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Issue Contents

Bankruptcy

General

Exemptions

Retirement accounts **163**

Federal Tax

Tax liens **163**

Federal Estate and Gift Taxation

Allocation of basis for deaths in 2010 **164**

Federal Farm Programs

No items

Federal Income Taxation

Bad debts **164**

Disaster losses **164**

Information returns **165**

Pension plans **165**

IRS publications **165**

Opportunity zone tax incentive **165**

Personal exemption **166**

Qualified business income deduction **166**

Recordkeeping **166**

Returns **166**

Tax return preparers **166**

Safe harbor interest rates

November 2018 **167**

Insurance

Statute of limitations **167**

Products Liability

Animal feed **167**

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Bankruptcy Automatic Stay Can Be Retroactively Annulled

by Robert P. Achenbach, Jr.*

In times of temporary or short term financial difficulties, small businesses, such as farmers and ranchers, may find themselves beset by creditors clamoring for immediate payment instead of patiently waiting for harvest or insurance proceeds to cover operating and other debts. One of the most immediate benefits of filing for Chapter 7, 11, 12 or 13 bankruptcy, is the imposition of the automatic stay of a number of legal and administrative actions against the debtor, giving the debtor some breathing space to attempt to reorganize or liquidate in an orderly manner.¹

Effect of Automatic Stay

Section 362(a) of the Bankruptcy Code identifies eight actions which are prohibited or stayed until relief from the automatic stay is granted by the Bankruptcy Court:

(1) initiating or continuing a suit against the debtor or property of the estate;²

(2) enforcement of judgments against the debtor;³

(3) actions to obtain possession of property of the estate or exercise control over property of the estate;⁴

(4) actions that create, perfect, or enforce liens against property of the estate;⁵

(5) actions that create, perfect, or enforce liens securing prepetition claims against property of the debtor;⁶

(6) actions to collect, assess, or recover prepetition claims;⁷

(7) the setoff of prepetition debts owing to the debtor;⁸ and

(8) continuing or commencing litigation in the U.S. Tax Court concerning a corporate debtor's tax liability for a taxable period that the bankruptcy court may determine or the tax liability of an individual for a tax period ending before the date of the order for relief.⁹

Actions Not Prohibited by the Automatic Stay

Section 362(b) and case law have identified over 28 actions not affected by the automatic stay, including—

(1) criminal actions against the debtor;¹⁰

(2) domestic support, paternity and child support enforcement actions;¹¹

(3) perfection of some security interests;¹²

(4) an audit by a government unit to determine tax liability; the issuance of a notice of tax deficiency by a governmental unit; the demand for tax returns; and making an assessment for tax and issuance of a notice and demand for payment of the assessment;¹³

(5) filing of notice under the Perishable Agricultural Commodities Act for eligibility of the producer for trust proceeds;¹⁴

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(6) the creation or perfection of a statutory lien for an ad valorem property tax, special tax or special assessment under real property if the tax imposed by governmental unit if the tax or assessment comes due after the date of filing;¹⁵ and

(7) a setoff under applicable nonbankruptcy law of an income tax refund by a governmental unit for a tax period ending before the date of filing against the income tax liability for a taxable period that also ended before the date of relief;¹⁶

Violation of Automatic Stay

Actions prohibited by an automatic stay are void¹⁷ but, as discussed below, may be resurrected by retroactive annulment of the automatic stay.¹⁸ A debtor may also file an action for damages; including costs; attorney's fees; and in some cases, punitive damages, for a willful violation of the automatic stay.¹⁹

Termination of Automatic Stay

The automatic stay continues as to estate property until the property is removed from the estate, either by exemption, court order, or abandonment.²⁰ Other prohibited actions are stayed until the case is dismissed or closed or the plan is confirmed or finally denied.²¹

Retroactive Annulment of an Automatic Stay

A recent case in a Wisconsin Bankruptcy Court²² examined what happens where a creditor unknowingly and in good faith fails to halt a prohibited action, in this case a replevin judgment against estate property, after the filing of a bankruptcy case?

In 2009, a creditor sued farm debtors to recover farm equipment collateral for which the debtors had defaulted on purchase loans. In 2010, the debtors filed for Chapter 12 and eight days later the creditor and state court learned about the bankruptcy filing. Five days after the bankruptcy filing but three days before the creditor and state court learned about the bankruptcy filing, the state court entered a default judgment against the debtors.

In 2017, after the Bankruptcy Court dismissed the last of the debtors' three serial Chapter 12 cases, the state court issued a writ of replevin against the debtors and the creditor took possession of the farm equipment. The debtors filed an action in the Bankruptcy Court to invalidate the state court default judgment as void under the automatic stay rules in Section 362(a). The creditor argued that, even if the 2010 judgment was void, the creditor had the right to repossess its collateral and there was no stay in effect when it did.

