VALTA MEETING SPRING 2008

What does an Auditor need to know about Bankruptcy ...and other fun facts.

Jeffrey Scharf & Mark Ames
Taxing Authority Consulting Services, P.C.

tacs

Who we are….

- Taxing Authority Consulting Services, P.C. (TACS) is a law firm based in Richmond specializing in representing State and local government with tax and bankruptcy issues
- Jeffrey Scharf is a former Deputy Commissioner of the Revenue and Deputy Treasurer in Arlington County, and a former attorney for the Virginia Department of Taxation
- Mark Ames was also counsel for the Department of Taxation working in both the Office of Tax Policy and the Compliance Division
- The information we are providing are not to be considered as legal advice and we recommend that you consult with your attorney before taking legal action.

Types of Bankruptcy

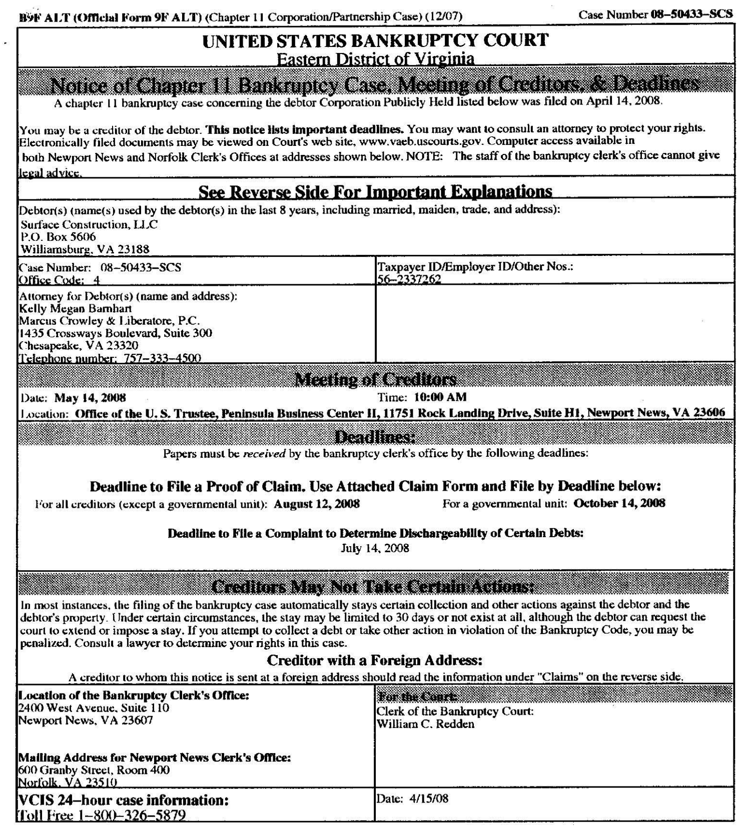
- Chapter 7
  - Individual or business liquidation
  - Trustee appointed
- Chapter 13
  - Individual reorganization
    - Payment plan
  - Standing Trustee
- Chapter 11
  - Corporate (or Individual)
  - Reorganization

Types of Bankruptcy

- Chapter 11 Reorganization
  - Large, multi-state corporations
  - Most likely audit candidates
  - No trustee appointed
    - Debtor continues to operate its affairs as a “Debtor in Possession”
    - If they were so good at it, why are they in bankruptcy in the first place
  - Plan proposed to pay all pre-petition debt

Notice of Commencement of Case

- Received from Bankruptcy court
- Case Info
- Debtor Info
  - Attorney
- Lists relevant dates
  - §341 meeting
  - bar dates



B9F ALT (Official Form 9F ALT) (Chapter 11 Corporation/Partnership Case) (12/07) Case Number **08–50433–SCS**

UNITED STATES BANKRUPTCY COURT
Eastern District of Virginia

Notice of Chapter 11 Bankruptcy Case, Meeting of Creditors, & Deadlines

A chapter 11 bankruptcy case concerning the debtor Corporation Publicly Held listed below was filed on April 14, 2008.

You may be a creditor of the debtor. **This notice lists important deadlines.** You may want to consult an attorney to protect your rights. Electronically filed documents may be viewed on Court's web site, www.vaeb.uscourts.gov. Computer access available in both Newport News and Norfolk Clerk's Offices at addresses shown below. NOTE: The staff of the bankruptcy clerk's office cannot give legal advice.

