1 in Virginia) is the day a property tax is “incurred by the estate.” *In re Members Warehouse*, 991 F.2d 116 (4th Cir. 1993); *In re Parr Meadows Racing Ass’n*, 880 F.2d 1540 (2d Cir. 1989) (superseded on other grounds by 11 U.S.C. § 362(b)(18)); *W. Va. State Dep’t of Taxation v. IRS (In re Columbia Gas Transmission Corp.)*, 37 F.3d 982 (3d Cir. 1994); *Midland Cent. Appraisal Dist. v. Midland Indus. Serv. Corp. (In re Midland Indus. Serv. Corp.)*, 35 F.3d 164 (5th Cir. 1994). This holding means that if a debtor files for bankruptcy, any property taxes due during that calendar year must be included on the proof of claim to be paid, even if the taxes are not yet due or even assessed. For example, if the debtor files for bankruptcy on January 4, 2024, the proof of claim must include all 2024 taxes, or the taxes may be discharged. Localities have 180 days to file. 11 U.S.C. § 502(b)(9).³² In this example, the proof of claim would have to be received by the bankruptcy court by July 3 to be valid.³³

³² The bar date is extended an additional sixty days after a related return is filed in a Chapter 13 case.

³³ There appears to be a conflict with this holding in the Western District, where tax claims are determined to be pre- or post-petition based on the due date. With regard to real estate taxes that a Chapter 11 debtor owes a landlord, a court has held that the taxes are considered a post-petition administrative expense based on the date the taxes accrue, not when they are billed. *In re Trak Auto Corp.*, 277 B.R. 655 (Bankr. E.D. Va. 2002), *rev’d on other grounds*, 367 F.3d 237 (4th Cir. 2004); *accord In re Circuit City Stores, Inc.*, 447 B.R. 475 (Bankr. E.D. Va. 2009).

14-4.05(b) Administrative Expense Taxes

Administrative expense taxes should be treated as other administrative expenses, and should be paid by the debtor when due. A governmental unit is not required to file a request for the payment of an administrative tax or penalty expense as a condition of its being an allowed administrative expense. 11 U.S.C. § 503(b)(1)(D). It is not necessary for a motion to be filed to obtain payment.³⁴

In Chapter 13 cases, taxes that become payable while the case is pending may be included in the debtor's plan of reorganization. 11 U.S.C. § 1305(a)(1).³⁵ One effective collection technique would be to send the debtor's counsel a draft motion to convert or dismiss for failure to pay these taxes. 11 U.S.C. §§ 1112(b)(I), 1128, and 1307. It is important to remain current with administrative expenses in reorganization cases, because post-petition debts arising before the debtor's plan is confirmed may be subject to discharge. 11 U.S.C. §§ 502(i), 1141(d), and 1328(a).

14-4.05(c) Estimating Future Debts

After the debtor files, localities should estimate any tax that may be due during the remainder of the calendar year, based on prior years' filings by the debtor. Most courts find that an ad valorem property tax is "assessed" on January 1, so if the debtor files in March, a locality may miss the deadline for filing a proof of claim if it waits for the assessment to go on the books.

If the assessor cannot provide a statutory or omitted assessment, the tax due should be estimated based on the prior year's taxes. The note "estimated" may be written next to the claim amount. Once the locality has a correct figure, it should file an amended proof of claim. See *United States v. Berger (In re Tanaka Brothers Farms)*, 36 F.3d 996 (10th Cir. 1994), where a 400 percent upwards amendment was permitted because the IRS listed the amount as "estimated."

14-4.06 Late, Untimely, or Omitted Proofs of Claim

Bankruptcy courts have long disfavored late-filed proofs of claim by taxing entities. *In re Stavriotis*, 977 F.2d 1202 (7th Cir. 1992) (refusing to allow IRS's amendment of claim that would increase tax liability from \$11,132.93 to \$2,435,078.39, and add tax liability for

³⁴ For pre-Reform Act cases, a request for payment of administrative expenses should be made by motion. In *In re ATCALL, Inc.*, 284 B.R. 791 (Bankr. E.D. Va. 2002), the court stated that it was the trustee's duty in a Chapter 7 case to include in his final report all filed requests for payment and notice those not allowed for a hearing. The claimants for administrative expenses were not obligated to notice the hearing themselves.

An unresolved question is whether post-petition real estate taxes, which are secured debts, are also administrative expenses. Bankruptcy estates are subject to tax and the effect of tax laws, which includes a duty to file returns and pay taxes when due. 28 U.S.C. §§ 959, 960. It would seem that where services funded by property taxes enhance the value of the property served, taxes are necessary to pay for services and improvements that directly or indirectly benefit the property, and are therefore a necessary cost of preserving the estate, § 506(c). The taxes should be an administrative expense and paid by the estate or out of the proceeds of the sale of the property. See *E & C Holding Co. v. Twp. of Piscataway (In re Eastern Steel Barrel Corp.)*, 164 B.R. 477 (Bankr. D.N.J. 1994) (post-petition property taxes and sewer charges are actual necessary expenses of preserving and disposing of debtor's collateral and therefore recoverable under § 506(c)). *But cf. In re Boston Harbor Marina, Co.*, 157 B.R. 726 (Bankr. D. Mass. 1993) (refusing to treat secured real estate tax claims as administrative expenses).

³⁵ Note, however, that because a bankruptcy estate under Chapter 12 or Chapter 13 is not a "taxable entity," any post-petition tax liability is incurred by the debtor, not the estate, and is thus not an administrative expense. However, as noted in the text above, the locality may nevertheless file a post-petition claim for taxes. See generally *Hall v. United States*, 566 U.S. 506, 132 S. Ct. 1882 (2012); see also *Raleigh v. Illinois Dep't of Revenue*, 530 U.S. 15, 120 S. Ct. 1951 (2000) (burden of proof concerning tax claims in bankruptcy governed by the substantive law creating the tax obligation).

additional tax year). Because reorganizing debtors needed to know the amount of payments to be made before proposing their plans, courts would bar or discharge tax claims filed late. In *In re Computer Learning Centers, Inc.*, 268 B.R. 468 (Bankr. E.D. Va. 2001), the court held that a lessor's error in calculating the amount due to cure a lease default (omitting amount due for second property) was correctable pursuant to Fed. R. Civ. P. 60(a) as a clerical error.

A Supreme Court case allowing a late-filed proof of claim was severely limited by amendment to § 502(b). *Pioneer Investment Services. v. Brunswick Associates, Ltd.*, 507 U.S. 380, 113 S. Ct. 1489 (1993) (applying Rule 9006(B)(1)'s excusable neglect standard). Late-filed proofs of claim are effectively barred, with the narrow exception of priority claims in Chapter 7 asset cases. Those claims remain priority claims if filed on or before the earlier of ten days after the mailing of a summary of the trustee's final report to the creditors or the date the trustee commences final distribution.³⁶ 11 U.S.C. § 726(a)(1). Again, a locality has up to 180 days to file a proof of claim.³⁷ 11 U.S.C. § 502(b)(9). Also, because the 180-day period begins to run from the date the debtor files the petition in bankruptcy, in an involuntary case, there may be more than six months to file a proof of claim. 11 U.S.C. § 303.

If no claim is filed, a creditor may lose the right to collect the debt. See, e.g., 11 U.S.C. §§ 1141(d)(1)(A) and 1328. For Chapter 11 cases, a proof of claim does not have to be filed if the debtor has scheduled the debt as noncontingent, liquidated, and undisputed, 11 U.S.C. § 1111(a), but as a practical matter, that does not happen. Even if the tax or debt is believed to be post-petition and paid as an administrative expense, it should still be listed on the proof of claim.

Because Chapter 13 is designed to satisfy all creditors and requires priority and secured claims to be paid in full, if a debt is not in the plan, the debtor will not have an opportunity to pay it. 11 U.S.C. §§ 1322(a)(2) and 1325(a)(5). The court will close the bankruptcy, and can discharge the debtor from most unfiled taxes if they are not provided for by the plan.³⁸ This "super discharge" prohibits collection even on tax debts, unless the debtor fails to complete the plan.³⁹ 11 U.S.C. § 1328.

Disallowed claims in Chapter 7 and 11 cases may be reconsidered by the court "for cause." 11 U.S.C. § 502(j). This may allow for an "excusable neglect" argument. See *In re Anderson*, 159 B.R. 830 (Bankr. N.D. Ill. 1993) (finding the balance of equities and due process supported allowance of late filing); *In re Unroe*, 937 F.2d 346 (7th Cir. 1991) (late proofs of claim allowed in Chapter 13 cases under the court's equitable powers because the taxing authorities did not have adequate notice of the bankruptcy). But see *In re Cassani*, No. 08-13185-SSM (Bankr. E.D. Va. Nov. 16, 2009) (unlike a Chapter 7 or 11, a bar date in a chapter 13 case cannot be extended after the fact even for equitable reasons); *In re*

³⁶ In a Chapter 7 case, and prior to the 1994 amendments to the Bankruptcy Code, the IRS filed two untimely priority claims for unpaid taxes. *Cooper v. IRS*, 167 F.3d 857 (4th Cir. 1999). The Fourth Circuit held the claims remained priority claims despite their untimeliness, ruling that the provisions of § 726(a)(1) [priority claims] prevailed over § 726(a)(3) [untimely claims]. This ruling produces essentially the same result as the 1994 amendments to § 726(a)(1).

³⁷ The bar date is extended an additional 60 days after a related return is filed in a Chapter 13 case.

³⁸ This rule does not apply to taxes with unfiled or late filed returns, trust fund taxes, and other items enumerated in § 1328(a).

³⁹ However, taxes related to unfiled, late, or fraudulent returns, or to willful attempts to evade or defeat taxes are excepted from the super discharge. See *Uplinger v. Commonwealth*, 561 B.R. 56 (E.D. Va. 2016) (although estimated taxes were paid according to the plan, because the debtor failed to prove she was not required to file a return, the actual amount of the tax debt was not discharged). Debts for trust fund taxes are also excepted from the discharge.

