

BANKRUPTCY ELIGIBILITY

Estates, Trusts, Banks & Lenders

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Tax collectors face special responsibilities when dealing with property owners who have filed some type of bankruptcy. It is helpful to know exactly who can and who cannot file for bankruptcy protection (although, as noted at the end, you must assume every filing notice you receive is an "eligible" filer). This presentation is intended to focus on the general requirements for filing a Bankruptcy Petition.

The Bankruptcy Code is derived from language in the U.S. Constitution which grants Congress the ability to make uniform laws governing bankruptcy. Article I Section 8 of US Constitution. The current Federal Bankruptcy Code is found in Title 11 of the United States Code (not to be confused with "Chapter 11"). This title is broken down into a series of "Chapters" (or sections) which capture various topics within the Code. The listing of the Bankruptcy Chapters under Title 11 helps in understanding the structure of the Federal Bankruptcy law:

Chapter 1 - General Provisions

Chapter 3 - Case Administration

Chapter 5 - Creditors, the Debtor and the Estate

Chapter 7 ... Liquidation

Chapter 9- Adjustment of Debts of Municipality

Chapter 11 - Reorganization

Chapter 12-Adjustment of Debts of a Family Farmer or Fisherman with Regular Annual Income

Chapter 13 -Adjustment of Debts of Individual with Regular Income

Chapter 15 - Ancillary and other Cross-Border Cases.

In general, the provisions of Chapters 1, 3 and 5 apply to all cases brought in Bankruptcy Court. 11 USC § 103(a). These contain definitions, concepts and procedures which apply to all types of cases. The provisions of Chapters 7, 9, 11, 12, 13 and 15 are intended to apply to the specific type of Debtor in bankruptcy.

While several of the Chapter names are "self-explanatory" as to the parties eligible to file (i.e. Chapter 9 - municipalities and municipal entities; Chapter 12, Family Farmers and Fishermen), the filing requirements for most all Code Chapters come from Chapter 1, Section 109 entitled "Who May be a Debtor". The full text of Section 109 is attached.

The section begins with the requirement that a party must be a person residing, living, conducting business or owning property in the United States. Foreigners who have no connection with the United States are not eligible to file bankruptcy here. The "connection" need not be particularly strong. In the case of In Re: Iglesias, 226 B.R. 721 (Bankr S.D. N.Y. 1998) a bank account in a US bank of \$500 was sufficient to allow a filing by a Citizen of Argentina. See also. Global Ocean Carriers. Ltd. 153 B.R. 409 (Bankr S.D. N.Y. 1993). A U.S. Citizen residing outside the country who maintains voting privileges and files tax returns using a parent's U.S. address was deemed eligible to file. In Re: Farmer, 288 B.R. 31 (Bankr N.D. N.Y. 2002).

The operational word for filing eligibility under Section 109 is the word "person". The Code defines a "person" as:

(41) The term "person" includes individual, partnership and corporation, but does not include governmental unit, except [exception not relevant to this presentation].

11 USC §101(41).

"Individual" is not specifically defined in the Code, but is considered to be a "natural person" (i.e. a human being). See. In Re: A & J Auto Sales, 205 B.R. 676 (Bankr D. NH 1996).

A "sole proprietorship" does not fall within the definition of "corporation" or partnerships. Typically a sole proprietorship is a form of business in which "one person owns all assets of the business in contrast to a partnership or a corporation." *Blacks Law Dictionary*, 5th Ed. 1979. As such, a "sole proprietorship" is not an entity that can file bankruptcy. In Re: Christenberry, 336 B.R. 353 (Bankr E.D. Tenn. 2005); In Re: CA

Financial Solutions, (Bankr D. Hawaii 2019) Docket #19-000676 (RJF). The appropriate "filer" in such circumstances would be the individual who is the sole proprietor.

Likewise, a "probate estate" cannot file bankruptcy. In RE: Estate of Brown, 16 B.R. 128 (Bankr D. D.C. 1981). Only "persons" qualify for relief under Title 11 and a probate estate is not a person. In Re: Estate of Roberts, 2005 W.L. 3108 224 (Bankr D. Md. 2005). In fact, if a debtor dies during the process of a Chapter 13 proceeding, the estate representative may not be "substituted" for the Decedent. In Re: Shepherd, 490 B.R. 338 (Bankr N.D. Ind. 2013).