See Reverse Side For Important Explanations

Debtor(s) (name(s) used by the debtor(s) in the last 8 years, including married, maiden, trade, and address):
Surface Construction, LLC
P.O. Box 5606
Williamsburg, VA 23188

Case Number: 08–50433–SCS Office Code: 4	Taxpayer ID/Employer ID/Other Nos.: 56–2337262
Attorney for Debtor(s) (name and address): Kelly Megan Barnhart Marcus Crowley & Liberatore, P.C. 1435 Crossways Boulevard, Suite 300 Chesapeake, VA 23320 Telephone number: 757–333–4500	

Meeting of Creditors

Date: **May 14, 2008** Time: **10:00 AM**
Location: **Office of the U. S. Trustee, Peninsula Business Center II, 11751 Rock Landing Drive, Suite H1, Newport News, VA 23606**

Deadlines:

Papers must be *received* by the bankruptcy clerk's office by the following deadlines:

Deadline to File a Proof of Claim. Use Attached Claim Form and File by Deadline below:
For all creditors (except a governmental unit): **August 12, 2008** For a governmental unit: **October 14, 2008**

Deadline to File a Complaint to Determine Dischargeability of Certain Debts:
July 14, 2008

Creditors May Not Take Certain Actions:

In most instances, the filing of the bankruptcy case automatically stays certain collection and other actions against the debtor and the debtor's property. Under certain circumstances, the stay may be limited to 30 days or not exist at all, although the debtor can request the court to extend or impose a stay. If you attempt to collect a debt or take other action in violation of the Bankruptcy Code, you may be penalized. Consult a lawyer to determine your rights in this case.

Creditor with a Foreign Address:

A creditor to whom this notice is sent at a foreign address should read the information under "Claims" on the reverse side.

Location of the Bankruptcy Clerk's Office: 2400 West Avenue, Suite 110 Newport News, VA 23607 **Mailing Address for Newport News Clerk's Office:** 600 Granby Street, Room 400 Norfolk, VA 23510	**For the Court:** Clerk of the Bankruptcy Court: William C. Redden
VCIS 24–hour case information: Toll Free 1–800–326–5879	Date: 4/15/08

Notice of Filing

- Confirm by calling VCIS or access the PACER system
  - Eastern District: www.vaeb.uscourts.gov
    - 1-800-326-5879
  - Western District: www.vawb.uscourts.gov
    - 1-540-857-2391
  - Other Courts
    - Vcis.org
    - Pacer

Local Treasurer or Local Government Attorney may have PACER account

Debtor’s Duty To File Tax Returns

- Recent Code amendments
  - Individual debtors must file Federal tax return 7 days before creditor’s meeting
  - In Chapter 13 cases, all tax returns for the last 4 years are required to be filed (§1308)
  - All debtors are required to comply with all laws including the filing and payment of postpetition taxes [§521(j)(1)]; Upon the failure to file the taxing authority can ask the court to convert or dismiss the case and must do so if the return is not filed within 90 days of the request
  - Failure to file post-petition is a specifically enumerated ground for dismissal or conversion in Chapter 11 cases—1112(b)(2)(I)

Filing Claims

- A Claim is the right to payment from the debtor, even if the debt is disputed, unliquidated or not mature

B-10
6205250 REV 3/96

United States Bankruptcy Court
For The Eastern District Of Virginia

PROOF OF CLAIM

In re (Name of Debtor)
Kim Basinger

Case Number
04-25632

NOTE: This form should not be used to make a claim for an administrative expense arising after the commencement of the case. A request for payment of an administrative expense may be filed pursuant to 11 U.S.C. Section 503.

Name of Creditor
(The person or other entity to whom the debtor owes money or property)
Virginia Department of Taxation

Name and Address Where Notices Should Be Sent

Wayne County Treasurer
P.O. Box xxxx
Batman, VA 60609

Telephone No 804-649-2445

___ Check if you are aware that anyone else has filed a proof of claim relating to your claim. Attach copy or statement giving particulars.

