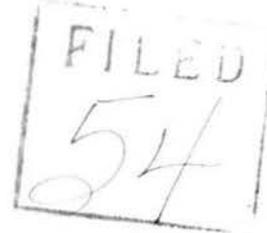


BANKRUPTCY: Action in nature of a suit should not be taken by a collector to collect taxes from a bankrupt railroad;

Claim for taxes should include interest, penalties and interest.

April 5, 1934.

4-9



Hon. Minor C. Livesay,
Prosecuting Attorney,
Versailles, Missouri.

Dear Sir:

This department acknowledges receipt of your letter of March 9, 1934 wherein you request an opinion relating to delinquent railroad taxes due and owing to the County of Morgan by the Chicago, Rock Island and Pacific Railway Company. You have very kindly attached the correspondence relating to the matter, which has been of assistance to us in rendering an opinion. Your letter is as follows:

"I am enclosing herewith copies of the correspondence and of law cited between the Collector of Morgan County and the Chicago, Rock Island and Pacific Railway Company.

The Collector has asked me to secure an opinion from your office as to what action, if any, he should take towards collection of railway taxes at this time.

The Statute of Missouri, Section 10038, R.S. Missouri require him to proceed by suit to collect these taxes.

I talked to one of the lawyers in your office some time ago and he suggested that suit be filed. However, I would appreciate a written opinion."

An action in the nature of a suit
should not be taken by a collector
to collect taxes from a railroad
company in bankruptcy.

Sec. 10038, R.S. Mo. 1929, mentioned in your letter, provides as follows:

"If, on the first day of January of any year, any taxes levied under the provisions of this article, in any county, remain delinquent and unpaid, it shall be the duty of the collector of such county, notwithstanding the right of seizure and sale of personal property, to proceed at once to enforce the lien of the state against the property of said company, and to compel the payment of such taxes by suit in the circuit court of said county; and in all such suits the general laws of the state as to practice and proceedings in civil cases shall apply, as far as applicable, and not inconsistent with this article."

We agree with you that under this section the ordinary procedure to collect delinquent taxes from a railroad or street car company would be by the method outlined, but in the instant case the railroad company appears to be insolvent; we must therefore determine whether or not an action can be brought when a railroad company is in bankruptcy. In the first instance the order, which is restraining in its nature would, as pointed out by Mr. Angell, in all probability place the one suing in contempt. In other words, we believe under this order your collector would be restrained from bringing any such suit.

In a decision in our own state, *Bank of Rothville v. Zaleuke*, 221 Mo. App. 1051, l.c. 1052, the Court said:

"Appellant presents eleven assignments of error but the solution of the first, to-wit, that the court erred in overruling defendant's motion to dismiss the action and his plea to the jurisdiction will determine them all. There is no dispute as to the material facts in the case, but as to the application of the law to the facts there is much controversy. It is urged by defendant, and is the law, that when a Federal court in a bankruptcy proceeding has acquired jurisdiction, a State court cannot render a judgment, jurisdiction of the cause being lodged in the Federal and not the State court. (Black on Bankruptcy (1926 Ed.), p. 135, sec. 90, and p. 475, sec. 364; *Putnam v. Coleman*, 277 S.W. 213)."

We are of the opinion that it would be necessary, before any suit could be maintained, that special leave of court should be given, as was held in the case of *Dayton v. Stanard*, 241 Sup. Ct. Rep. 1190, l.c. 1192:

"This is a controversy growing out of the sale for taxes and special assessments of divers tracts of real property belonging to a bankrupt estate then in the course of administration in a court of bankruptcy. The property was in custodia legis and was sold without leave of court. Because of this the court held the sales invalid, and entered a decree canceling the certificates of purchase, and enjoining the county treasurer from issuing tax deeds thereon. Thus far there is no room to complain."

Also, in the case of *People of State of New York v. Irving Trust Co.*, 288 U.S. 329, it was held:

"The Federal government possesses supreme power in respect of bankruptcies. *International Shoe Company v. Pinkus*, 278 U.S. 261, 265, 49 S. Ct. 108, 73 L. Ed. 318. If a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated."

We are of the further opinion that your collector could not bring any action for the collection of the delinquent taxes. Having so held, then what should be the procedure? The pertinent part of the National Bankruptcy Act, provides as follows (U.S.C.A. Title 11, p. 71):

"(a) The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors, and upon filing the receipts of the proper public officers for such payment he shall be credited with the amount thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court."

Sec. 103 of the same Act deals with debts provable against the bankrupt and is in part as follows:

"(a) Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; (2) due as costs taxable against an involuntary bankrupt who was at the time of the filing of the petition against him plaintiff in a cause of action which would pass to the trustee and which the trustee declines to prosecute after notice; (3) founded upon a claim for taxable costs incurred in good faith by a creditor before the filing of a petition in an action to recover a provable debt; (4) founded upon an open account, or upon a contract express or implied; and (5) founded upon provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments."