Blakely, 440 B.R. 443 (Bankr. E.D. Va. 2010) (discussing creditor's options when claimed barred); *Gardenhire v. IRS*, 209 F.3d 1145 (9th Cir. 2000), *abrogated on other grounds by Young v. United States*, 535 U.S. 43, 122 S. Ct. 1036 (2002)); *In re Bender*, No. AZ-07-1178-NKD (Bankr. App. 9th Cir. Nov. 21, 2007) (unpubl.) (equitable tolling cannot be used to extend the 180-day time period specified in § 502(b)(9) and Rules 3002(c)(1) and 9006(b)(3)); *In re: Mitchell*, No. 14-24877 (Bankr. D. Md. Sept. 14, 2015) (unpubl.) (argument that *In re: Unroe* supports a court's use of its equitable power to allow a late claim disregards 11 U.S.C. § 502(b)(9), enacted after *In re: Unroe* was decided). Usually, the trustee will allow a creditor to file a claim late if the creditor was not on the list of creditors and did not receive timely notice.⁴⁰ *In re Nwonwu*, 362 B.R. 705 (Bankr. E.D. Va. 2007) (noting that Trustee not prohibited from paying late-filed claim if no prejudice to other creditors); see section 14-1.03(b), Effect of No Notice. Amendments to the Federal Bankruptcy Rules allow the filing of a late claim in Chapter 13 cases where there was insufficient notice of the case. Rule 3002(c)(6). Permission to file the late claim must be made by motion, but this finally gives the courts authority to allow such a claim as the courts previously decided there was no such authority.

Accordingly, if a locality receives notice of the bankruptcy after the filing date has passed, it should file a late proof of claim and contact the trustee and debtor's counsel to determine whether either will object. Frequently, allowing a late-filed proof of claim will inure to the benefit of the debtor, as it will allow the debtor to provide for payment of the plan through the bankruptcy, thus affording the debtor the "fresh start" sought through the bankruptcy process. Additionally, as a due process matter, some courts allow late-filed proofs of claim where the creditor did not receive notice of the bankruptcy until after the bar date had passed. See, e.g., *In re Adams*, 502 B.R. 645 (N.D. Ga. 2013) (compiling cases).

In a case in which a debtor had scheduled a creditor but listed the wrong address so that the creditor did not receive notice until after the bar date, a federal district court held that a "mechanical application" of § 523(a)(3)(A) resulting in nondischargeability of the debt would produce a result contrary to the express intent of the Code. Courts should apply a three-part test to determine if an omitted debt should be discharged: 1) the reasons the debtor failed to list the creditor, 2) the amount of disruption which would likely occur, and 3) any prejudice suffered by the listed creditors and the unlisted creditor in question. *Bougie v. Livingston*, No. 1:15cv36 (W.D. Va. Jan. 4, 2016) (noting split in authority).

14-4.07 Default Judgments

A federal statute directs federal courts to afford state court judgments full faith and credit. 28 U.S.C. § 1738.⁴¹ In general, if a default judgment would be entitled to preclusive effect under state law, it must be given such effect in bankruptcy claims allowance proceedings. *In re Genesys Data Technologies, Inc.*, 245 F.3d 312 (4th Cir. 2001). See *Fox v. Crowgey*, 517 B.R. 639 (Bankr. W.D. Va. 2014) (preclusive effect given to determination of fraud as a result of an Oklahoma state court default judgment when debtor participated to some degree in proceedings); *In re Bane*, 236 B.R. 352 (Bankr. W.D. Va. 1999) (default judgment for fraudulent conversion collaterally estops addressing the issue of fraud).⁴²

⁴⁰ In *In re Day*, No. 07-13016-RGM (Bankr. E.D. Va. Sept. 30, 2009), a trustee had discretion not to object to the late filed proof of claim where notice was improper and filing an objection would itself create an injustice or where no purpose would be served by objecting to the claim.

⁴¹ Accordingly, a bankruptcy court does not have the authority to change in any way a prior state court judgment by entering its own judgment (which could have the effect of changing the rate of interest or limitations period). The court may only determine whether the prior state court judgment is dischargeable. *In re Heckert*, 272 F.3d 253 (4th Cir. 2001).

⁴² Similarly, even if a tax agreement between a government and taxpayer provides for the payment of a penalty pursuant to a fraud provision, collateral estoppel does not apply unless the agreement

14-5 PROCEEDINGS

14-5.01 Objections to the Proof of Claim

Disallowance of a claim to which an objection is made in bankruptcy is not automatic. Rather, absent a finding of a statutorily enumerated reason, the claim should be considered allowed. 11 U.S.C. § 502(a); Fed. R. Bankr. P. 3001(f); *Robinson v. Olin Fed. Credit Union*, 48 B.R. 732 (D. Conn. 1984) (citing § 502(a)). If the debtor objects, he has the burden of going forward with evidence to rebut the presumption of the validity of the claim. *In re Farmer's Co-op*, 43 B.R. 619 (Bankr. W.D. Ark. 1984); *In re White*, 168 B.R. 825 (Bankr. D. Conn. 1994). In a Chapter 13 case, the debtor may object to an unsecured creditor's claim after plan confirmation. *LVNV Funding, LLC v. Harling*, 852 F.3d 367 (4th Cir. 2017).

Increasingly common are omnibus objections filed by large Chapter 11 debtors against all claims. Upon receiving an objection to a proof of claim, a creditor should file a response in opposition to the objection, request the court to schedule a hearing and be prepared to appear. See *Horn v. United States ex rel IRS (In re Horn)*, 169 B.R. 218 (Bankr. E.D. Okla. 1994) (noting that default judgment entered based on failure of IRS to appear). At this point, the debtor usually will contact the creditor to negotiate the claim. If the debtor pursues the objection to claim in a foreign venue, the creditor should find local counsel. Counsel for the Virginia Department of Taxation are in contact with taxation counsel in other states, who may be willing to present a response on a locality's behalf. Also, through LGA one may find other jurisdictions that have similar claims and who are willing to split the cost of local counsel.

Be aware that a bankruptcy court may determine the amount of any unpaid tax liability,⁴³ just as state courts may review assessments. 11 U.S.C. § 505; *In re AWB Assocs., G.P.*, 144 B.R. 270 (Bankr. E.D. Pa. 1992); Va. Code § 58.1-3984. In general, "the validity of a creditor's claim is determined by rules of state law." *Grogan v. Garner*, 498 U.S. 279, 111 S. Ct. 654 (1991). In Virginia,

it is well settled that there is a presumption in favor of the correctness of a tax assessment and that the burden is upon the property owner who questions it to show that the value fixed by the assessing authority is excessive. The effect of this presumption is that even if the assessor is unable to come forward with evidence to prove the correctness of the assessment this does not impeach it since the taxpayer has the burden of proving the assessment erroneous.

Norfolk & Western Ry. v. Commonwealth, 211 Va. 692, 695, 179 S.E.2d 623, 626 (1971) (internal citations omitted); see also *Raleigh v. Illinois Dep't of Revenue*, 530 U.S. 15, 120 S. Ct. 1951 (2000) (burden of proof on taxpayer). The taxpayer must show manifest error in the making of the assessment, and the court should not impose its own methodology in place of an assessment by a duly constituted taxing authority. *City of Richmond v. Gordon*, 224 Va. 103, 294 S.E.2d 846 (1982); *In re Metromedia Fiber Network, Inc.*, 299 B.R. 251 (Bankr. S.D.N.Y. 2003). An assertion that the proof of claim does not agree with the debtor's records should not be sufficient to overcome this presumption of correctness.

Fortunately, a bankruptcy court cannot review a tax assessment if the time for challenging such assessment has passed under state law. 11 U.S.C. § 505(a)(2)(C); *In re Custom Distribution Servs. Inc.*, 224 F.3d 235 (3rd Cir. 2000); *ANC Rental Corp. v. Tarrant Cnty.*, 316 B.R. 150 (Bankr. D. Del. 2004) (exhaustion of state administrative tax remedies required). Likewise, if the tax was contested judicially before filing, the bankruptcy court

evinces a clear intent that it is to be preclusive on the issue of fraud. *In re Boddiford*, 312 B.R. 827 (Bankr. W.D. Va. 2004).

⁴³ Under the Code, upon the locality's request, the Clerk is required to maintain a list of the local government's address for service of request for determination of tax liability. 11 U.S.C. § 505 (b)(1).

should not allow the debtor to relitigate what the debtor failed to achieve in state court. 11 U.S.C. § 505(a)(2)(A); *In re Bennett*, 80 B.R. 800 (Bankr. E.D. Va. 1988) (refusing to relitigate dischargeability of debt where default judgment previously granted by state court). A bankruptcy court does have the power to allocate tax payments to specific years and accounts. *In re M.C. Tooling Consultants*, 165 B.R. 590 (Bankr. D.S.C. 1993).

An objection to a proof of claim is a contested motion and must be served in compliance with Rule 3007 of the Federal Rules of Bankruptcy Procedure. Rule 3007 requires the objecting party to provide notice and an opportunity for a hearing on the objection. Importantly, where an objection is not properly served and the defending party does not receive actual notice of the objection, the defending party is deprived of its due process rights and any subsequent order disallowing the proof of claim is void ab initio. *Monk v. LSI Title Co. of Ore.* (*In re Monk*), No. 10-6067-fra (D. Ore. Aug. 9, 2013).

Under Rule 3012, a request to determine the amount of a secured claim of a governmental unit may be made only by motion or in a claim objection, but not until the governmental unit has filed a proof of claim or its time for filing a proof of claim has expired. Under Rule 7001, such a determination does not require an adversary proceeding.

14-5.02 Plan of Reorganization

The debtor in a Chapter 11 case must have its Plan of Reorganization approved by the creditors. Because creditors who will be paid in full are not able to vote on the plan, those who receive a ballot should check the plan to make sure they are properly classified. Priority tax claims and governmental secured claims that would be priority claims but for their secured status in Chapter 11 must be paid over no more than five years from the date of petition, with interest, and the terms must be at least as favorable as those of the most favored nonpriority unsecured claim. 11 U.S.C. § 1129(a)(9)(C); *In re Architectural Design, Inc.*, 59 B.R. 1019 (W.D. Va. 1986) (providing for interest at the federal statutory rate for unpaid debts to the IRS). Under § 511, the locality's interest rate for unpaid taxes should apply.