___ Check if you never received any notices from the bankruptcy court in this case.

___ Check if this address differs from the address on the envelope sent to you by the court.

THIS SPACE IS FOR COURT USE ONLY

ACCOUNT OR OTHER NUMBER BY WHICH CREDITOR IDENTIFIES DEBTOR:

Check here if this claim
___ replaces
___ amends
a previous filed claim dated: ___________

1.BASIS FOR CLAIM
___ Goods Sold
___ Service performed
___ Money loaned
___ Personal injury/wrongful death
___ Taxes
___ Other (Describe briefly)

___ Retiree Benefits as defined in U.S.C.§ 1114(a)
___ Wages, salaries, and commissions (fill out below)
Your social security number___________________
Unpaid compensation for services performed
from ______________ to ______________
(date) (date)

2. DATE DEBT WAS INCURRED

3. IF COURT JUDGEMENT, DATE OBTAINED

4. CLASSIFICATION OF CLAIM. Under the Bankruptcy Code all claims are classified as one or more of the following: (1) Unsecured nonpriority. (2) Unsecured Priority. (3) Secured. It is possible for part of a claim to be in one category and part in another.
CHECK THE APPROPRIATE BOX OR BOXES that best describe your claim and STATE THE AMOUNT OF THE CLAIM.

___ SECURED CLAIM ______________
Attach evidence of perfection of security interest
Brief Description of Collateral:
__ Real Estate __ Motor Vehicle __ Other (Describe)

Amount of arrearage and other charges included in secured claim above if and $___________________________________

__ UNSECURED NONPRIORITY CLAIMS $______________
A claim is unsecured if there is no collateral or lien on property of the debtor securing the claim or to the extent that the value of such property is less than the amount of the claim.

___ UNSECURED PRIORITY CLAIM $_________________ Specify the priority of the claim.
___ Wages, salaries, or commissions (up to $2,000, earned not more than 90 days before filing of the bankruptcy petition or cessation of the debtor's business, whichever is earlier – 11 U.S.C.§ 507(a)(3))
___ Contribution to an employee benefit plan - 11 U.S.C.§ 507(a)(4)
___ Up to $900 of deposits toward purchase, lease, or rental of property or services for personal, family, or household use – 11 U.S.C § 507(a)(6)
___ Taxes or penalties of government units – 11 U.S.C. § 507(a)(7)
___ Other – 11 U.S.C. §§ 507(a)(2), (a)(5) – (Describe briefly)

5. TOTAL AMOUNT OF CLAIM AT TIME CASE FILED:
$ __________ (Unsecured) $ __________ (Secured) $ __________ (Priority) $ (Total)

__ Check if claim includes prepetition charges in addition to the principal amount of the claim. Attach itemized statement of all additional charges.

6. CREDITS AND SETOFFS: The amount of all payments on this claim has been credited and deducted for the purpose of making this proof of claim. In filing this claim, claimant has deducted all amounts that claimant owes to debtor.
7. SUPPORTING DOCUMENT: **Attach copies of supporting documents**, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, court judgements, or evidence or security interest. If the documents are not available, explain. If the documents are voluminous, attach a summary.
8. TIME-STAMPED COPY: To receive an acknowledgement of the filing of your claim, enclose a stamped, self-addressed envelope and copy of this proof of claim.

THIS SPACE IS FOR COURT USE ONLY

Date:

Sign and print the name and title, if any, of the creditor or other person authorized to file this claim (attach copy of power of attorney, if any).

Penalty for Presenting Fraudulent Claim: fine of up to $500,000.00 or imprisonment for up to 5 years, or both. 18 U.S.C. §§ 152 and 357

Filing Claims

- “Mark”, you may ask “Why is Filing Proofs of Claim important”?
  - Its’ the only way to get paid from the bankruptcy case
- “Well, but why is it important for auditors?”
  - Assuming you consider the audit itself more than an academic exercise, the Claim, is the mechanism to get paid in bankruptcy
  - Claims Bar Dates

Claims Bar Dates--Deadlines

- Chapter 7 and 13:
  - Government entities have 180 days after petition filed
- Chapter 11
  - No set bar date
  - Set by the court separately in each case
    - You should receive a separate notice of the bar date

Claims Bar Dates--Effect

- Chapter 7
  - Late Claim may still be payable if filed before report of trustee or distribution
- Chapter 13
  - Late Claim will NOT have to be paid
- Chapter 11
  - If a claim is not filed by the bar date, it will NOT be paid
    - except with court intervention in limited circumstance
  - Even if there is a pending audit
  - Even if additional liability is discovered later

So—what do you do?

