

**MAP 20
BANKRUPTCY**

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NOTE: ((**)) = Indicates confidential and/or proprietary information has been deleted.

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20.1 INTRODUCTION

When a taxpayer files a bankruptcy petition, it can materially impact FTB decisions, including those made by audit. This is true whether the taxpayer is currently in a bankruptcy case or previously filed a bankruptcy case.

For example, if FTB does not timely file a proof of claim in a pending bankruptcy case, it may be precluded from receiving funds from a bankruptcy estate and may be barred from recovering the tax liability in the future. See MAP 20.7 Bar Date.

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In addition, FTB may be barred from taking certain actions, because of the automatic stay or the bankruptcy discharge. Significantly, FTB can be held liable for damages, including attorneys' fees, if it is found to have violated the automatic stay or the discharge.

Because of this, it is important that audit promptly contact those with bankruptcy expertise whenever they become aware that a taxpayer may be in bankruptcy, may have filed a bankruptcy subsequent to the tax year that is being considered, may have confirmed a Chapter 11 plan subsequent to the tax year that is being considered, or whenever a taxpayer contends that the taxpayer's liability is affected by a bankruptcy case.

Under any of these circumstances, the auditor should immediately contact both the designated Audit/Bankruptcy Liaison in your program area, and a member of the ARM Division Bankruptcy Section.

When taxpayers tell us that they have filed a bankruptcy petition, you may ask them the chapter under which they have filed. You may also request copies of the bankruptcy documents. See MAP 20.4 Types of Bankruptcy for some definitions of the various types. You should not, however, delay contacting the designated Audit/Bankruptcy Liaison or the designated ARM Division Bankruptcy Section member, while awaiting such information.

If you are auditing or resolving a protest with a taxpayer who is in bankruptcy, be sure to keep the designated Audit/Bankruptcy Liaison and/or ARM Division Bankruptcy Section informed of the status of the audit/protest and contact them prior to issuing any Notices. Periodically check in TPF, BETS, or TI to see if the taxpayer has been noted/coded as being in bankruptcy, even if the taxpayer has not informed you of a pending bankruptcy. See MAP 20.8 Identifying a Taxpayer in Bankruptcy.

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**20.2 THE
BANKRUPTCY
SECTION**

The Bankruptcy Section is in the Special Programs Bureau of the Accounts Receivable Management (ARM) Division. They coordinate all bankruptcy actions. The Bankruptcy Section files claims with the Bankruptcy Court, advises other units on bankruptcy procedures, provides training, and coordinates activities among our employees, the Attorney General's Office, and taxpayers on bankruptcy matters.

The Bankruptcy Section is responsible for collecting amounts during the course of a bankruptcy proceeding that may be due or may become due from taxpayers. They are an important source of information and support when you audit a taxpayer that files a bankruptcy petition. The Audit/Bankruptcy Liaison should be called first. If the Audit/Bankruptcy Liaison is not available, your Lead Auditor may contact the Bankruptcy Section directly. To call the Bankruptcy Section, call the designated Bankruptcy Section member.

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**20.3 BANKRUPTCY
TERMINOLOGY**

There are a number of terms that are important when dealing with a bankruptcy case.

Automatic Stay - When a bankruptcy petition is filed, an automatic stay is imposed in most cases. Generally, it prohibits creditors and potential creditors from taking collection actions against the person or entity in bankruptcy or against property of the person or entity in bankruptcy. See MAP 20.5 Automatic Stay.

Bar Date – The Bar Date is the deadline set by the Bankruptcy Court or the Bankruptcy Code for filing a claim for prepetition liability. In Chapter 11 cases, the Court may also set a deadline for filing administrative expenses (post-petition) claims. See MAP 20.7 Bar Date.