Usually, a plan of reorganization cannot be confirmed unless each impaired class of creditor agrees.⁴⁴ In certain circumstances, a debtor may "cram down" creditors, forcing confirmation of the plan. 11 U.S.C. §§ 1129(b) and 1325(a)(5); see *In re Bate Land & Timber LLC*, 877 F.3d 188 (4th Cir. 2017) ("cram down" allowed when bankruptcy court found that a transfer of land in lieu of payment of debt (dirt-for-debt) was the "indubitable equivalent" of the claimed debt); cf. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 132 S. Ct. 2065 (2012) (debtors cannot obtain confirmation of a Chapter 11 cram down plan that provides for the sale of collateral free and clear of a bank's lien, but does not permit the bank to credit-bid (use the debt to offset the purchase price) at the sale). If the debtor is an individual and an unsecured creditor objects to the plan, the plan may still be confirmed if the plan provides for payment of the claim in full or for payment that is no less than the projected disposable income as computed under § 1325(b)(2) during the period for which the plan provides payments, or five years, whichever is longer. 11 U.S.C. § 1129(a)(15); *Ransom v. FIA Card Servs.*, 562 U.S. 61, 131 S. Ct. 716 (2011) (holding no car ownership allowance when calculating disposable income if no loan or lease payments are due); *Hamilton v. Lanning*, 560 U.S. 505, 130 S. Ct. 2464 (2010) (under Reform Act, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation); *In Re Quigley*, 673 F.3d 269 (4th Cir. 2012) (following *Lanning*).

⁴⁴ Only holders of allowed claims may vote. See *Jacksonville Airport, Inc. v. Michkeldel, Inc.*, 434 F.3d 729 (4th Cir. 2006) (failure to contest objection to claim meant claim was not allowed, even if objection was invalid or void; therefore, creditor could not vote).

Secured creditors, even if “crammed down,” retain their lien, and if not paid in full upon confirmation of the plan, receive interest at prime plus an adjustment for the risk of nonpayment. *Till v. SCS Credit Corp.*, 541 U.S. 465, 124 S. Ct. 1951 (2004) (plurality opinion) (rejecting coerced loan, presumptive contract rate, and cost of funds approaches). Classifying an IRS lien as “contingent,” a bankruptcy court “crammed down” a Chapter 11 confirmation plan, ruling that the validity of the lien could be resolved post-confirmation. The district court held that the bankruptcy court had no authority to “cram down” the plan under those circumstances. Before a plan can be crammed down, the debtor must show by clear and convincing evidence that the plan is fair and equitable. To be fair and equitable, secured claim holders must retain their liens. The bankruptcy court had no authority to label one as contingent. *United States v. Woodway Stone Co.*, 187 B.R. 916 (W.D. Va. 1995); see also *In re Stewart*, 172 B.R. 14 (W.D. Va. 1994) (finding plan should not have been confirmed where § 1325 requirements not met in Chapter 13 proceeding). *But see In re Deel*, 213 B.R. 112 (Bankr. W.D. Va. 1997) (Chapter 13 plan confirmed despite classification of IRS lien as contingent and unliquidated; court held Plan could be modified pursuant to § 1329 when adversary proceeding addressing validity of lien decided).

Additionally, in order to be “fair and equitable,” a proposed plan must provide that

the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.

11 U.S.C. § 1129(b)(2)(B)(ii). Known as the absolute priority rule, this provision essentially requires that, “if the proposed plan allow[s] the debtor to retain property, any dissenting creditors must be paid in full in order for the plan to be ‘crammed down.’” *In re Maharaj*, 681 F.3d 558 (4th Cir. 2012). In the case of individual debtors, the Fourth Circuit found that a debtor cannot cram down a proposed plan that provides for the retention of pre-petition property by the debtor, unless all creditors will be paid in full. However, the plan sought to be crammed down may allow for the retention of post-petition property.⁴⁵

The Code provides that the plan can be confirmed if, with regard to the secured claims, the debtor “surrenders” the property securing the claim to the lien holder. 11 U.S.C. § 1325(a)(5)(C). In *In re White*, 487 F.3d 199 (4th Cir. 2007), the court held that property is not surrendered if the holder must resort to adversarial litigation to obtain physical possession of the property or can only obtain possession post confirmation.

Chapter 13 debtors must have their plans approved by the trustee and by the court. 11 U.S.C. § 1325(b). A Chapter 13 plan must address the rights of each secured creditor individually by setting out the mode of satisfying that claim in relation to the

⁴⁵*Maharaj* recognized a split in authority regarding an amendment to the absolute priority rule, which added the following italicized language to 11 U.S.C. § 1129(b)(2)(B)(ii): “the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, *except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.*” The “broad view” courts interpreted that amendment to mean that Congress intended to include the entirety of the bankruptcy estate as property that the individual debtor may retain, thus effectively abrogating the absolute priority rule in Chapter 11 for individual debtors. The “narrow view” courts have held that Congress did not intend such a sweeping change to Chapter 11, and that the Reform Act amendments merely have the effect of allowing individual Chapter 11 debtors to retain property and earnings acquired after the commencement of the case that would otherwise be excluded under § 541(a)(6) and (7). The Fourth Circuit adopted the narrow view, holding that an individual creditor could not cram down a plan and retain pre-petition property.

secured creditor's collateral. The holder of a secured claim must accept the plan. 11 U.S.C. § 1325(a)(5) (requiring an analysis for "each allowed secured claim provided for by the plan"). No parallel provision exists for unsecured creditors' claims, so whether an unsecured creditor "consents" to a Chapter 13 plan is irrelevant for purposes of plan confirmation. *LVNV Funding, LLC v. Harling*, 852 F.3d 367 (4th Cir. 2017).

If the trustee or an unsecured creditor objects to confirmation of the plan, the plan must either fully pay the unsecured claim or provide that all the debtor's "projected disposable income" to be received during the "applicable commitment period"⁴⁶ will be applied to make payments to unsecured creditors.⁴⁷ 11 U.S.C. § 1325(b)(1). A tax that is not included in the Chapter 13 plan, where a proof of claim has been filed, is not dischargeable. *In re Doane*, 19 B.R. 1007 (W.D. Va. 1982) ("[T]he discharge of debts in a Chapter 13 case only discharges those debts which were included in the plan"); 11 U.S.C. § 1327(a). However, debtors may pay less than 100 percent of nondischargeable debt under their plans. 11 U.S.C. § 523. When this scenario occurs, the balance should be paid after the conclusion of the case unless the debtor receives a hardship discharge, 11 U.S.C. § 1328(b), which expunges the remaining debt, except for certain debts exempt under § 1328(c). *In re Anderson*, 228 B.R. 844 (Bankr. W.D. Va. 1998) (trust fund tax for which no claim was filed not discharged pursuant to a § 1328(b) hardship discharge in a Chapter 13 case). Upon completion of the plan payments, the debtor is given a "super discharge" of all debts provided for by the plan.⁴⁸ 11 U.S.C. § 1328(a); *In re McAloon*, 44 B.R. 831 (Bankr. E.D. Va. 1984) (only dischargeable debts under Chapter 13 are those provided for under § 1322(b)(5) and those found in § 523(a)(5)). A Chapter 13 plan may, upon agreement, include post-petition debts, such as taxes, incurred before the plan is confirmed. 11 U.S.C. § 1305(a)(1).

If the debtor files for bankruptcy without listing a debt, the debtor later may file an amendment to add the omitted debt and allow additional time to file the corresponding proof of claim.

Pursuant to Bankruptcy Rule 7001(6), courts may only make an undue hardship determination through an adversarial proceeding. Accordingly, absent such a proceeding, courts should not confirm a Chapter 13 plan that provides for discharge of otherwise nondischargeable debt. See 11 U.S.C. § 523(a)(8) (delineating undue hardship discharge for educational loans) and § 1325(a) (instructing a bankruptcy court to confirm a plan only if the court finds that the plan complies with the applicable provisions of the Code); see also *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 130 S. Ct. 1367 (2010) ("[T]o comply with § 523(a)(8)'s directive, the bankruptcy court must make an independent

⁴⁶ The "applicable commitment period" is an obligatory period of time a confirmed Chapter 13 plan will remain in effect, which may vary based on the debtor's income and plan provisions, i.e., a "freestanding plan length requirement." "[F]or purposes of plan modification, the applicable commitment period appears to serve as a measure of plan duration wholly unrelated to debtors' disposable income." *Pliler v. Stearns*, 747 F.3d 260 (4th Cir. 2014). If a debtor wants an early discharge before the end of the commitment period, he must obtain a modification of the confirmed plan. *In re Niday*, 498 B.R. 83 (Bankr. W.D. Va. 2013).

⁴⁷ While Social Security income is excluded from the calculation of "projected disposable income," in evaluating whether a debtor will be able to make all payments under the plan and comply with the plan, the bankruptcy court must take into account any Social Security income the debtor proposes to rely upon, and may not limit its feasibility analysis by considering only the debtor's "disposable income." *Mort Ranta v. Gorman*, 721 F.3d 241 (4th Cir. 2013). In *Mort Ranta*, the court allowed the consideration of Social Security income to effectuate the debtor's plan, and in *In re Riggs*, 495 B.R. 704 (Bankr. W.D. Va. July 9, 2013), the bankruptcy court's consideration of Social Security income in a Chapter 7 "totality of circumstances" analysis resulted in the dismissal of the petition as an abuse of discretion.

⁴⁸ Section 1328(a)(2) does not allow discharge of trust fund taxes, taxes where the returns were not filed or filed late, and taxes which the debtor willfully tried to evade or defeat.

determination of undue hardship before a plan is confirmed, even if the creditor fails to object or appear in the adversary proceeding.”)

Claims not scheduled to be paid in full under the plan at the time of plan confirmation are considered impaired. An impaired creditor may object to the plan unless “crammed down” pursuant to 11 U.S.C. § 1325(a)(5)(B)(ii). The IRS routinely objects to plans that pay less than 100 percent of the claim, do not provide equal treatment compared with other creditors in the same class,⁴⁹ or fail to provide for interest. If elements of a plan are objectionable, and the debtor is unwilling to negotiate, creditors may wish to work with others similarly situated to maximize resources. Local rules will dictate how to file an objection to the plan, and many jurisdictions allow for the filing of objections and responsive pleadings by local government attorneys without requiring pro hac vice admission or local representation.

While noting that the Fourth Circuit has not addressed the issue, a district court held that post-petition payments of a mortgage debt, a long-term debt, whether paid directly or through the trustee, are treated as paid “under the plan” when the plan also provides for the curing of pre-petition arrears on the debt. *Evans v. Stackhouse*, 564 B.R. 513 (E.D. Va. 2017) (no discharge granted).

