



Bankruptcy's Impact on Municipalities: Be Aggressive!

By Richard D. Trenk

In the wake of the largest and most damaging corporate bankruptcies in the history of America, the full financial impact is slowly becoming apparent. Many of the problems that have resulted are not covered by the mass media, but are intrinsically related to the municipalities in which we live. All bankruptcy, whether personal or corporate, has the potential to cause major problems for municipal budgets. The laws in the Federal Bankruptcy Code and the New Jersey State Statutes afford municipalities a substantial amount of protection from the effects of bankruptcy. However, it is important to know the potential problems and the relevant legal maneuvers that a municipality can use to shield itself from financial worry

Collecting Tax Liens Tax collection in Morrisville, North Carolina failed to provide sufficient revenue for the 2002-2003 fiscal year when Midway Airlines filed for bankruptcy. The federal government granted them \$12.5 million to revive the airport, and US Airways entered into talks to adopt Midway as one of its express carriers. However, the corporation still suffered from continuing losses, leaving Morrisville with a budgetary mess. Recently, US Airways filed for bankruptcy as

well, so it is unlikely that Morrisville will be able to rely on tax revenue from Midway anytime soon.

New Jersey has passed legislation that softens the blow of major corporate bankruptcies on real estate tax collections, ensuring that the interest of the municipality is preserved. According to New Jersey law, all unpaid taxes assessed before the owner of the real

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estate files for bankruptcy are consolidated as a lien against the property. This lien has to be paid off upon purchase of the property by the new owner. All taxes assessed after the filing of the bankruptcy petition (including interest) are categorized as "administrative" expenses under the Bankruptcy Code and are held against the property as a statutory lien. Additionally, they are given priority over other claims that other creditors have against the real estate owner. However, a lien may rest against a property indefinitely, so it is hard for the municipality to predict when they might be reimbursed for the taxes contained in the lien. Another problem that arises is that, under the Bankruptcy Code, courts may review the assessment of the debtor's real

property even though the debtor failed to timely file a tax appeal and pay the taxes as required outside of bankruptcy.

These problems have been resolved under New Jersey law. State statutes authorize municipalities to enforce a tax lien by selling the lien certificates in a "tax sale." Some New Jersey courts have ruled these types of sales to be void. This is because after someone has filed for bankruptcy, an "automatic stay" is placed on his or her property. The automatic stay keeps creditors from repossessing or selling the debtor's property. According to the courts, a tax sale violates the automatic stay. However, if the tax liens are sold prior to the filing of bankruptcy, they can become a very efficient method of tax collection.

When someone purchases a tax lien, they pay the municipality for the cost of the lien and then charge the property owner a rate of interest, issuing bills for the payment of the lien to the property owner until it is paid off completely. The municipality receives its money right away and the tax lien holder receives a return on his investment by charging interest.

The Rights of the Tax Lien Holder

When an individual files for bankruptcy and owns property, the municipality in which the property is located should be given notice of the bankruptcy so that they can keep watch of any new developments regarding the property. Even if formal notice is not given, the municipality may be charged with notice if it had actual notice or had reason to know of the bankruptcy filing. The question arises then, if the tax lien holder should receive the same notice. Although there is no law requiring bankruptcy attorneys to give the lien holder notice, there should be. The lien holder is considered a creditor and should be informed if the property owner is unable to pay him. He also needs to be informed of the bankruptcy, so that he can join the pool of creditors who will be fighting over the assets of the debtor once the bankruptcy petition is filed. As a creditor, he has to file a "proof of claim," or a statement that lists the amounts of money (taxes) owed to him by the debtor. The municipality files a proof of claim in

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these circumstances, to guard their interests.

This begs the question, could a tax lien holder sue the municipality if he or she was not put on notice and the municipality was, and in the process of the bankruptcy, the claim to the tax lien is sold to someone else? As a precaution, municipal attorneys should get into the practice of putting municipal lien holders on notice when a property owner files for bankruptcy in order to avoid any type of conflict that may arise with the lien holders later on, when the assets are sold.

Environmental Cleanup: Who Is Responsible? Another issue that arises when a landowner files for bankruptcy is the environmental cleanup that may be left on the property. In some circumstances, the property owner will file bankruptcy, turning their property into an asset used to pay off their debts. However, this process can take an extensive amount of time in a highly disputed case, creating a public health and safety risk due to the lingering contamination. The property owner obviously has no money to clean up the site, so the question becomes, who does? When issues of public health and safety are at stake, the local government feels pressure to take care of the problem as soon as possible.

The Bankruptcy Code allows a municipality to enforce a debtor's compliance with local ordinances to protect the welfare of the general public. This law shields the municipality from having to expend monies from the local budget for the debts and responsibilities of a single entity or individual.

Cleanup has recently been shifted away from the local, state and federal government, in favor of providing private investors incentives to purchase the property and clean up the waste at their own cost. The purchase and sale of contaminated property in New Jersey has become very popular.

Can Bankruptcy Get You Out of Paying Your Parking Tickets? The short answer is: no. Many municipalities have implemented technology to allow citizens to pay their parking tickets, code violations, and various municipal fines with their credit card accounts on-line. In bankruptcy, any individual credit card account is considered "consumer debt" and is therefore, discharged from the individual's total debt when they file for bankruptcy. At first glance, it appears that the municipality stands to lose fine revenue through bankruptcy proceedings. However, when an individual pays with their credit card, the municipality will receive the payment as soon as the transaction goes through, and it is the credit card company who takes the loss, not the municipality.

Furthermore, the Bankruptcy Code provides that municipal fines and penalties may not be discharged through a bankruptcy proceeding. So even though it may take longer to collect the fine or penalty, the municipality will always be able to collect.

Be Aggressive! Too many municipalities are sitting on thousands, millions of dollars in unpaid tax liens and municipal fines. It is important for municipalities to be aggressive in collecting outstanding monies owed to them. It is the responsibility of the individual filing bankruptcy to make sure that all debts are settled, and that they pay their share of the burden imposed on the municipality for property maintenance and the security of health and safety. All municipalities should streamline their collection department, deliver appropriate fines and collect aggressively. The additional revenue is well worth the additional time it takes to get the process running smoothly. Bankruptcy should not bring a halt to collection efforts – just a different and more coordinated mechanism to insure that further obligations are met in a

timely fashion. Most bankruptcy judges are sensitive to the critical lifeblood which real estate taxes mean to all communities. Due to this fact, most courts will favorably consider lifting the stay to permit tax sales to go forward and will not tolerate post-petition arrearages of any obligations. Courts are even receptive to orders compelling monthly payments for real estate taxes instead of the normal quarterly payments.

A Word to the Wise Two years ago, the New Jersey Department of Community Affairs had to suspend their computer upgrade, leaving their network in limbo when the computer company in charge of the transition went bankrupt. The Department was stuck with the contract with the computer company that required a legal battle to dissolve, not to mention the interruption the whole event caused to their computer services.

These things happen. The uncertainty that bankruptcy proceedings bring to a municipality can be overwhelming. However, the best way to manage this uncertainty is to plan ahead as best as possible and make smart decisions when contracting corporations to do work for the municipality. Whenever possible, bonds from reputable insurance or bonding companies must be required. The law provides numerous protections for the interest of the municipality, but it is ultimately the responsibility of the municipality to enforce those laws and utilize the protections available in order to make sure that the budget will survive. ❖