Case Number – The Case Number designated by the court for the particular bankruptcy matter. Depending on the court, knowing the Bankruptcy Case number can get you more information. For example:

CASE NUMBER 1-90-12345-11

1 = court number

90 = year filed

12345 = petition number

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	<p style="text-align: center;">11 = chapter number</p> <p>Confirmation Date - The date the reorganization plan is approved by the bankruptcy court. (Only for Chapter 9, 11, 12, or 13.)</p> <p>Debtor – The person or entity that is in bankruptcy.</p> <p>Debtor in Possession – The Debtor in a Chapter 11 case where no trustee is appointed.</p> <p>Discharge – A person or entity may receive a discharge in a bankruptcy case. Among other things, a discharge operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover, or offset any discharged debt as a personal liability of the Debtor, whether or not discharge of such debt is waived. Certain debts are not discharged in a bankruptcy proceeding.</p> <p>Mailing Matrix – List of creditors supplied to the court by the petitioner (debtor).</p> <p>Petition Date - The date a Petition for Bankruptcy is filed with the court.</p> <p style="text-align: right;">Rev. 7/17</p>
<p>20.4 TYPES OF BANKRUPTCY</p>	<p>Bankruptcy Section actions vary depending on the type of bankruptcy that the taxpayer files.</p> <ul style="list-style-type: none">• Chapter 7 - (Individual) – Bankruptcy liquidates assets of Debtor and pays creditors in accordance with Bankruptcy Code priorities. The Debtor typically receives a discharge that may impact the Debtors tax obligations for any prepetition tax year.• Chapter 7 - (Business Entities) – Bankruptcy trustee liquidates assets of Debtor and pays creditors in accordance with Bankruptcy Code priorities. The tax liabilities not paid from the liquidated assets are not discharged. However, no collection actions should be undertaken without Bankruptcy Section approval.• Chapter 11 - liquidation (Business Entities) – Business liquidates all its assets and pays creditors in accordance with Chapter 11 plan. The tax liabilities not paid from the liquidated assets are not discharged. However, no collection actions should be undertaken without Bankruptcy Section approval.

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- **Chapter 11 – reorganization** – A Chapter 11 plan, if approved by the Bankruptcy Court, will determine the rights of the parties related to obligations arising prior to the Confirmation Date. The Debtor or a successor in interest to the Debtor will continue to operate.

These accounts are followed up by Bankruptcy Section for adherence to the Chapter 11 plan on pre-Petition and pre-Confirmation Date liabilities. Confirmation Date taxes are generally collectible according to the Plan only.

Often Chapter 11 cases convert to Chapter 7. This may create a new opportunity to file a claim.

- **Chapter 13** – Taxpayer (debtor) is generally a wage earner with a regular income. A Chapter 13 plan is proposed by the Debtor, and, if approved by the court, monitored by a trustee.

A plan is typically between 3 and 5 years and these accounts are followed up by the Bankruptcy Section for adherence to the Chapter 13 plan. A discharge is granted at the end of the plan and may impact the debtor's income tax obligations for any prepetition tax year.

Most of the other types of bankruptcy chapters are seldom used. They are:

- **Chapter 9** - For Municipalities.
- **Chapter 12** - Adjustment of debts of a family farmer. This is similar to a Chapter 11 case.
- **Chapter 15**- A case that is filed in the U.S. courts for recognition of a foreign bankruptcy proceeding.

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**20.5 AUTOMATIC
STAY**

Before taking any action, you should contact the designated Audit/Bankruptcy Liaison and the designated ARM Division Bankruptcy Section member. As noted below, actions taken in violation of the automatic stay may subject FTB to sanctions.

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When a bankruptcy petition is filed, an automatic stay is imposed in most cases. Generally, it prohibits creditors and potential creditors from taking collection actions against the person or entity in bankruptcy or against property of the person or entity in bankruptcy. While the automatic stay is in effect, we may do the following:

- An audit to determine tax liability, including corresponding with the Debtor and requesting information.
- The issuance of a notice of proposed assessment.
- The making of an assessment and the issuance of a notice and demand for payment of such assessment.

However, we may not issue a demand penalty (See MAP 11.4 Failure to Furnish Information Penalty) or take any collection action against the debtor.

It is the duty of each FTB employee, including FTB auditors, to ensure that FTB does not take actions that violate the automatic stay. Thus, FTB and its employees have the duty to determine whether their actions violate the stay, and no communication with the taxpayers should state that FTB (or the Office of Tax Appeals) does not have jurisdiction to determine whether FTB actions violate the automatic stay.

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20.6 DISCHARGE

A person or entity may receive a discharge in a bankruptcy case. A discharge is granted by court order in the bankruptcy proceeding. Among other things, a discharge operates as an injunction against the commencement or continuation of an action, the employment of process, or an act to collect, recover or offset any discharged debt as a personal liability of the Debtor, whether or not discharge of such debt is waived.