The Bankruptcy Court ordered the debtors to explain why the Court should not annul the original automatic stay for cause under Section 362(d)(1) but the debtors failed to properly respond. The Bankruptcy Court then ruled that the case was to be dismissed for failure of the debtors to respond to the court order; however, the court also ruled on the merits of the annulment issue.

Section 362(d) states that, "[o]n request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under [Section 362(a)], such as by terminating, annulling, modifying, or conditioning such stay-(1) for cause" The court explained that annulment referred to retroactively granting relief from the automatic stay in contrast to a termination of the automatic stay, which affects only actions filed after the termination.²³

The court also noted case precedent²⁴ that an annulment of an automatic stay was appropriate where enforcement of the automatic stay would result only in redundancy and delay in

that the creditor would be forced to conduct another foreclosure proceeding. That same case²⁵ listed the requirements for annulment: (1) the creditor had no knowledge of the bankruptcy filing; (2) the creditor in good faith sought the foreclosure; (3) the debtor's interest in the collateral was unenforceable as against the creditor's interest; and (4) the debtor failed to assert the automatic stay before the foreclosure.

The court found that the creditor and state court in good faith had no knowledge of the original bankruptcy filing at the time of the original replevin judgment and the debtor failed to assert the automatic stay as to the original replevin judgment during any of the three Chapter 12 cases. Thus, the court held that the automatic stay that arose in the original Chapter 12 case, and continued through the following two Chapter 12 cases, was retroactively annulled and the state court replevin decision was valid and enforceable against the farm equipment after the dismissal of the final Chapter 12 case.

The result makes good sense in light of the waste of time, money and judicial resources that would result from forcing the creditor to re-file and re-try the replevin action, especially where the debtors failed to assert the automatic stay in not one but three bankruptcy cases.

ENDNOTES

¹ See Harl and Achenbach, *Agricultural Law*, § 120.03[1] (2018) for discussion of the automatic stay.

² 11 U.S.C. § 362(a)(1); *see, e.g., In re Wegner Farms, Co.*, 49 B.R. 440 (Bankr. N.D. Iowa 1985) (cancellation of grain dealer's bond after filing of bankruptcy petition violates automatic stay as proceeding against debtor and as action to obtain property, bond, of debtor).

³ 11 U.S.C. § 362(a)(2); *but see, In re Karis*, 208 B.R. 913 (Bankr. W.D. Wis. 1997) (sale of collateral cattle after repossession did not violate automatic stay because debtor no longer had any rights in cattle).

⁴ 11 U.S.C. § 362(a)(3); *see, e.g., In re Benefield*, 102 B.R. 157 (Bankr. E.D. Ark. 1989) (leasing of estate's interest in farmland by debtor was without authority, violation of automatic stay and voidable by trustee).

⁵ 11 U.S.C. § 362(a)(4); *see Makoroff v. Lockport*, 916 F.2d 890 (3d Cir. 1990), *aff'g* 111 B.R. 107 (W.D. Pa. 1990), *aff'g* 95 B.R. 370 (Bankr. W.D. Pa. 1989) (property tax liens that arose postpetition void as violating automatic stay).

⁶ 11 U.S.C. § 362(a)(5); *see In re Winzenburg*, 61 B.R. 141 (Bankr. N.D. Iowa 1986) (mortgagee not allowed to sequester debtor's farm profits and rents during automatic stay where, under Iowa statute, security interest in rents and profits would not arise until after mortgage foreclosure action commenced and automatic stay prevented foreclosure action).

⁷ 11 U.S.C. § 362(a)(6); *see In re Crosby*, 109 B.R. 195 (Bankr. S.D. Miss. 1989) (tax sale of debtor's real property in order to pay delinquent ad valorem taxes was violation of automatic stay and sale void).

⁸ 11 U.S.C. § 362(a)(7); *see United States v. Gerth*, 991 F.2d 1428 (8th Cir. 1993), *rev'g* 136 B.R. 241 (Bankr. D.S.D. 1991) (ASCS allowed setoff of prepetition claim against Chapter 12 debtor's postpetition CRP payments because CRP contracts were executory with continuing obligations by both parties).

⁹ 11 U.S.C. § 362(a)(8); *see* *Nichols v. Comm’r*, T.C. Memo. 1988-257 (Tax Court case commenced by debtor dismissed for violation of automatic stay).

¹⁰ 11 U.S.C. § 362(b)(1).

¹¹ 11 U.S.C. § 362(b)(2)(A).

¹² *See In re Aznoe Agribiz, Inc.*, 416 B.R. 755 (Bankr. D. Mont. 2009) (postpetition filing of statutory agricultural supplier’s lien did not violate automatic stay).

¹³ 11 U.S.C. § 362(b)(7). *See, e.g., Pitts v. Comm’r*, 2005-2 U.S. Tax Cas. (CCH) ¶ 50,655 (S.D. N.Y. 2005) (IRS sending of Form CP-158 to demand debtor file income tax returns did not violate automatic stay).