14-5.03 Objecting to Plans

The importance of objecting to plans of reorganization that inappropriately prejudice a locality’s secured or priority claims cannot be overstated. Frequently, debtors will include provisions in plans that unduly prejudice locality claims. This may be due to ignorance of the first priority status of certain locality liens, or, alternatively, in the hope that localities will either overlook or fail to comprehend objectionable plan provisions. While courts have a duty to confirm a plan “only if the court finds, inter alia, that the plan complies with the applicable provisions of the Code,” *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 130 S. Ct. 1367 (2010), courts will accept certain otherwise objectionable provisions and confirm a plan if it is accepted by secured or impaired claimholders, see 11 U.S.C. §§ 1129(a)(7), 1325(a)(5). See also *In re Reg'l Bldg. Sys., Inc.*, 254 F.3d 528 (4th Cir. 2001) (finding secured creditor bound by Chapter 11 plan to which it failed to object); *In re Rosa*, 495 B.R. 522 (Bankr. D. Haw. 2013) (finding creditors “accepted” Chapter 13 plan to which they were provided notice and they did not object); *In re Maddox*, No. 13-31273 (Bankr. E.D. Tenn. July 11, 2013) (“failure by a secured creditor to object to confirmation of a plan which provides for the treatment of its secured claim in a manner contrary to § 1325(a)(5)(B) constitutes an acceptance by the creditor of the plan”).

14-5.04 Duties of the Trustee

In most Chapter 11 cases, the court does not appoint a trustee. The debtor operates as a debtor-in-possession. Most courts have appointed a standing trustee for all Chapter 13 cases. All Chapter 7 cases have a court appointed trustee. The trustee’s duties include:

- recovering assets⁵⁰
- accepting and reviewing proofs of claim
- operating the debtor’s business
- distributing assets, including abandonment and return of property

⁴⁹ For example, paying certain secured creditors in full while deferring IRS payments. If the debtor were to liquidate (convert from a Chapter 11 to a Chapter 7 case) in a year or so, the other secured creditors already would be paid in full, while the taxing authority would have to write off much of its claim.

⁵⁰ Although it recognized a split in authority, the federal district court in *Mitrano v. United States*, 468 B.R. 795 (E.D. Va. 2012), held that a debtor cannot exercise avoidance powers in concurrence with the trustee.

Those who have not received payment as scheduled in the debtor's plan should contact the trustee. Because trustees are required to report on tax matters for the estate, 11 U.S.C. §§ 704(8) and 1106(a)(6), they should work with localities to see that the debtor files returns and pays taxes in a timely fashion. A trustee who fails to pay required taxes when funds are available may have personal liability if the assets of the estate later dissipate. *In re El San Juan Hotel Corp.*, 847 F.2d 931 (1st Cir. 1988).

The Office of the United States Trustee was established to monitor the performance of the case trustee. If the case trustee is not found helpful, one may also contact the U.S. Trustee for assistance. The contact information for the U.S. Trustees in Virginia may be accessed through the Justice Department [website](#).

14-5.04(a) Avoidance of Liens

As a general rule, liens pass through the bankruptcy process unaffected. *Cen-Pen Corp. v. Hanson*, 58 F.3d 89 (4th Cir. 1995). A bankruptcy discharge extinguishes only *in personam* claims against the debtor(s) but generally has no effect on an *in rem* claim against the debtor's property. To extinguish or modify a lien, the debtor must take some affirmative step toward that end. Bankruptcy Rule 7001(2) specifies the appropriate affirmative step: an adversary proceeding to extinguish or modify a lien. *Id.* A plan that lists tax debts with less favorable priority than specified in the proof of claim is not a sufficient affirmative step to modify the lien. Instead, the debtor must give specific notice of intent to accord liens less than full protection. *In re Deutchman*, 192 F.3d 457 (4th Cir. 1999); *see also Keene v. Charles*, 222 B.R. 511 (E.D. Va. 1998) (lien not avoided because of failure to invoke adversary proceeding), *aff'd mem.*, 178 F.3d 1284 (4th Cir. 1999). However, confirmation in a Chapter 11 case, unlike in a Chapter 13 case, extinguishes liens on property dealt with under the plan that are not expressly preserved in the plan, subject to certain exceptions. Rule 1141(c); *In re Reg'l Bldg. Sys., Inc.*, 254 F.3d 528 (4th Cir. 2001); *see section 14-6.03(b)*.

In *Coleman v. Community Trust Bank*, 426 F.3d 719 (4th Cir. 2005), the Fourth Circuit overruled the district court, 299 B.R. 780 (W.D. Va. 2003), which had construed § 544(b) and § 550 together to determine that a fraudulent transfer (in that case, deeds of trust) could be avoided only to the extent it benefited the estate. The Fourth Circuit held that the recovery statute (§ 550) has no application if the transfer is successfully avoided under § 544. Instead, the avoidance is absolute and not limited to the extent it benefits the estate.

A perfected, nonavoidable tax lien based on an ad valorem tax on real or personal property is not subject to the subordination provisions of § 724(b), except to pay employee claims for wages, salaries, and commissions, and for contributions to employee benefit plans. Before subordinating non-ad valorem tax liens, a trustee must first exhaust other unencumbered assets and surcharge other secured creditors, consistent with § 506(c), for the costs of preserving their assets. 11 U.S.C. § 724(b), (e), and (f).

If any documents from the court indicate a sale free and clear of liens,⁵¹ and taxes are owed on that property, the locality should call opposing counsel and the trustee to verify that the taxes will be paid (and confirm this understanding with a letter). If not, the locality should immediately file an objection to the motion.⁵² The locality also should file an amended proof of claim with the following suggested language:

⁵¹ This is generally accomplished through an adversary proceeding. *See* Fed. R. Bankr. P. 7001(2).

⁵² Before the October 22, 1994, amendments creating § 362(b)(18), post-petition statutory liens were prevented by the automatic stay, so post-petition real estate taxes were not affected by § 724. *In re Pad Enterprises*, 139 B.R. 516 (Bankr. D. Or. 1992); *In re Wendy's Food Sys.*, 117 B.R. 333

"This claim is secured under 11 U.S.C. § 506 to the extent of any value in the collateral to which the statutory lien attaches, and asserted as a priority claim to the extent of any deficiency."

Even if the lien is avoided, the debt may be preserved as a priority claim. Alternatively, the locality can list the initial claim as both secured and priority to the extent there is no security interest. Beware of a sale of property under § 363.⁵³ The trustee should (but often does not) ensure that the locality's lien attaches to the property or proceeds of sale. If the sale is "free and clear of all liens" the locality may lose its lien inadvertently without a true lien avoidance proceeding.⁵⁴ Similarly, localities should watch out for sale proposals that allow for credit bidding. A junior lienholder may credit bid on the property—thus giving the junior lienholder title to the property—and attempt to sell the property free and clear of senior tax liens outside of the bankruptcy procedure.

Trustees cannot avoid a statutory tax lien on personal property or real estate. 11 U.S.C. § 545(2). Judicial liens may be avoided, 11 U.S.C. § 522(f), but only to the extent that the debtor has a valid exemption that is impaired by the lien. See *Owen v. Owen*, 500 U.S. 305, 111 S. Ct. 1833 (1991) (superseded in part by § 522(f)(3); *Botkin v. DuPont Community Credit Union*, 650 F.3d 396 (4th Cir. 2011) (debtor can avoid a judicial lien even if there is no claimed exemption in the property subject to the lien). In some instances, a judicial lien also may be avoided by a Chapter 13 plan.⁵⁵ Accordingly, if a Chapter 13 plan provides for the stripping down of a locality's lien, the locality should obtain a copy of the plan, file a timely objection, and request a hearing.

However, the debtor does have the right to sell property, including the property subject to the tax assessment, free of debt through the court, provided there is adequate security for existing creditors, or the trustee otherwise meets the requirements of § 363(f).

In *In re Hamlett*, 322 F.3d 342 (4th Cir. 2003), the debtor argued that because the secured proof of claim was disallowed by the bankruptcy court, the lien was void pursuant to § 506. The court held that when a claim is disallowed merely because it was filed late, the lien is not avoided. A bankruptcy discharge extinguishes in personam claims against the debtors, and generally has no effect on an in rem claim against the debtor's property.

14-5.04(a)(1) Lien Stripping

For reorganization cases, a creditor with an allowed secured claim on collateral with a value less than the amount owed has two claims: a secured claim up to the value of the collateral, and an unsecured claim for the excess. The unsecured claim may be "stripped" by the plan

(Bankr. S.D. Ohio 1990). Section 724 now likely may be used to avoid even *post-petition* real estate tax liens.

⁵³ For a good discussion of the § 363(f) factors, see *In re Silver*, 338 B.R. 277 (Bankr. E.D. Va. 2004) (denying trustee's motion for sale free and clear of liens on basis that lienholders would not be paid in full through sale). Because it is questionable whether a judge would have sua sponte denied the trustee's sale motion in *Silver* if two secured creditors had not objected, *Silver's* holding does not obviate the need for localities to object to a sale free and clear of liens that does not indicate their liens will be paid from the sale proceeds.

⁵⁴ But see *In re Harold & Williams Dev. Co.*, 163 B.R. 77 (Bankr. E.D. Va. 1994), where the court ordered disgorgement of sale proceeds to the taxing authority *after* disbursement.

⁵⁵ Compare *In re Williams*, 166 B.R. 615 (Bankr. E.D. Va. 1994) (holding that debtor can provide for avoidance of lien in Chapter 13 plan without instituting adversary proceeding under Rule 4003(d)) with *Wright v. Comm. Credit Corp.*, 178 B.R. 703 (E.D. Va. 1995) (finding adversary proceeding necessary to determine creditor's status as secured or unsecured based on valuation of property underlying lien). Subsequently, Rule 4003(d) was amended to provide that a request under § 522(f) to avoid a lien or other transfer of exempt property may be made by motion or by a Chapter 12 or 13 plan. An adversary proceeding continues to be required for lien avoidance not governed by Rule 4003(d).

of reorganization unless the creditor elects to allow the lien to remain on the secured portion, while relinquishing the unsecured deficiency. 11 U.S.C. §§ 506(a) and 1111(b); *Dever v. IRS (In re Dever)*, 164 B.R. 132 (Bankr. C.D. Cal. 1994). Because of the priority in payment accorded real estate tax liens in Virginia, lien stripping of real property tax liens is unlikely here. *In re Leedy*, 230 B.R. 678 (Bankr. E.D. Va. 1999).

Debtors generally may not use § 506(a) and § 506(d) to strip down unsecured liens in Chapter 7 or Chapter 13 cases. *Dewsnup v. Timm*, 502 U.S. 410, 112 S. Ct. 773 (1992); *In re Ryan*, 725 F.3d 623 (7th Cir. 2013) (holding “the [Supreme] Court’s interpretation of § 506(d) in *Dewsnup* applies in Chapter 13 cases as well”); *Crossroads of Hillsville v. Payne*, 179 B.R. 486 (W.D. Va. 1995) (interpreting *Dewsnup* and holding that Chapter 7 lien stripping not allowed and that post discharge an in rem (but not a personal) action can be brought on the debt).