- Notify the Treasurer or Local Government Attorney that there is a pending audit and that you expect there will be liability
- Attempt to conclude the audit in time for the claim to be filed

Automatic Stay

11 USC §362, in effect when petition is filed

- Prohibits collection of debts and any action that would change the relative position of the parties from what it was on the day the petition was filed

WAIT ONE MOMENT…

- How can I conclude the audit in time for the claim to be filed?
- I thought the "automatic stay" prohibited any further action

Automatic Stay

11 U.S.C. §362 Automatic Stay (in part)

(b) The filing of a petition under…this title…, does not operate as a stay—

(9) under subsection (a), of—

(A) an audit by a governmental unit to determine tax liability;

(B) the issuance to the debtor by a governmental unit of a notice of tax deficiency;

(C) a demand for tax returns; or

(D) the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment…

Exceptions to the Automatic Stay

So you can:

- **Audit**
- **Demand tax returns**
- **Issue a Notice of tax deficiency** (without threat of collection action)
- **Issue a Notice and Demand for payment of a new assessment**

So—what do you do?

- Notify the Treasurer or Local Government Attorney that there is a pending audit and that you expect there will be liability
- Attempt to conclude the audit in time for the claim to be filed
- Estimate the liability

B-10
6205250 REV 3/96

United States Bankruptcy Court
For The Eastern District Of Virginia

PROOF OF CLAIM

In re (Name of Debtor)
Kim Basinger

Case Number
04-25632

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Check here if this claim
___ replaces
___ amends
a previous filed claim dated: ____________

1.BASIS FOR CLAIM
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___ Money loaned
___ Personal injury/wrongful death
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___ UNSECURED PRIORITY CLAIM $________________ Specify the priority of the claim.
___ Wages, salaries, or commissions (up to $2,000, earned not more than 90 days before filing of the bankruptcy petition or cessation of the debtor's business, whichever is earlier – 11 U.S.C.§ 507(a)(3))
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___ Up to $900 of deposits toward purchase, lease, or rental of property or services for personal, family, or household use – 11 U.S.C § 507(a)(6)
___ Taxes or penalties of government units – 11 U.S.C. § 507(a)(7)
___ Other – 11 U.S.C. §§ 507(a)(2), (a)(5) – (Describe briefly)

5. TOTAL AMOUNT OF CLAIM AT TIME CASE FILED:

$ ________	$ ________	$ ________	$
(Unsecured)	(Secured)	(Priority)	(Total)

__ Check if claim includes prepetition charges in addition to the principal amount of the claim. Attach itemized statement of all additional charges.

6. CREDITS AND SETOFFS: The amount of all payments on this claim has been credited and deducted for the purpose of making this proof of claim. In filing this claim, claimant has deducted all amounts that claimant owes to debtor.
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Penalty for Presenting Fraudulent Claim: fine of up to $500,000.00 or imprisonment for up to 5 years, or both. 18 U.S.C. §§ 152 and 357

Estimated Claims

- No requirement that the claim filed be 100% accurate
- It does not lock the locality into the amount that it files
- So, if an audit is underway, and it is not practical or possible to conclude in time for the audit to be included in the claim, the claim can be *Estimated*

Estimated Claims

- Communicate the estimate to whoever is going to file the claim
  - Treasurer's Office
  - Local Government Attorney
- Provide as much detail as possible
  - Tax types
  - Tax Periods
  - Amounts Due
- Be as accurate as possible

Estimated Claims

- Object of Estimated Claim is to put the debtor (and the other creditors) on notice that your locality is asserting a claim for certain taxes and tax periods
- Not only for audits, but also where tax returns are unfiled

Amended Claims

- Once the estimated claim is filed, you have met the required bar date
- Once the true amount of the audit is determined (or the missing tax return filed), the claim can be amended to reflect the correct amount
- **May amend any claim after claims filing deadline**