Conclusion

In view of the foregoing, it is the opinion of this department that the proper procedure would be, as stated by Mr. Angell, for you to file a claim for the unpaid taxes.

II.

The claim for taxes should include interest, penalties and commission

We are not in accord with Mr. Angell in his statement that Sec. 93 of the National Bankruptcy Act as enumerated would exempt the payment of penalties and commissions. Sec. 93, U.S.C.A. Title 11, p. 287 states as follows:

"Debts owing to the United States, a State, a county, a district, or a municipality, as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

Corpus Juris, Vol. 7, P. 307, Sec. 501 provides as follows:

"Debts owing to the United States, a state, a county, a district, or a municipality as a penalty or forfeiture cannot be allowed except for the amount of the pecuniary loss sustained by reason of the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs sustained thereby, and such interest as may have accrued thereon according to law. But where a penalty for nonpayment of a delinquent tax takes the place of interest, such penalty can be allowed as a claim against the bankrupt estate of the taxpayer along with the tax. Where a lease to a bankrupt of a store service system for a term of ten years provided that, on a breach by the lessee or its bankruptcy, the lessor might enter and take possession of the property, which it did after the bankruptcy, a further provision that in such case the rent for the entire term should immediately become due and payable was one for a penalty, and a claim therefor against the bankrupt estate could not be allowed."

A case also bearing on the question is that of *In Re Scheidt Bros.*, 177 F. 599, in which the Court said:

"Section 2855, Rev. St. Ohio 1908, provides that immediately after the semiannual settlement for taxes in August of each year the county auditor shall add a penalty of 10 per cent. to all taxes on personal property remaining unpaid, as shown by the County treasurer's books. If the taxes be not then paid within the time named in section 1094, Rev. St. 1908, and the county treasurer thereafter proceeds to collect them

by distress, or action, or rule of court, or special effort in person or through his agent (Hunter v. Borck, 51 Ohio St. 320, 37 N.E. 714), a further penalty of 5 per cent. is added to them, for his use as compensation. Taxes on personalty, unlike those on realty, are not made a lien on any of the owner's property. The referee held that under Section 57j of the bankruptcy act (Act July 1, 1898, c. 541, 30 Stat. 561 (U.S. Comp. St. 1901, p. 3444) the penalty is not allowable as a claim against the estate.

No question as to taxes accruing and penalties imposed subsequent to the institution of the bankruptcy proceedings is involved. Whatever may be the rule elsewhere, in Ohio the penalty takes the place of interest. Bridge Co. v. Mayer, 31 Ohio St. 317, 328. Its allowance is intended to cover interest until the delinquent taxes are put into judgment (Wheeling & Lake Erie Ry. Co. v. Wolfe, 13 Ohio Cir. Ct. R. 374) or are paid voluntarily, or are collected by special effort of the treasurer, in person or by his agent--in some manner other than by a part of the tax itself. 27 Am. & Eng. Ency. Law, 777, 778, 779. Under section 64 of the bankruptcy act, the referee should have directed payment of both taxes and penalty. Re Kallak (D.C.) 147 Fed. 276. Referee reversed."

We also refer you to the case of In Re S. Alex Smith & Co., 289 F. 524, wherein the court said (l.c. 525):

"In this matter the town of Madison made a claim for taxes for the years 1921 and 1922 due from the bankrupt. Upon a hearing before the referee an order was made on the 28th day of April, 1923, denying the petition of the town to have the taxes due for 1921 paid by the trustee as a priority. It is this order that is brought here for review.

The decision of the question here involved must be governed by the terms of the Bankruptcy Act (Comp. St. Secs. 9585-9656). Section 64 provides for the priority of payment out of the bankruptcy estate and specifically says:

'The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to ***** municipality in advance of the payment of dividends to creditors.'

Are these taxes legally due? The amount and due assessment are not questioned. The payment is objected to because the tax collector might have collected same by levy and sale prior to the bankruptcy proceedings. But the fact that he did not do so in no wise discharges the obligation of the taxpayer, nor releases his estate should he subsequently go into bankruptcy. Nor does the payment of such taxes by the trustee depend upon any question of lien. The referee seems to have been led astray in the order made by the assumption that the lien for taxes attached only to the particular personal property upon which such tax was assessed. As I understand the law, the lien for taxes attaches to all the property possessed by the taxpayer, whether possessed at the time of the levy of the tax or subsequently acquired. But, be this as it may, the payment of taxes properly assessed against and owing by the bankrupt at the time of bankruptcy must be paid from the estate before any dividends are distributed to the creditors, as provided by the bankruptcy act.

The petition to review is granted, and the matter remanded to the referee, with instructions to order the trustee to pay the town of Madison the amount due for taxes for the year 1931."

Conclusion

In view of the above authorities, it is the opinion of this department that you may rightfully and legally file a demand or claim for the full amount of the taxes, penalties, etc. now due and owing by the railroad company.

Respectfully submitted,

OLLIVER W. NOLEN,
Assistant Attorney General

APPROVED:

ROY McKITTRICK,
Attorney General

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