Although some courts had drawn a distinction between “stripping down” and “stripping off” a junior lien whose full value was completely in excess of the value of the collateral, the Supreme Court in *Bank of America v. Caulkett*, 575 U.S. 790, 135 S. Ct. 1995 (2015), held that *Dewsnup*’s construction of “secured claim” in § 506(d) prevails in Chapter 7 cases even if the value of the collateral available to secure the lien is zero. Under *Dewsnup*’s definition of “secured claim,” § 506(d)’s function is reduced to voiding a lien whenever a claim secured by the lien itself has not been allowed. The Court stated it was bound by *Dewsnup* as the parties had not asked for it to be overruled even though it found that construction in conflict with “a straightforward reading of the statute.”

What is forbidden in a Chapter 7 case under § 506 may be allowable under § 1322 in a Chapter 13 case. In *In re Davis*, 716 F.3d 331 (4th Cir. 2013), the Fourth Circuit held that a bankruptcy court may strip off a valueless lien in a typical Chapter 13 proceeding pursuant to § 1322(b)(2). See *Burkhart v. Grigsby*, 886 F.3d 434 (4th Cir. 2018) (under Chapter 13, a lien that is entirely without value may be stripped regardless of whether a proof of claim has been filed).

The *Davis* court went on to hold that the Reform Act does not preclude the stripping off of valueless liens by Chapter 20 (see section 14-1.01(f)) debtors ineligible for a discharge. However, stripping down, i.e., reducing a lien to the value of the collateral, is not allowed for liens secured by real property that is the debtor’s principal residence under Chapter 13. See 11 U.S.C. § 1322(b)(2); *Anderson v. Hancock*, 820 F.3d 670 (4th Cir. 2016) (addressing whether an interest rate reversion to a pre-default rate contrary to promissory note terms would be an impermissible modification or a permitted curing of a default and holding that it would be an impermissible modification); *Birmingham v. PNC Bank (In re Birmingham)*, 846 F.3d 88 (4th Cir. 2017) (inclusion of miscellaneous proceeds, escrow funds, and insurance proceeds in a deed of trust is incidental property and does not constitute additional collateral that waives the anti-modification provision). In *In re Dean*, 319 B.R. 474 (Bankr. E.D. Va. 2004), the court held that the date of valuation of real property for the purpose of determining if a junior lien is wholly unsecured is the date of the petition. Accord *In re Reconco*, No. 13-10564-RGM (Bankr. E.D. Va. Mar. 31, 2014); *Pierce v. New Generations Fed. Credit Union (In re Pierce)*, No. 10-35404 (Bankr. E.D. Va. May 24, 2012). A bankruptcy court lacks authority in a Chapter 13 proceeding to strip off a valueless lien on property held in a tenancy by the entirety, when only one tenant spouse filed a bankruptcy petition. *In re Alvarez*, 733 F.3d 136 (4th Cir. 2013). Compare *In re Bunker*, 312 F.3d 145 (4th Cir. 2002), in which the court of appeals held that property held as tenants in the entirety by husband and wife debtors who filed joint Chapter 7 petitions was exempt from their individual creditors, even if the cases were subsequently substantively consolidated. See also *In re Mandehzadeh*, 515 B.R. 300 (Bankr. E.D. Va. 2014) (*Alvarez* applies even if the non-filing spouse is not liable on the note secured by the lien); *In re Anderson*, 603 B.R. 564 (Bankr. W.D. Va. 2019) (trustee may not sell both the estate’s and non-debtor co-owner’s interest in property held by tenants in the entirety).

unless the benefit to the estate outweighs the detriment to co-owner, which is not the case when proceeds would go to unsecured creditors of debtor only); *Lopez v. Specialized Loan Servicing (In re Lopez)*, No. 19-32600 (Bankr. E.D. Va. 2019) (lien may be stripped off property held by joint tenancy with right of survivorship to service debt of one tenant regardless of whether joint tenant also filed bankruptcy).

14-5.04(b) Abandonment of Property

A trustee or debtor in possession may abandon property of the estate if that property is not essential to the debtor's reorganization, has inconsequential value, or is so encumbered or burdensome as to have no benefit to the estate. 11 U.S.C. § 554; Fed. R. Bankr. P. 6007. Abandoned property, unless claimed by an interested party through court proceedings, reverts to the debtor. *In re McGowan*, 95 B.R. 104 (Bankr. N.D. Iowa 1988); see *In re Ahearn*, 318 B.R. 638 (Bankr. E.D. Va. 2003) (property cannot be abandoned if not scheduled even if trustee aware of asset); *Kocher v. Campbell*, 282 Va. 113, 712 S.E.2d 477 (2011) (when inchoate personal property action was exempted from estate, it was not abandoned and left unadministered by the trustee at the close of the bankruptcy case so as to revert to the debtor); see also *Siok v. Turner*, No. CL10-3665 (City of Richmond Cir. Ct. May 3, 2012) and *Battle v. City of Richmond*, 84 Va. Cir. 230 (City of Richmond 2012) (also addressing exemption and abandonment). Because the debtor is still protected by the automatic stay, the preferred course of action is to move the court to lift the stay before taking action against the property. Collection efforts may be commenced for taxes or other debts assessed against that property (in rem, not in personam, action). *Unisys Corp. v. Dataware Prods., Inc.*, 848 F.2d 311 (1st Cir. 1988). A problem often arises in the Eastern District since Local Rule 6007 does not require the trustee to notify creditors which property has been abandoned. Outside of creditor's meetings, creditors will not learn that assessed property was abandoned until the trustee objects to the tax claim when Chapter 7 assets are distributed. By that time, the property has been sold to a bona fide purchaser or has lost much of its value, leaving the locality with a lien of little, if any, value.

14-5.04(c) Preferences

Generally, a payment made to or for the benefit of a creditor⁵⁶ within ninety days of the filing of the bankruptcy petition for an antecedent debt while the debtor was insolvent that enables a creditor to receive more than it would receive if the case were filed under Chapter 7 is a preferential transfer and may be recovered by the trustee. 11 U.S.C. § 547(b). Importantly, payments made in the ordinary course of business (including timely paid taxes and utility bills) are not avoidable. 11 U.S.C. § 547(c)(2); *In re ESA Envt'l Specialists*, 709 F.3d 388 (4th Cir. 2013) (addressing preferential payments and the defenses of "earmarking," "new value," and equity). Under the Bankruptcy Code, a payment will not be subject to set aside as a preference if it was made either in the ordinary course of the business of the debtor and the transferee or according to ordinary business terms. 11 U.S.C. § 547(c)(2). Similarly, payments that constitute contemporaneous exchange for new value (which includes the release of first-priority liens on the property) are not avoidable. *Id.* § 547(c)(1). Generally, payment of a debt with accrued penalty and interest is *not* in the ordinary course of business. *In re Valley Steel Products Co.*, 214 B.R. 202 (E.D. Mo. 1997). Payment by the debtor of a secured or priority tax should not be considered a preference. *In re Sin-ko, Inc.*, 72 B.R. 651 (Bankr. N.D. Ohio 1987). Preference actions generally must be filed within two years after entry of the order of relief. 11 U.S.C. § 546(a).

⁵⁶ Interestingly, § 547(b)(1) does not require an *intent* to benefit a creditor, only that the transfer actually benefited a creditor. Thus, a debtor's payment to a senior lienholder during the preference period that increases the debtor's equity in collateral securing the claim of a junior lienholder, thereby increasing the securitization of the junior creditor, may constitute a preferential transfer subject to avoidance, even though the senior creditor did not receive more than it would have under Chapter 7. *In re Vassau*, 499 B.R. 864 (Bankr. S.D. Ca. 2013).

A tax lien issued before the debtor files for bankruptcy attaches to all funds accumulated or held pre-petition even if the monies have not been paid over and is not a preference. 11 U.S.C. § 547(c)(6).

14-5.04(d) Homestead Exemptions

Bankruptcy law permits the debtor to claim certain exemptions against assets available for distribution to creditors. 11 U.S.C. § 522(d). Virginia chose not to permit debtors to claim the federal exemptions. Va. Code § 34-3.1. Of the state exemptions, Va. Code § 34-3 provides that they “shall not extend to distress for state or local taxes or levies.” To qualify for an exemption from non-tax debts, the debtor must file a homestead deed and a schedule of exempt property with the bankruptcy petition. Va. Code § 34-4 et seq. However, if the property is claimed exempt under Chapter 11, the schedule of exempt property is sufficient to claim the homestead exemption. Va. Code § 34-6. If the property is out of state, the deed must be filed both in the county where the debtor lives and the county where the property is located. *Id.*; *In re McWilliams*, 296 B.R. 424 (Bankr. E.D. Va. 2002); *Ricketts v. Strange*, 293 Va. 101, 796 S.E.2d 182 (2017) (describing the level of specificity with which an asset must be identified in a debtor's schedules to exempt it from the bankruptcy estate). If the deed is timely delivered and fees are paid, the property is properly set aside for bankruptcy purposes even if the deed was not recorded by the clerk in time. *In re Nguyen*, 211 F.3d 105 (4th Cir. 2000).

In *Sheehan v. Peveich*, 574 F.3d 248 (4th Cir. 2009), the trustee claimed a West Virginia state law that provided for certain debtors' exemptions only in bankruptcy proceedings was preempted under the Supremacy Clause as contrary to the distributive scheme of the Bankruptcy Code. The Fourth Circuit upheld the state scheme finding that § 522(b)(1) affords states the authority to restrict their respective residents to exemptions promulgated by state legislatures. A bankruptcy court may not order that a debtor's exempt assets be used to pay administrative expenses incurred as a result of the debtor's misconduct. *Law v. Siegel*, 571 U.S. 415, 134 S. Ct. 1188 (2014) (rejecting bankruptcy court's holding that § 105(a) and its inherent power to sanction abusive litigation practices enabled the court to make homestead exemption funds available to defray attorney's fees incurred in overcoming debtor's fraudulent misrepresentations). A debtor need not invoke an exemption to which the statute entitles him; but if he does, the court may not refuse to honor the exemption absent a valid statutory basis for doing so. *Id.*

Pursuant to 11 U.S.C. § 522(f)(1), a debtor “may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled” under subsection (b) of § 522. Thus, the Code provides that the debtor may avoid the fixing of certain liens that would impair an otherwise applicable homestead exemption. Importantly, only judicial liens and certain nonpossessory, nonpurchase-money security interests may be avoided under this provision. See 11 U.S.C. § 522(f)(1)(A), (B). Accordingly, a locality should object to any motions to avoid statutory liens (such as those for taxes or water and sewer services) under this provision. Moreover, pursuant to Virginia Code § 34-3, Virginia's homestead exemptions “shall not extend to distress or lien for state or local taxes or levies.”