As noted in Section 109 (b) there are several specific prohibitions against filing:

- A railroad may not file Chapter 7 Liquidation. 11 USC 109(b)(1). It may however, file for reorganization under Chapter 11. 11 USC 109(d).
- Domestic Insurance Companies, banks, savings banks, co-op banks, and most other entities that are subject to regulation by the FDIC may not file Chapter 7 (or Chapter 11). This is because they are subject to separate liquidation rules under other Federal or State laws. Most domestic insurance companies are subject to administration by State regulators. .E.:9:., RSA Chapter 402-C. See. In Re: Matter of Liquidationof Home Insurance, 154 NH 472 (2006). Note that this prohibition does not ~~mm!¥~~ to private non-bank lenders (e.g. Ditech Corp.).
- Foreign Insurance Companies and foreign banks are generally prohibited from filing.
- There are specific asset and income limitations as to who may file for relief under Chapter 13. 11 USC §109(c).
- As a result of congressional efforts to limit bankruptcy filings, there are now requirements for "credit counseling" within 180 days prior to filing a bankruptcy petition. 11 USC §109(h). There are various qualifications and exceptions to this rule which are beyond the scope of this outline.

Of most interest (and considerable litigation) are the provisions related to "corporations". Corporations fall within the definition of "person" meaning that a "corporation" can file for bankruptcy relief. 11 USC §101(41). The definition includes such terms as would be typical for "corporations" under law (a separate legal entity; debts limited to the entity

and not necessarily the assets of individual investors). See, 11 USC 101(9)(A)(i) and (ii). But it also includes the phrase "business trusts". USC 101(9)(A)(v).

It is clear from settled decisions of the Courts that:

"Generally trusts are not eligible for relief in the bankruptcy court."

In Re: Armstead and Wayson Trust,
29 B.R. 58 (Bankr D. Md 1982).

Accord, In Re: Hughes Living Trust, 305 B.R. 59 (Bankr W.D. Okla. 2004).

A business trust is generally distinguished from an "estate planning" or family Trust. The latter may not file in bankruptcy.

In New Hampshire, the distinctions between a "business trust" (eligible to file) as opposed to a "family trust" (not eligible to file) are set forth in three (3) sequential opinions issued by former Bankruptcy Judge James Yacos:

- 1) In RE: Gonic Realty Trust, 50 B.R. 710 (Bankr D N.H. 1985). Raymond Crowley established the Gonic Realty Trust in 1977. He served as Trustee and he and his wife were beneficiaries. The Trust owned a large mill and related land in Rochester, New Hampshire. It rented out space in its properties, and maintained the properties through contracted vendors. The Trust (through the Trustee) entered into a loan arrangement with Laconia National Bank and Trust. When the load defaulted, Laconia National began collection proceedings. The Trust filed bankruptcy. The bank moved to Dismiss, claiming the Trust was not a "business trust". Judge Yacos denied the Motion to Dismiss. In his opinion he stated:

In the present case it is clear that Gonic was conducting a business operation relating to the leasing of various portions of the mill complex to commercial and industrial tenants. This was something more than mere holding and conserving particular property in a "simple land trust".

Id at 714.

In reaching his conclusion, the Judge rejected the argument that the Trust needed "transferable ownership shares" to constitute a "business trust". Id. at 713.

- 2) In Re: Woodsville Realty Trust, 120 B.R. 2 (Bankr D NH. 1990). Woodsville Realty Trust owned a commercial building in Woodsville, New Hampshire. It used a management company to manage and collect rents; maintain the properties, and provide regular reports to the Trustee, Melvin Zimmennan. The Trust contained a "Schedule of Beneficiaries" which included language that prohibited the assignment of any beneficial interest in the Trust. It also provided that the Trust could be terminated by the beneficiaries, and ended automatically 20 years from formation. A Creditor Lender, Bank of New England, moved to Dismiss a Chapter 11 filing by the Trust. In an evolution of his thinking on business trusts, Judge Yacos ruled that because "business trust" was within the definition of "corporation" within the Bankruptcy Code, he concluded that the Trust Entity must contain "attributes of a Corporation." Id. at 3. After surveying holdings of various other Bankruptcy Courts, Judge Yacos adopted the language of a 1990 Massachusetts decision:

Since the Code defines a corporation to include a business trust, it stands to reason that a business trust should have at least some of the indicia of a corporation and be more than a mere agency. It is not this Court's intention to look behind the trust to find an eligible debtor in the form of the beneficiary.