Amended Claims

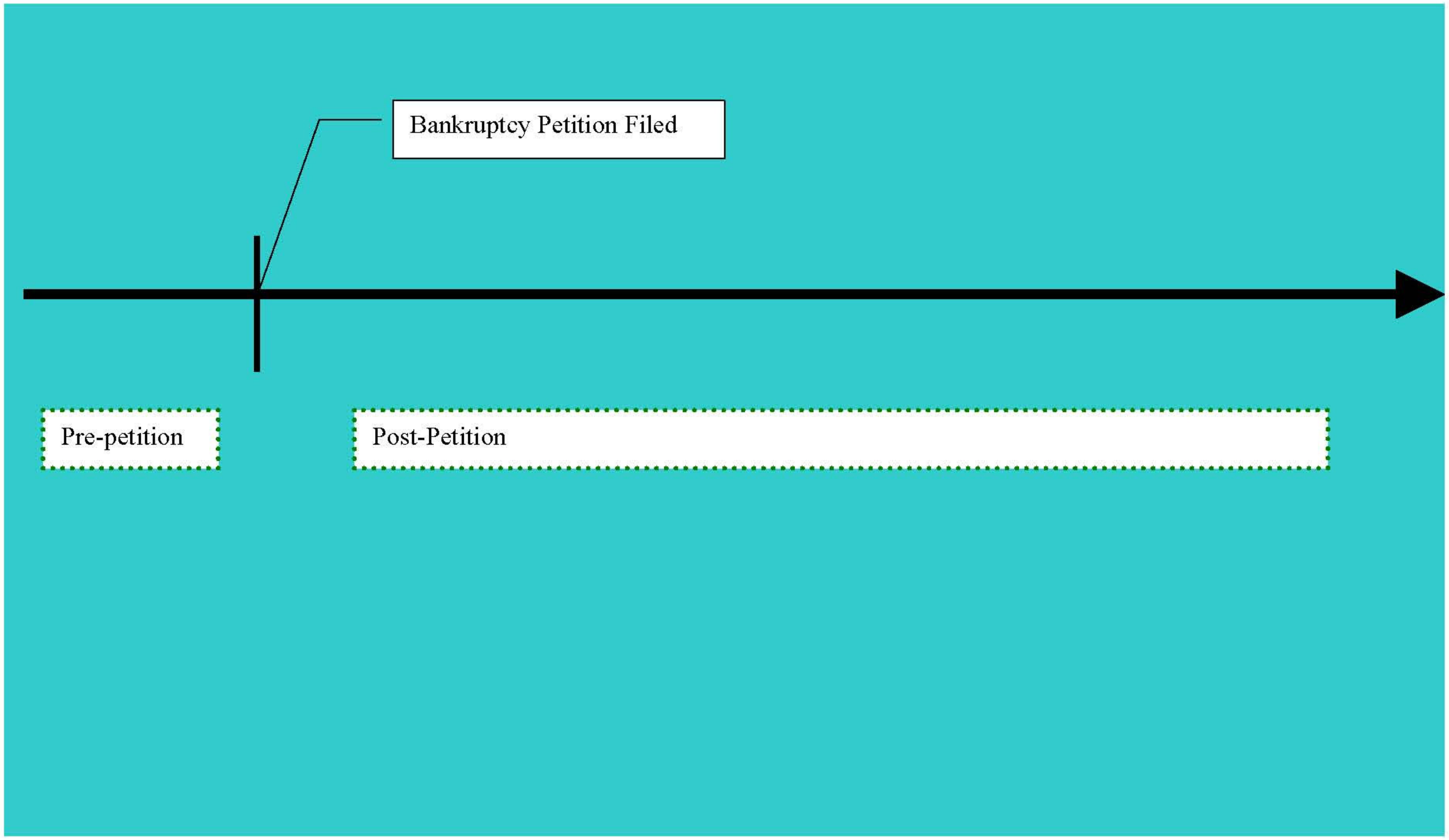
- **May amend any claim after claims filing deadline so long as you are not creating a new claim (e.g. new tax type or different tax period)**
- **Very important to include all possible tax types and tax periods in the audit estimate to permit liberal amendment of the estimated claim**

So, for what period does the Claim need to be filed?

- **The filing of the petition freezes the position of the parties**
  - **Remember the automatic stay**
- **All pre-petition debts are covered by the bankruptcy and must be included in a timely filed claim in order to be paid in the bankruptcy case**

So, for what period does the Claim need to be filed?

- **Filing creates 2 separate periods**
  - **Pre-petition**
    - **Before the case was filed**
  - **Post-petition**
    - **After the case was filed**


Bankruptcy Petition Filed
Pre-petition
Post-Petition

So, for what period does the Claim need to be filed?