14-5.04(e) Pursuing Legal Claims

A bankruptcy trustee “has capacity to sue and be sued” on behalf of the estate. 11 U.S.C. § 323(b). A debtor's right to bring a legal claim is part of the bankruptcy estate under § 541(a). *Vieira v. Anderson (In re Beach First Nat'l Bancshares, Inc.)*, 702 F.3d 772 (4th Cir. 2012).

For Chapter 7 cases, this standing to sue is exclusive to the trustee: “[i]f a cause of action is part of the estate of the bankrupt then the trustee alone has standing to bring that claim.” *Nat'l Am. Ins. Co. v. Ruppert Landscaping Co.*, 187 F.3d 439 (4th Cir. 1999); see also *Steyr-Daimler-Puch of Am. Corp. v. Pappas*, 852 F.2d 132 (4th Cir. 1988) (when a

"claim is property of the estate, the trustee is given full authority over it"); *Vanderheyden v. Peninsula Airport Comm'n*, No. 4:12cv46 (E.D. Va. Jan. 2, 2013) (Chapter 7 trustee has exclusive standing to all legal claims of the estate). The same is true for Chapter 11 cases. *Weyerhaeuser Co. v. Yellow Poplar Lumber Co.*, No. 1:13cv62 (W.D. Va. Jan. 3, 2017). If the trustee abandons a legal claim as worthless or low value, the debtor may prosecute the suit in her own name. *Martineau v. Wier*, 934 F.3d 385 (4th Cir. 2020) (holding debtor had standing to pursue tort claim abandoned by trustee). A Chapter 13 debtor, however, possesses standing—concurrent with that of the trustee—to maintain a non-bankruptcy cause of action on behalf of the estate. *Wilson v. Dollar Gen. Corp.*, 717 F.3d 337 (4th Cir. 2013).⁵⁷

An innocent trustee can pursue for the benefit of creditors a judgment or cause of action that the debtor fails to disclose in bankruptcy. This duty is not extinguished by the conclusion of the bankruptcy case, and the case may be reopened to give the trustee an opportunity to address the claim. *Haydu v. Tidewater Cmty. Coll.*, 268 F. Supp. 3d 843 (E.D. Va. 2017); *but see Ricketts v. Strange*, 293 Va. 101, 796 S.E.2d 182 (2017) (disallowing substitution of trustee to pursue personal injury action).

14-6 CLOSE OF THE CASE

14-6.01 Duration of Bankruptcy

Chapter 7 no asset bankruptcies in the Eastern District close in about six months (unless the debtor voluntarily dismisses the case) and rarely go beyond a year. Normally a reorganization bankruptcy can last no more than five years from the date the plan is approved. Once a debtor has been discharged from bankruptcy under Chapter 7 or 11, it may not receive another discharge for eight years after the case is closed. 11 U.S.C. § 727(a)(8).

Courts in Virginia usually will notify creditors when a case is closed. Creditors also may use a toll-free number (866-222-8029) or use PACER. If the case is awaiting a closing order, or the trustee's final report, it should close within a month.

14-6.02 Dismissal

A dismissal is not the same as a discharge. A debtor may dismiss a case at any time. See *In re Fisher*, No. 14-61076 (Bankr. W.D. Va. Mar. 19, 2015) (construing *Law v. Siegel*, 571 U.S. 415, 134 S. Ct. 1188 (2014), and refusing to impose a bad faith limitation on the absolute right of dismissal but also noting that other sanctions exist).

14-6.02(a) Dismissal of Chapter 13 Case

In a Chapter 13 case, any party in interest or the trustee may request dismissal for reasons specified in § 1307(c), which can be granted after notice and a hearing.⁵⁸

14-6.02(b) Dismissal of Chapter 7 Case

A bankruptcy court may dismiss a case under Chapter 7 "for cause" after notice and a hearing. 11 U.S.C. § 707(a). Although "cause" is not defined in the Bankruptcy Code, § 707(a) provides three non-exclusive causes: unreasonable delay by the debtor that is prejudicial to creditors, nonpayment of statutory fees, and the failure of the debtor to file the information required under § 521(a)(1) of the Code. *Id.* Most courts, including the Fourth Circuit, have held that "a debtor's bad faith in filing may constitute cause for

⁵⁷ Note that personal injury and wrongful death claims cannot be adjudicated by the bankruptcy court, but must be brought in the district court where the bankruptcy case is pending or where the claim arose. 28 USC § 157; *In re Ayers*, 581 B.R. 168 (Bankr. W.D. Va. 2018), *aff'd sub nom.*, *Ayers v. U.S. Dep't of Def.*, No. 00032 (W.D. Va. Aug. 30, 2019).

⁵⁸ In *No v. Gorman*, 891 F.3d 138 (4th Cir. 2018), the Fourth Circuit invalidated an Eastern District local rule that allowed the bankruptcy court to dismiss the case if the trustee certified that no payments had been made, holding that notice and hearing must be held.

dismissal under § 707(a).” *In re Robinson*, No. 18-31989 (Bankr. E.D. Va. March 17, 2023), quoting *Janvey v. Romero*, 883 F.3d 406 (4th Cir. 2018).⁵⁹

In a consumer Chapter 7 case, if a court finds abuse, it may dismiss⁶⁰ or, with the consent of the debtor, convert the Chapter 7 case to a case under Chapter 11 or 13. The statute sets forth a means-based test by which abuse can be presumed. 11 U.S.C. § 707(b); *Calhoun v. United States Trustee*, 650 F.3d 338 (4th Cir. 2011) (finding abuse as result of means test); *In re Dowd*, 607 B.R. 833 (Bankr. E.D. Va. 2019) (same; debtor’s post-petition purchase of new vehicle does not entitle her to new means test calculation); *In re Alther*, 537 B.R. 262 (Bankr. W.D. Va. Sept. 11, 2015) (to rebut the presumption of abuse, debtors must demonstrate not simply special circumstances but special circumstances which result in adjustment to the current monthly income calculation bringing it below statutory thresholds giving rise to the presumption of abuse); *In re Riggs*, 495 B.R. 704 (Bankr. W.D. Va. July 9, 2013) (consideration of Social Security income in a Chapter 7 “totality of circumstances” analysis under § 707(b)(3) resulted in the dismissal of the petition as an abuse of discretion); *In re Burdett*, No. 12-12066-BFK (Bankr. E.D. Va. Mar. 7, 2013) (“special circumstances” that affect abuse determination must be of a more severe nature than ordinary job changes or income fluctuations). Section 707(b) is applicable to converted Chapter 7 cases. *In re Reece*, 498 B.R. 72 (Bankr. W.D. Va. 2013).

Unless the case is dismissed with prejudice, the debtor can refile at any time. This allowance, of course, is subject to abuse. See *In re Doniff*, 133 B.R. 351 (Bankr. E.D. Va. 1991) (dismissing with prejudice upon finding that debtor’s filing was abusive). Even where bad faith is demonstrated, dismissal is the exception rather than the rule. See *Janvey v. Romero*, 883 F.3d 406 (4th Cir. 2018) (bad faith may constitute cause for dismissal under § 707(a), but the “bar for finding bad faith is a high one”); *Carolin Corp. v. Miller*, 886 F.2d 693 (4th Cir. 1989) (requiring showing of both objective futility and subjective bad faith to warrant dismissal). When a bankruptcy case is dismissed, it is as though the debtor was never in bankruptcy. See 11 U.S.C. § 349. No debts are wiped out, and the debtor is exposed to the full range of Virginia collection laws. Dismissal of prior filings may also alter the availability of the automatic stay in subsequent filings for individuals and small businesses. See section 14-2.01.

In *Colonial Auto Center v. Tomlin*, 105 F.3d 933 (4th Cir. 1997), the Fourth Circuit reversed the district court’s holding that a dismissal with prejudice of a prior bankruptcy petition rendered debts pending prior to dismissal nondischargeable in a later bankruptcy proceeding. The court of appeals held that the dismissal with prejudice had been intended by the bankruptcy court only to invoke the proscription barring the debtor from filing another petition within 180 days. Additionally, the court can fashion the dismissal with prejudice to bar refiling within a specified time period and assign other sanctions. See *In re Weaver*, 222 B.R. 521 (Bankr. E.D. Va. 1998) (prohibiting debtor from filing bankruptcy for twelve

⁵⁹ In *In re Robinson*, the debtor filed a voluntary chapter 13 case that included a rental property. After confirmation of the chapter 13 repayment plan, the rental property was destroyed by a fire and the debtor received a substantial insurance payment as a result of the fire. The debtor did not disclose the fire to the Chapter 13 Trustee until the case was converted to chapter 7, approximately seventeen months after the debtor received the proceeds. When disclosing the insurance proceeds, the debtor failed to inform the Trustee that the proceeds greatly exceeded the payoff on the lien for the rental property. The debtor expended nearly \$80,000 in insurance proceeds with only a few thousand dollars in proceeds remaining before she sought to convert her case to chapter 7. The court, considering the totality of the circumstances, found that the debtor failed to act in good faith and therefore dismissed the bankruptcy case pursuant to 11 U.S.C. § 707(a).

⁶⁰ An order denying a trustee’s motion to dismiss a debtor’s Chapter 7 case as abusive under 11 U.S.C. § 707(b) is a final and appealable order. *McDow v. Dudley*, 662 F.3d 284 (4th Cir. 2011). A bankruptcy court’s order denying confirmation of a debtor’s proposed repayment plan is not a final order that the debtor can immediately appeal. *Bullard v. Blue Hills Bank*, 575 U.S. 496, 135 S. Ct. 1686 (2015).

months and ordering permanent denial of discharge in bankruptcy of debt to specific creditor due to debtor's flagrant abuse of the bankruptcy process).

If conditions have changed in ways that make a return to the pre-petition status quo difficult or impossible, a bankruptcy court, for cause, may alter the dismissal's ordinary restorative consequences through what is called a "structured dismissal."⁶¹ A distribution scheme ordered in connection with such a structured dismissal cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distributions of estate value in business bankruptcies. *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 137 S. Ct. 973 (2017).⁶²

When a bankruptcy action is dismissed, a creditor is ordinarily allowed to levy on individuals who possess the debtor's property. Finding that the Bankruptcy Code conflicts with and thus preempts a Virginia statute that allows service on a trustee (Va. Code § 63.2-1929; child support), the Fourth Circuit held that the rule does not apply to property held by a trustee in a Chapter 13 case. Pursuant to § 1326(a)(2), the trustee is obligated to return all funds held to the debtor. *Dep't of Soc. Servs., Div. of Child Support Enf't v. Webb*, 908 F.3d 941 (4th Cir. 2018).