Woodsville Realty. supra at 9,
citing, In RE: Village Green Realty Trust,
113 B.R. 105 (Bankr D Mass 1990).

Judge Yacos acknowledged that this new standard modified his holding in Gonic Realty, stating that:

"I agree that the mere fact that the Trust happens to engage in business activities does not therefore make it a "business trust".

Woodsville Realty supra at 5.

He then points out why the Woodsville Trusts is not a business trust:

- Beneficiaries control the Trustee
- Interest shares not transferable
- Fixed termination date.

The Judge concluded that the Woodsville Trust was not a business trust and dismissed its bankruptcy filing.

3) In Re: BKC Realty Trust: 125 B.R. 65 (Bankr D NH 1991). In this case Judge Yacos adopts an additional criteria for a "business trust" that is that it be formed for business and commercial purposes. The BKC Realty Trust was formed in 1987. The Trust was a "grantor type" trust into which the Trustee conveyed several pieces of commercial real estate. The purpose of the Trust was stated as being to hold property for the benefit of the beneficiaries (the Trustee's two (2) sons). The Court distinguished a "business trust" and a "family trust" whose primary purpose was to hold property for family and/or avoid probate proceedings. Judge Yacos adopts the requirement that:

"a qualifying trust must be created to transact business for the benefit of investorsn.

BKC Realty. supra. at 68
Citing. In Re: Medallation Realty Trust
103 B.R. 8 (Bankr D Ma 1989).

Because BKC Realty was initially established as a "family Trust", the filing was dismissed.

The New Hampshire cases as outlined above generally reflect the prevailing thinking with regard to the ability of trusts to file bankruptcy. In the 2004 case of Hughes Living Trust, 305 B.R. 59 (Bankr W.D. Okla. 2008), the Court describes the difference between a "business trust" (an allowed filer) and a "trust" in the following way:

The basic distinction between business trusts and nonbusiness trusts is that business trusts are created for the purpose of carrying on some kind of business or commercial activity for profit; the object of a nonbusiness trust is to protect and preserve the trust res. The powers granted in a traditional trust are incidental to the principal purpose of holding and

conserving particular property, whereas the powers within a business trust are central to its purpose. It is the business trust's similarity to a corporation that permits it to be a debtor in bankruptcy.

Id at 62,
citing. In Re: Treasure Island Land Trust,
2 B.R. 332, 334 (Bankr M.D. Fla. 1980).

The important thing to remember is that whether or not a filer is a "qualified" filer is something to be judicially determined by the Court, generally through the filing of a Motion to Dismiss (although the Court, on its own, can raise the issue). When notice of a bankruptcy filing is received, you need to act as if it is valid until the case is dismissed. The "automatic stay" under 11 USC 362 is triggered on filing. Therefore, no matter how skeptical you may be that the filing is legitimate, you must treat it as valid. If the community wishes to challenge the filing, you need to retain Counsel, and file a Motion to Dismiss the case.

Finally, it should be pointed out that there are state proceedings that can (in theory) be started outside of the Bankruptcy Courts. Under NH RSA Chapter 568, there is a process for "Insolvency" that can be filed with the Probate Court. Most of the reported cases involving this statute are prior to 1900. It is essentially a "bankruptcy law" at the state level. See, Howland's Appeal, 67 NH 575 (1894). The statute uses the term "inhabitant" and indicates it is available to inhabitants "not entitled to proceed under the Bankruptcy Act". RSA 568:6.

There is also the common law process of filing for "Receivership" which is the equivalent of an "involuntary bankruptcy" where creditors can force a person/entity to liquidate to pay debts. This is done through a Petition to the Superior Court. RSA 498:12. The basic reason is to secure and conserve property for the benefit of all persons interested therein. Petition of Leon Keyser, Inc., 98 NH 198 (1953). The author has used the process on at least one (1) occasion.