- You want to bring your audit forward as much as possible to include all liabilities through at least the petition date
- The claim also needs to encompass taxes and tax periods which are deemed by law to have been incurred pre-petition

Special Treatment of Property Tax

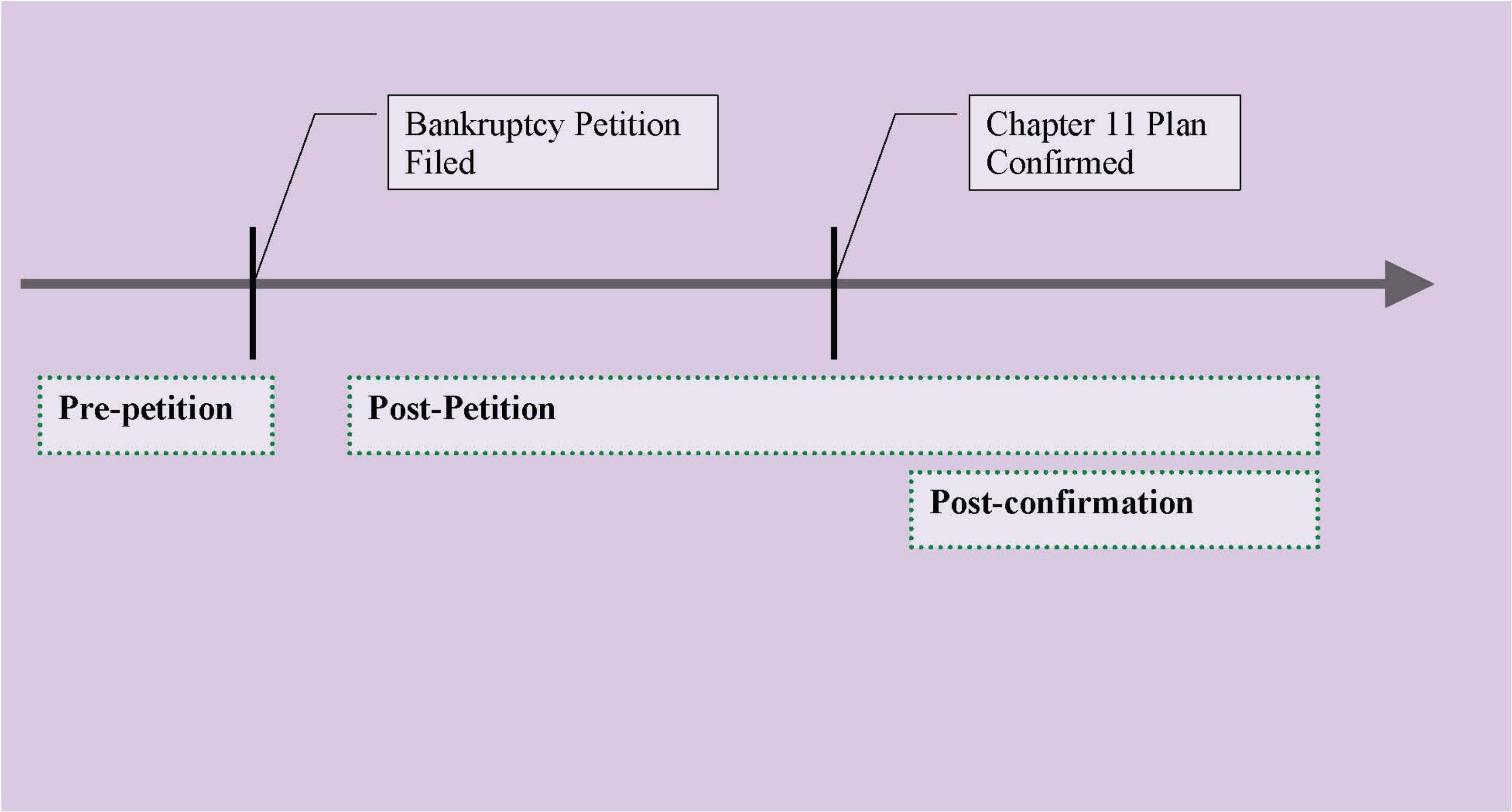
- **Since property taxes are deemed under Virginia law to have been assessed as of January 1 or each year, the bankruptcy courts have decided that any property tax is considered assessed (for claims filing purposes) as of January 1 of that year**
- **This means that in a bankruptcy case filed on February 1, 2008, the 2008 business personal property tax would be considered a pre-petition tax**
  - **Even though the:**
    - **Tax is not yet due**
    - **Tax return not due or filed**
    - **Tax rate is not even set**

Special Treatment of Property Tax

- **Creates another instance (besides audit and unfiled returns) where a claim would have to be estimated**
- **Once return filed, claim can be amended to reflect actual amount due**

Why should I work my audit further than the petition date?