Actions that may not have violated the automatic stay may violate the discharge injunction.

Before taking any action after a discharge has been issued, you should contact the designated Audit/Bankruptcy Liaison and the designated ARM Division Bankruptcy Section member. Actions taken in violation of the discharge injunction may subject FTB to sanctions.

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It is the duty of each FTB employee, including auditors, to ensure that FTB does not take actions that violate the discharge injunction. Thus, FTB and its employees have the duty to determine whether their actions violate the discharge injunction, and no communication with taxpayers should state that FTB (or the Office of Tax Appeals) does not have jurisdiction to determine whether FTB actions violate the discharge injunction.

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20.7 BAR DATE

Bankruptcy laws require that we file bankruptcy claims before the Bar Date. The Bar Date is set by the court of the Bankruptcy Code and is the last day to file claims in a bankruptcy case. The period between the filing of the bankruptcy petition and the Bar Date may vary. If a claim is not filed timely, we may be barred from collecting prepetition liabilities against the bankruptcy estate, and, if the obligation is discharged, from the taxpayer. Bankruptcy Section personnel will need time to prepare and file the claim. Please allow time for this. Work with the member of the ARM Division Bankruptcy Section or the Audit/Bankruptcy Liaison to facilitate filing a timely claim.

In Chapter 11 cases, the Court may also set a deadline to file administrative expense (post-petition) claims.

For audit purposes, we are concerned with the Bar Date, since we consider this an additional statute of limitations. Notices **may** be issued after the Bar Date, but in order to receive a distribution from the bankruptcy estate, a claim should be filed prior to the Bar Date. It is critical to know the Bar Date or if one is set. If the Bar Date is not available in the file, the designated ARM Division Bankruptcy Section member can get the Bar Date or find out if a date is set. Consult your lead or the Audit/Bankruptcy Liaison if you need information about the Bar Date.

If FTB was unaware of the potential liability at the time of the Bar Date or the Bar Date has already passed, there may be remedies available. Contact the ARM Division Bankruptcy Section or the Audit/Bankruptcy Liaison immediately because FTB must act promptly to protect our interest in this scenario.

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**20.8 IDENTIFYING A
TAXPAYER IN
BANKRUPTCY**

Individuals (TI)

Check the Taxpayer Information System (TI). You may see a bankruptcy indication in the **Taxpayer Status Field** or the **Protest Field**.

For PIT taxpayers, auditors should check TI before sending an ICL to determine whether there is a bankruptcy flag on the taxpayer's account. Auditors should also check TI periodically and inform the ARM Division Bankruptcy Section if there is a bankruptcy.

To check for the existence of a Bankruptcy Flag, choose the command "***" from TI. The BK status would be shown on the top right hand corner next to "Taxpayer Status".

If you think the taxpayer may be in bankruptcy, but the indication is not in TI, contact the ARM Division Bankruptcy Section member to confirm the taxpayer's status.

Business Entity Tax System (BETS)

**** and **** will provide the Bankruptcy status information, chapter filed and petition date.

Taxpayer Folder (TPF)

The entity's Taxpayer Folder may contain comments regarding the Bankruptcy.

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**20.8.1 Indicators of a
Potential Bankruptcy
Case**

If a taxpayer does not inform the auditor of their intention to file for bankruptcy, the following are some indicators that can help to identify a potential bankruptcy situation:

- Negative cash flow or cash flow problems
- Change from profit to loss on tax returns
- High debt to equity ratio
- Large adverse litigation judgments
- Significant drop in the price of stock