¹⁴ *See In re Prange Foods Corp.*, 63 B.R. 211 (Bankr. W.D. Mich. 1986) (automatic stay does not toll 30-day period for filing of notice under Perishable Agricultural Commodities Act for eligibility of producer for trust proceeds; in addition producer need not file motion to lift stay to file PACA claim).

¹⁵ 11 U.S.C. § 362(b)(18).

¹⁶ 11 U.S.C. § 362(b)(26); *see In re Ewing*, 400 B.R. 913 (N.D. Ga. 2008) (Chapter 13 petition did not stay right of IRS to offset prepetition tax refund against prepetition tax liability); *In re Bryant*, 399 B.R. 477 (Bankr. W.D. Ky. 2009) (Chapter 7 discharge did not stay right of IRS to offset prepetition tax refund against prepetition tax liability).

¹⁷ *See In re Myers*, 491 F.3d 120 (3d Cir. 2007); *Makoroff v. Lockport*, n. 5 *above*.

¹⁸ *Id.*, *see also* ns. 20-25 below and accompanying text.

¹⁹ 11 U.S.C. § 362(k); *see Archer v. Macomb County Bank*, 853 F.2d 497 (6th Cir. 1988) (debtor awarded actual damages for lost horse breeding and training contracts and punitive damages where mortgagor attempted foreclosure after notice of bankruptcy filing); *In re Herbert*, 2000-1 U.S. Tax Cas. (CCH) ¶ 50,206 (9th Cir. 1999) (debtors allowed actual damages for IRS violation of automatic stay; punitive damages not allowed against IRS).

²⁰ *See, e.g., In re Kretzer*, 48 B.R. 585 (Bankr. D. Nev. 1985) (repossession action against pickup truck did not violate automatic stay where truck was exempt property removed from bankruptcy estate).

²¹ 11 U.S.C. § 362(c)(2); *see, e.g. In re Dickey*, 64 B.R. 3 (Bankr. E.D. Va. 1986) (assessment and levy by IRS after confirmation of debtor’s Chapter 13 plan for postpetition income taxes not in violation of automatic stay because confirmation of plan terminates stay).

²² *In re Schonscheck*, 2018 Bankr. LEXIS 3231 (Bankr. E.D. Wis. 2018).

²³ *In re Albany Partners, Ltd.*, 749 F.2d 670, 675 (11th Cir. 1984) (“[A]n order annulling the stay [can] operate retroactively to the date of the filing of the petition which gave rise to the stay, and thus validate actions taken by the party at a time when he may have been unaware of the existence of the stay.”)

²⁴ *In re Pinetree, Ltd.*, 876 F.2d 34 (5th Cir. 1989).

²⁵ *In re Pinetree, Ltd.*, 876 F.2d 34 (5th Cir. 1989).

CASES, REGULATIONS AND STATUTES

BANKRUPTCY

GENERAL

EXEMPTIONS

RETIREMENT ACCOUNTS. Prior to filing for Chapter 7, the debtor was divorced and the divorce decree property settlement provided that the debtor was awarded one-half of the former spouse’s I.R.C. § 401(k) account and all of the funds in the former spouse’s IRA. At the time of the filing for bankruptcy, neither property transfer had occurred. The debtor claimed the 401(k) and IRA funds as exempt funds under Section 522(d)(12) but a creditor objected to the exemptions. Section 522(d)(12) provides an exemption for “Retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.” The court cited *Clark v. Rameker*, 134 S. Ct. 2242 (2014) for a definition of retirement funds: “The ordinary meaning of “fund[s]” is “sum[s] of money ... set aside for a specific purpose.” And “retirement” means “[w]ithdrawal from one’s occupation, business, or office.” Section 522(b)(3)(C)’s reference to “retirement funds” is therefore properly understood

to mean sums of money set aside for the day an individual stops working.” The debtor argued that the 401(k) and IRA accounts were created by the former spouse as funds for their retirement. However, the court found that the funds in the hands of the debtor were merely part of the divorce property settlement and held that they were not eligible for the retirement fund exemption. *In re Lerbakken*, 2018-2 U.S. Tax Cas. (CCH) ¶ 50,454 (Bankr. 8th Cir. 2018).

FEDERAL TAX

TAX LIENS. The debtor filed for Chapter 7 and the estate included the debtor’s residence for which the debtor claimed the Washington state exemption of \$125,000. A bank had a secured claim against the property of \$476,240 and an unsecured judgment claim for \$1.4 million. The IRS had a tax lien against the property for \$687,661. The total secured claims exceeded the value of the property after the exemption amount. The property was sold under an agreement that the bank would allow the trustee to receive part of the proceeds due to the bank to compensate the trustee for the costs of the sale and that the debtor would receive the exemption amount. The IRS objected to the sale and the trustee agreed to leave the issue of the exemption to further court proceedings. The property was sold and the trustee (1) filed a motion to distribute the exemption amount to the IRS but (2) sought to use Section 724(b) to reduce the amount paid to the IRS by the costs of the