- Claims filing process includes debts due up to the petition date
- The Proposed bankruptcy plan, if confirmed, will govern all debts due up until confirmation of the plan
  - This could be years after the filing
- These post-petition debts are supposed to be paid as they come due
  - But are often not
  - Especially if you are talking about an audit liability that might not be know


Bankruptcy Petition Filed
Chapter 11 Plan Confirmed
Pre-petition
Post-Petition
Post-confirmation

Why should I work my audit further than the petition date?

- **To claim anything due for tax periods up to the confirmation of a bankruptcy plan of reorganization**
- **CAVEAT: If you do so, you should divide the audit into separate discreet periods to match the pre-petition and post-petition periods**

Use the Bankruptcy

- **A major company filing for Chapter 11 can almost be an audit flag**
- **Since pre-petition debts won't be paid unless a claim is filed by the bar date; the Notice of Bankruptcy can be an alert to the locality to conduct any audit**
  - **Not just to complete planned audits**
  - **Accelerate those contemplated**
  - **Consider additional audit based on bankruptcy filing alone**

Tax Determination

- Under §505, a Bankruptcy court can determine the tax liability of the debtor
- However, the Court cannot make determination if state law statute of limitations for contesting the assessment has expired

Tax Determination

- Trustee (or Debtor in Possession) can request that a government entity review a filed tax return
- Taxing authority has 60 days in which to select the return for audit or the bankruptcy estate will be discharged from liability for that tax

Bankruptcy Recap

- Pay attention to Filings
  - Not just audits pending but as an audit flag
- Complete audits to allow claims filing
  - Or provide estimate of liability so claim can be filed for relevant taxes and tax periods
- Work with and communicate with the Treasurer and Local Government Attorney
- Separate audit periods to reflect bankruptcy periods

Other Issues

- Statutes of Limitation
  - Basic 3 year statute to contest erroneous assessment (from end of the tax year for which assessment is made) or within 1 year from date of assessment
    - Commissioner of Revenue (§58.1-3980)
    - Court (§58.1-3984)
  - 5 years for unpaid tangible personal property tax if not subject to the tax at all for year in question (§58.1-3980 B)

Statutes of Limitation

- Also, if an erroneously assessed tax has been paid by involuntary means, the statute of limitations to contest the assessment is one year from the date of the involuntary payment (§58.1-3980B)
  - Reduces time period in many cases
  - Increases time where collection was made in fourth or fifth year after assessment
    - Statute of Limitations on Collection is 5 years (§58.1-3940)

Statutes of Limitation—options where statutory time has passed

- Court
  - Correction of double assessments
    - Not limited by time (§58.1-3986)
  - CoR determines tax improper or based on obvious error but should be corrected to serve the ends of justice (§58.1-3984B)
    - Outside of time in which correction can be made

TAX COMMISSIONER APPEALS

- BPOL (§58.1-3903.1)
  - Only applies to appealable events
    - Audit assessments
    - Denial of refund from amended return
  - Must be filed within 90 days of local determination
  - Copy to Commissioner of Revenue
  - ***<u>Can participate in proceedings</u>***
  - Appealable to Circuit Court

TAX COMMISSIONER APPEALS

- BPP (§58.1-3983.1)
  - Additional Remedy to Circuit Court
  - Must be filed within 90 days of local determination
  - Copy to Commissioner of Revenue
  - ***Opportunity to respond and participate in proceedings***
  - Appealable to Circuit Court

TAX COMMISSIONER APPEALS

- Process designed to be less costly and quicker than appeal to court
  - Less costly? — YES
  - Quicker? — NO
- Certainly less formal and more easily subject to making a decision based on a well presented case by one party
  - More likely to be done by the taxpayer
- Participate in the proceedings
  - Treat like a court appeal
  - Get the local government attorney involved
  - File a brief in support of the CoR decision
  - See if other localities have dealt with same issue or same taxpayer

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