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	<ul style="list-style-type: none">• Substantial under-funding of pension plan.• Major management shakeups• Foreclosure proceedings• Retention of bankruptcy counsel• Representative complaining of nonpayment• Negative reports or publicity• Hiring of a turnaround specialist <p style="text-align: right;">Rev. 7/17</p>
20.9 NPAS AND BANKRUPTCY CLAIMS	<p>Prior to discharge, NPAs may be issued while the taxpayer is in bankruptcy. Before issuing any type of Notice, contact the designated Audit/Bankruptcy Liaison and/or a member of the ARM Division Bankruptcy Section.</p> <p>An NPA is not required in order to file a proof of claim in the bankruptcy case. Nevertheless, it is in the interests of all parties that an accurate proof of claim be filed. Accordingly, if the taxpayer that filed bankruptcy is currently under audit/protest, the audit/protest should be expedited. Seek the taxpayer's cooperation in rapidly concluding the audit/protest so that accurate figures can be used in issuing an NPA and the Bankruptcy Section can file the most accurate claim.</p> <p>If an audit cannot be completed prior to the Bar Date, an estimated proof of claim should be filed prior to the Bar Date. The auditor should work with a member of the ARM Division Bankruptcy Section to prepare and file such a proof of claim. Once filed, the claim generally can be amended based on information subsequently obtained.</p> <p>Once a proof of claim is filed, it is subject to objection by parties in interest (including the taxpayer). After an objection is filed, FTB may need to promptly defend its proof of claim. Accordingly, it is in FTB's interests to promptly complete the audit/protest cases where an estimated proof of claim is filed.</p>

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	<p>If NPA Is in the Review Process</p> <p>Sometimes you may hear of a bankruptcy after an audit has been submitted for review, but before the final NPA has been issued to the taxpayer. In this situation, notify the designated member of the ARM Division Bankruptcy Section member that an NPA is pending. The FTB may need to file a claim with the bankruptcy court before the NPA completes the review process and posts to the system.</p> <p style="text-align: right;">Rev. 7/17</p>
<p>20.10 PROMPT AUDIT REQUESTS</p>	<p>A trustee of a bankruptcy estate (or the Debtor in Possession) can avoid personal liability of the bankruptcy estate, the trustee, the Debtor, and any successor to the Debtor by requesting a prompt audit of the returns filed under the trustee's (or the Debtor in Possession's) administration of the bankruptcy estate and paying the tax shown on such return. We have 60 days from the request to notify the trustee (of the Debtor in Possession) that such returns have been selected for examination. Unless we timely notify the trustee (or the Debtor in Possession), we can no longer audit the returns, unless the returns are fraudulent or contain a material misrepresentation (The determination of whether the returns are fraudulent or contain a material misrepresentation should only be made with the Bankruptcy Section's input).</p> <p>If we timely notify the trustee (or the Debtor in Possession) that such returns have been selected for examination, we have 180 days after the trustee's (or the Debtor in Possession's) initial request, or such additional time as the Bankruptcy Court permits, to notify the trustee (or the Debtor in Possession) of any tax due. You should promptly contact the Audit/Bankruptcy Liaison and/or Bankruptcy Section as soon as you believe that more than 180 days is needed to complete the examination so that appropriate relief can be requested from the Bankruptcy Court. Again, unless we so notify the trustee (or the Debtor in Possession), we can no longer audit the returns, unless the returns are fraudulent or contain a material misrepresentation. (As stated before, the determination of whether the returns are fraudulent or contain a material misrepresentation should only be made with Bankruptcy Section input.)</p> <p style="text-align: right;">Rev. 7/17</p>
<p>20.11 CLOSED BANKRUPTCY CASES</p>	<p>Under the general guidance of the Bankruptcy Section, after a bankruptcy case is closed, FTB may take certain audit actions.</p>

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20.12 FRANCHISE TAX AND BANKRUPTCY	<p>Corporations that file Chapter 7 will liquidate.</p> <p>The Bankruptcy Abuse Prevention and Consumer Protection Act, effective for bankruptcies filed on or after October 17, 2005, provides that all tax returns and applicable tax owed per federal and state tax law are required to be filed and paid.</p> <p style="text-align: right;">Rev. 7/17</p>
20.13 PENALTIES	<p>Audit can assess all applicable penalties on bankruptcy estates except the possibility of a Demand Penalty (Failure to Furnish Information Penalty). Contact the Audit/Bankruptcy Liaison and/or ARM Division Bankruptcy Section member before proposing to assess the Demand Penalty (Failure to Furnish Information Penalty).</p> <p style="text-align: right;">Rev. 7/17</p>
20.14 TAX NOTICE WORKSHEET (NPA, NOA OR NOD)	<p>Include the following bankruptcy information on the notice worksheets:</p> <ul style="list-style-type: none">• Use NPA paragraph 50500.• Attach a form FTB 7011, pink RUSH tag. Mark the bankruptcy box. <p style="text-align: right;">Rev. 7/17</p>