A similar process by a different name is an "Assessment for Benefit of Creditors". This is another "non-bankruptcy" process to distribute the assets of an insolvent entity.

While not fully researched, the author is aware that the process is employed in other states.

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11 U.S. Code § 109. Who may be a debtor

U.S. Code Notes

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not-

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a New Markets Venture Capital company as defined in section 351 of the Small Business Investment Act of 1958, a small business investment company licensed by the Small Business Administration under section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act of 1950, except that an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991, may be a debtor if a petition is filed at the direction of the Board of Governors of the Federal Reserve System; or

(3)

{A} a foreign insurance company, engaged in such business in the United States; or

{B} a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union, that

has a branch or agency (as defined in section 1(b) of the International Banking Act of 1978) in the United States.

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity-

(1) is a jurisdiction;

(2) is specifically authorized, in its capacity as a municipality, or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is Insolvent;

(4) desires to effect a plan to adjust such debts; and

(5)

(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

(d) Only a partner, a person that may be a partner under section 7 of this title (except a stockbroker or a commodity broker), and an unaffiliated State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor under chapter 11 of this title.

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than \$250,000 and noncontingent, liquidated, secured debts of less than \$750,000, or an individual with regular income and such individual's

spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than \$250,000 and noncontingent, liquidated, secured debts of less than \$750,000 may be a debtor under chapter 13 of this title.

(f) Only a family farmer or family farmer with regular annual income may be a debtor under chapter 12 of this title.

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if-

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

(h)

(1) Subject to paragraphs (2) and (3), and notwithstanding any other provision of this section other than paragraph (4) of this subsection, an individual may not be a debtor under this title unless such individual has, during the 180-day period ending on the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a), an individual or group briefing (Including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

(2)

{A} Paragraph (1) shall not apply with respect to a debtor who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved nonprofit budget and credit counseling agencies for such district are not reasonably able to provide adequate services to the additional individuals who would otherwise seek credit counseling from such agencies by reason of the requirements of paragraph (1).

{B} The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in subparagraph (A) shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually

thereafter. Notwithstanding the preceding sentence, a nonprofit budget and credit counseling agency may be disapproved by the United States trustee (or the bankruptcy administrator, if any) at any time.

(3)

(A) Subject to subparagraph (B), the requirements of paragraph (1) shall not apply with respect to a debtor who submits to the court a certification that-

(i) describes exigent circumstances that merit a waiver of the requirements of paragraph (1);

(ii) states that the debtor requested credit counseling services from an approved nonprofit budget and credit counseling agency, but was unable to obtain the services referred to in paragraph (1) during the 7-day period beginning on the date on which the debtor made that request; and

(iii) is satisfactory to the court.

(B) With respect to a debtor, an exemption under subparagraph (A) shall cease to apply to that debtor on the date on which the debtor meets the requirements of paragraph (1), but in no case may the exemption apply to that debtor after the date that is 30 days after the debtor files a petition, except that the court, for cause, may order an additional 15 days.

(4) The requirements of paragraph (1) shall not apply with respect to a debtor whom the court determines, after notice and hearing, is unable to complete those requirements because of incapacity, disability, or active military duty in a military combat zone. For the purposes of this paragraph, incapacity means that the debtors impaired by reason of mental illness or mental deficiency so that he is incapable of realizing and making rational decisions with respect to his financial responsibilities; and "disability" means that the debtor is so physically impaired as to be unable, after reasonable effort, to participate in an in person, telephone, or Internet briefing required under paragraph (1).

(Pub. L. 95-598, Nov. 6, 1978, 92 Stat. 2557; Pub. L. 97-320, title VII, §20 (9), Oct. 15, 1982, 96 Stat. 1539; P.L. 98-353, title III, §§301, 425, July 10, 1984, 98 Stat. 369; Pub. L. 99-554, title I, §101, Oct. 27, 1986, 100 Stat. 3105; Pub. L. 100-597, §1, Nov. 3, 1988, 102 Stat. 3028;