14-6.03 Discharge and Exceptions to Discharge

Courts usually send a notice of discharge of debtor to all listed creditors. This informs creditors that the automatic stay is lifted and all unsecured debts are discharged. Once creditors are notified that a bankruptcy case is closed or dismissed, and the debtor is discharged, normal collection action can resume on both post-petition and nondischarged pre-petition debts. Creditors are barred from attempting to collect any debt covered by the discharge order. 11 U.S.C. § 524(a)(2). When there has been an alleged violation of the order, a creditor may be held in civil contempt only if there is "no fair ground of doubt as to whether the discharge order barred the creditor's conduct." *Taggart v. Lorenzen*, 587 U.S. ___, 139 S. Ct. 1795 (2019). A creditor's subjective belief that it was in compliance with the order will not insulate it from civil contempt if the belief was objectively unreasonable. *Id.*; see also *Skaggs v. Gooch*, 644 B.R. 149 (Bankr. W.D. Va. 2022) (holding creditor in civil contempt because, at the time it pursued collection of debt, there was no "objectively reasonable" basis for belief that it had not been discharged); *Adams v. Hall*, No. 17-33303 (Bankr. E.D. Va. June 23, 2023) (lienholder had sufficient knowledge to warrant finding of civil contempt for violating discharge injunction where his counsel filed counterclaim for deficiency judgment in debtor's state court action and there was no evidence contrary to debtor's testimony that lienholder was aware of the counterclaim when it was filed). The Fourth Circuit held that the *Taggart* standard applies equally to civil contempt in Chapter 7 and Chapter 11 contexts. *Beckhart v. Newrez LLC*, 31 F.3d 274 (2022).

Bankruptcy has res judicata effects. See *Providence Hall Assocs. L.P. v. Wells Fargo Bank, N.A.*, 816 F.3d 273 (4th Cir. 2016) (as asset sales that were used to satisfy debtor's obligations to lender were final orders on the merits, res judicata barred subsequent suit alleging lender liability based on false representations and sham transactions); *Covert v. LVNV Funding, LLC*, 779 F.3d 242 (4th Cir. 2015) (res judicata barred suit alleging violation of federal Fair Debt Collection Practices Act); compare *LVNV Funding, LLC v. Harling*, 852 F.3d 367 (4th Cir. 2017) (*Covert* did not hold that confirmation of a Chapter 13 plan is a final adjudication of the merits of all creditor claims filed prior to entry of the confirmation order; confirmed plan had no res judicata effect on later objection to unsecured creditor's

⁶¹ The Bankruptcy Code does not expressly mention structured dismissals. Section 349(b) states that "unless the court, for cause, orders otherwise," a dismissal reinstates the status quo. In practice, bankruptcy courts have used this authority to impose a hybrid dismissal and confirmation order that typically dismisses the case while approving certain distributions and not necessarily unwinding transactions undertaken during the case.

⁶² The Court expressly did not rule on the legality of structured dismissals in general.

claim). A generic reservation of rights clause in a Chapter 11 plan was insufficient to avoid the res judicata effect of bankruptcy on a pre-petition claim in *Bill Greever Corp. v. Tazewell National Bank*, 256 Va. 250, 504 S.E.2d 854 (1998). See also *In re Delph*, No. 19-07024-SCS (Bankr. E.D. Va. June 7, 2021) (where there is no evidence that state court considered documentary evidence or heard testimony regarding debtor's alleged fraud, conversion, conspiracy, and defamation, bankruptcy court cannot conclude the factual issues were "actually litigated" as necessary to grant summary judgment and enter nondischargeability judgment). Res judicata barred a taxpayer from seeking an income tax refund for taxes paid pursuant to a settlement with the IRS during bankruptcy proceedings. *Holywell v. United States*, No. 97-0131-C (W.D. Va. Aug. 25, 1998), *aff'd mem.*, 229 F.3d 1142 (4th Cir. 2000); *In re Ascue*, No. 93-01085 (Bankr. W.D. Va. Aug. 17, 2021) (res judicata barred debtor from seeking "another bite at the apple" regarding grounds for appeal of superior court's finding of nondischargeability of debt).

Judicially confirmed arbitration awards also have preclusive effects in bankruptcy dischargeability proceedings. *In re NGO*, No. 20-12224-BFK (Bankr. E.D. Va. July 2, 2021). Therefore, if they address the same issues as those under decision by the bankruptcy court, they are entitled to collateral estoppel. *Id.* Moreover, any debt caused by willful and malicious injury is not dischargeable, nor is any debt that is the result of the debtor's embezzlement, larceny, or fraud while acting in a fiduciary capacity. *Id.*; 11 USC §§ 523(a)(6) and 523(a)(4). In *In re NGO*, the arbitrator's findings related to the debtor's misappropriation of her employer's trade secrets were entitled to collateral estoppel as to the issues of the debtor's willful and malicious conduct and fraud while acting in a fiduciary capacity for purposes of the Bankruptcy Code dischargeability exceptions. Therefore, the judgment of the arbitrator, awarding attorney's fees and costs in the trade secrets case, was non-dischargeable pursuant to §§ 523(a)(6) and (a)(4).

14-6.03(a) Effect on Taxes

For individuals,⁶³ recently incurred tax claims generally are not dischargeable in bankruptcy.⁶⁴ 11 U.S.C. § 523(a)(1). Except in a Chapter 13 case, priority taxes are nondischargeable even if a proof of claim is not filed. 11 U.S.C. § 523(a)(1)(A); *Grynberg v. United States (In re Grynberg)*, 986 F.2d 367 (10th Cir. 1993). Taxes for which a return, or equivalent report or notice, was not filed, or were filed late within the past two years, are nondischargeable. 11 U.S.C. § 523(a)(1)(B); *In re Ciotti*, 638 F.3d 276 (4th Cir. 2011) (examining "return, or equivalent report or notice" language of § 523(a)(1)(B)). If the debtor voluntarily chose not to pay a tax, it may be nondischargeable. 11 U.S.C. § 523(a)(1)(C); *United States v. Toti*, 149 B.R. 829 (E.D. Mich. 1993), *aff'd*, 24 F.3d 806 (6th Cir. 1994) (where debtor had ability to pay taxes and did not, it was "willful attempt to evade" and nondischargeable). Where a debtor "willfully attempted in any manner to evade or defeat" the tax, it is not discharged. 11 U.S.C. § 523(a)(1)(C).

⁶³ A Fourth Circuit decision held that the exceptions to discharge listed in § 523(a) apply not only to individuals but also to corporations. *In re Cleary Packaging, LLC*, 36 F.4th 509 (2022). Acknowledging that "the question is a close one," the court found that § 523(a) applies to *kinds of debts* regardless of the *class of debtor*. Thus, in that case, a \$4.7 million judgment against the debtor corporation for intentional interference with contracts and tortious interference with business relations was non-dischargeable as a debt "for willful and malicious injury by the debtor to another entity" per § 523(a)(6), even though that section refers to debts of "an individual debtor."

⁶⁴ Even if the tax has been paid, post-petition penalty and interest still may be collected. *In re Irvin*, 129 B.R. 187 (W.D. Mo. 1990). In *In re Barranco*, 307 B.R. 539 (Bankr. W.D. Va. 2004), the debtor had argued that the language in § 523(a)(1)(A) that excepts from discharge "a tax . . . of the kind" specified in § 507(a)(8), which refers to unsecured tax claims of governmental units, confined the denial of a discharge to only such unsecured claims. The court held that as the reference in § 523(a)(1)(A) was to the "kind of debt" (i.e., a tax claim), and not to the "kind of claim" (i.e., an unsecured claim), secured as well as unsecured claims of governmental units were excepted from discharge.

[A] debtor will be considered to have willfully attempted to evade a tax if he acted voluntarily, consciously or intentionally or with reckless disregard for whether the tax has been paid. With respect to § 523(a)(1)(C), a debtor acts with reckless disregard if he knew or should have known that the tax was due and did not pay the tax.⁶⁵

Irvine v. Comm’r (In re Irvine), 163 B.R. 983 (Bankr. E.D. Pa. 1994). The taxing authority has the burden of proof to show willful evasion by a preponderance of the evidence. *Griffith v. United States (In re Griffith)*, 206 F.3d 1389 (11th Cir. Fla. 2000). The authority may meet this burden through circumstantial evidence.

The taxing authority is not required to file an action to determine dischargeability, because the exceptions to discharge for taxes are not conditioned on a judicial finding of nondischargeability. *In re Fernandez*, 112 B.R. 888 (Bankr. N.D. Ohio 1990). A tax claim will not survive discharge if specifically knocked out by the bankruptcy court or if not paid through the plan in a completed Chapter 13 reorganization.⁶⁶ However, trust fund taxes and taxes for which no return was timely filed are not subject to the Chapter 13 discharge. 11 U.S.C. § 1328(a)(2).

For businesses, including partnerships, the discharge works a little differently. Because in a Chapter 7 case the business will be liquidated, creditors not receiving a distribution from the court will not have anything to go after once the case closes. In a Chapter 11 reorganization, the debtor files a plan specifying payment to creditors. Once this plan is confirmed or agreed to by the court, the debtor is discharged from all debts not covered by the plan as long as creditors received proper notice. 11 U.S.C. § 1141(d); *Snug Enters. v. Sage (In re Snug Enters.)*, 169 B.R. 31 (Bankr. E.D. Va. 1994) (creditor’s claim not discharged due to lack of notice of plan). Under new § 1141(d)(5), an individual Chapter 11 debtor must make all plan payments in order to receive a discharge.

The debtor remains under the protection of the bankruptcy court while making payments under the plan (which now may last up to five years from the date of petition for priority taxes). 11 U.S.C. §§ 1129(a)(9)(C) and 1322(d). Taxes that arise after the plan is confirmed should be paid when due. It is not a violation of the automatic stay to collect post-confirmation debts in a Chapter 11 reorganization. *Quillen v. United States*, 160 B.R. 776 (W.D. Va. 1993). Whether it is a violation of the automatic stay to collect post-confirmation debts in a Chapter 13 reorganization depends on the extent of the remaining bankruptcy estate. *In re Reynard*, 250 B.R. 241 (Bankr. E.D. Va. 2000) (post-confirmation collection activities in Chapter 13 and the extent of the post-confirmation estate); *In re Schechter*, No. 10-72175-FJS (Bankr. E.D. Va. Aug. 16, 2012) (post-confirmation collection activities in Chapter 13).

The statute of limitations on filing suit for the collection of taxes and other debts is tolled during the period when the bankruptcy is pending. 11 U.S.C. § 507(a)(8); Va. Code §§ 8.01-229(D) and 58.1-3940(D). In addition, the time for determining priority status of taxes under § 507(b)(8) and whether the debt will be excepted from discharge under § 523(a)(1) is tolled during the current and any prior bankruptcies, plus another ninety days.

⁶⁵ Despite this standard, courts often find the debtor did not willfully attempt to evade the taxes. In *Irvine*, the debtor embezzled money for gambling, and the tax debt was discharged!

⁶⁶ Because § 1328(a) overrides § 523(a)(1)(A), even a priority tax will be discharged if no proof of claim is filed. *In re Tomlan*, 102 B.R. 790 (E.D. Wash. 1989) (discharging IRS claim based on untimely filing of proof of claim).

14-6.03(a)(1) Effect on Penalties and Interest

For individuals, a penalty that does not represent actual pecuniary loss (a “punitive” penalty) is nondischargeable if imposed less than three years before the petition was filed. 11 U.S.C. § 523(a)(7); *Va. State Bar v. Young (In re Young)*, 577 B.R. 227 (Bankr. W.D. Va. 2017); *In re Allen*, 272 B.R. 913 (Bankr. E.D. Va. 2002). Remember that “pecuniary” penalties are priority debts. 11 U.S.C. § 507(a)(8)(G). If the tax is a priority tax, then the penalty is nondischargeable.

Pre-petition interest on nondischargeable taxes also is nondischargeable as the word “claim” is broadly defined to include interest, and interest may be considered a pecuniary penalty. 11 U.S.C. § 507(a)(8); *In re Larson*, 862 F.2d 112 (7th Cir. 1988); *see also Leahey v. United States (In re Leahey)*, 169 B.R. 96 (Bankr. D.N.J. 1994) (pre-petition interest associated with an underlying tax debt that is non-dischargeable under § 523(a)(1)(C) is also non-dischargeable); *In re H.G.D. & J. Mining Co., Inc.*, 74 B.R. 122 (S.D. W. Va. 1986). A Florida court has found that traffic fines constitute “fines, penalties, and forfeitures” exempt from discharge by § 523(a)(7). Thus, the locality did not violate the debtor’s discharge by refusing to renew the debtor’s driver’s license while traffic fines remain unpaid. *In re Fish*, No. 8:12-cv-2498-T-33 (M.D. Fla. Mar. 18, 2013).

Post-petition interest follows the tax. If the tax is nondischargeable, the interest will be nondischargeable and will remain a personal liability of the debtor. The penalties attributable to the underlying tax are nondischargeable if the underlying tax liability is nondischargeable. *In re Putnam*, 131 B.R. 52, 53 (Bankr. W.D. Va. 1991). Even if the claim for post-petition interest would have been disallowed during a Chapter 13 bankruptcy, if a locality chooses to file a claim for taxes that come due while the case is pending, § 1305 converts the administrative tax claim to a priority tax claim and the interest is nondischargeable. *Ridder v. Great Lakes Higher Educ. Corp. (In re Ridder)*, 171 B.R. 345 (Bankr. W.D. Wis. 1994).

14-6.03(a)(2) Other Effects of Discharge

Debt from money borrowed to pay federal taxes and nondischargeable state or local taxes too is nondischargeable. 11 U.S.C. § 523(a)(14). Criminal fines and restitution are nondischargeable, even under the Chapter 13 “super discharge.” 11 U.S.C. § 523(a)(7); *Thompson v. Virginia (In re Thompson)*, 16 F.3d 576 (4th Cir. 1994).⁶⁷ Domestic support obligations, including amounts owed to a municipality in the nature of alimony, maintenance, or child support, are not subject to discharge. 11 U.S.C. §§ 523(a)(5) and 523(a)(15). Debt obtained by false pretenses, a false representation, or actual fraud is not dischargeable. 11 U.S.C. § 532(a)(2)(A); *Husky Int’l Elecs., Inc. v. Ritz*, 578 U.S. 356, 136 S. Ct. 1581 (2016) (actual fraud encompasses fraudulent conveyance schemes even if false pretenses or false representations are not involved); *Field v. Mans*, 516 U.S. 59, 116 S. Ct. 437 (1995) (justifiable reliance on false representations prevents discharge); *TKC Aero Inc. v. Muhs*, 923 F.3d 377 (4th Cir. 2019) (to establish “willful and malicious injury by the debtor” to render the debt nondischargeable, intent to injure is required, not merely a deliberate or intentional act that leads to injury); *Hanson v. Cassidy (In re Cassidy)*, 595 B.R. 507 (Bankr. W.D. Va. 2019) (award to victim of assault and intentional infliction of emotional distress committed by debtor nondischargeable). After a Chapter 13 plan is confirmed, assets except payments made to the Chapter 13 trustee revert to the debtor, and so may be distrained for post-confirmation debts. *In re Thompson*, 142 B.R. 961 (Bankr. D. Colo. 1992).

14-6.03(b) Discharge of Liens

Statutory liens are liens created by operation of law, such as the lien on real estate, Va. Code § 58.1-3340, or the lien on personal property. Va. Code §§ 58.1-3941 and 58.1-3942;

⁶⁷ The court in *In re Wilson*, 299 B.R. 380 (Bankr. E.D. Va. 2003), distinguished *Thompson* and held that civil liability to a private creditor pursuant to a criminal restitution order was dischargeable.

1982-83 Op. Va. Att’y. Gen. 618. *But see City of Martinsville v. Tultex Corp.*, 250 B.R. 560 (Bankr. W.D. Va. 2000). Judicial liens are created when a court judgment is docketed. Va. Code § 8.01-458. Although a tax debt may be discharged, extinguishing the debtor’s personal obligation to pay, the tax lien survives the discharge in bankruptcy and continues in force, absent a lien avoidance proceeding within the bankruptcy. *In re Trammel*, 63 B.R. 878 (Bankr. E.D. Va. 1986); *In re Junes*, 99 B.R. 978 (B.A.P. 9th Cir. 1989). Any property to which the lien attached continues to be available for payment after an in rem proceeding. Similarly, judicial liens do not have to be released or satisfied because a debtor files for bankruptcy. *Leasing Service Corp. v. Justice*, 243 Va. 441, 416 S.E.2d 439 (1992). Thus, only liens specifically discharged by the court should be released. In *Cen-Pen Corp. v. Hanson*, 58 F.3d 89 (4th Cir. 1995), the Fourth Circuit held that a creditor’s secured lien survived a Chapter 13 confirmation despite (1) the creditor’s failure to object after notice of the plan that classified the lien as unsecured, (2) the creditor’s failure to file a proof of claim, (3) a confirmed plan that stated liens were voided if no proof of claim was filed, and (4) § 1327, which provides that the provisions of a confirmed plan bind each creditor whether or not the creditor’s claim is provided for in the plan and regardless of whether the creditor objected to the plan. In holding that the confirmation did not have preclusive effect, the court relied on the general rule that liens were unaffected by bankruptcy, citing *Dewsnup v. Timm*, 502 U.S. 410, 112 S. Ct. 773 (1992). The court held that unless the debtor takes appropriate affirmative action to avoid a security interest in property of the estate that property remains subject to the security interest following confirmation. *See also In re Deutchman*, 192 F.3d 457 (4th Cir. 1999) (as a general rule, liens pass through the bankruptcy process unaffected).

A different result is reached under Chapter 11. In *Universal Supplies Inc. v. Regional Building Systems Inc. (In re Regional Bldg. Sys. Inc.)*, 254 F.3d 528 (4th Cir. 2001), the Fourth Circuit held that a creditor’s lien was extinguished by the confirmed plan because the property to which the lien could attach was dealt with in the plan. The creditor’s claim was considered unsecured because it was secured by collateral of no value at the time of the petition. After confirmation, the creditor argued that its lien attached to a settlement that was paid to the debtor post-petition. Because the plan provided that the settlement would be distributed pro rata to unsecured creditors, the court held that § 1141(c) operated to extinguish the lien. *See also In re Penrod*, 50 F.3d 459 (7th Cir. 1995) (confirmed Chapter 11 plan extinguished lien when creditor participated in confirmation process).

14-6.03(c) Uncollectible Accounts

Tax accounts may be written off as uncollectible under Virginia law and stricken from the treasurer’s books. Va. Code § 58.1-3921 et seq. The statute of limitations is tolled with regard to any tax not discharged or otherwise rendered unenforceable during the time substantially all of the assets of the taxpayer are in bankruptcy, receivership, or otherwise within the control of a court. Va. Code § 58.1-3940(D); see section [14-6.03\(a\)](#). In *In re Varona*, 388 B.R. 705 (Bankr. E.D. Va. 2008), the court rejected the debtor’s attempt to use § 105 to sanction the filing of a proof of claim as false or fraudulent because, while collection of the claims was arguably time-barred, the debts continued to exist under state law and there was no showing of prejudice to the debtors so as to prohibit the withdrawal of the claims. The Fourth Circuit has held that a time-barred debt falls within the Code’s “broad definition of a claim.” *Dubois v. Atlas Acquisitions, LLC (In re Dubois)*, 834 F.3d 522 (4th Cir. 2016); see also *Midland Funding, LLC v. Johnson*, 581 U.S. 224, 137 S. Ct. 1407 (2017) (filing of a proof of claim that is obviously time barred is not a false, deceptive, misleading, unfair, or unconscionable debt collection practice within the meaning of the Fair Debt Collection Practices Act). *But see Thomas v. Midland Funding, LLC (In re Thomas)*, No. 16-50396 (Bankr. W.D. Va. Oct. 28, 2020) (distinguishing *Midland v. Johnson*; complaint alleging intentional filing of materially false statements in connection with proofs of claim is not precluded by Bankruptcy Code and Rules, and states claim under Fair Debt Collection Practices Act).

14-7 BANKRUPTCY COURTS AND TRUSTEES

The bankruptcy court websites for the [Eastern District](#) and for the [Western District](#) contain much useful information. The [contact information for U.S. Trustees](#) in Virginia may be accessed through the Justice Department website.

The United States government also maintains a [searchable database](#) of unclaimed funds held by some, but not all, bankruptcy courts. The database may be used to identify unclaimed funds owing to a locality and held by the bankruptcy court.