TAXATION AND REVENUE: Delinquent taxes to be paid with interest at legal rate of six per cent rather than ten per cent if taxpayer in bankruptcy.

March 28, 1935.

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16

Hon. David R. Clevenger
Prosecuting Attorney
Platte County, Missouri
Platte City, Missouri

Dear Mr. Clevenger:

This office acknowledges receipt of your request for an opinion on the following subject:

"The Chicago, Rock Island and Pacific Railroad Company, which has a line through Platte City, failed to pay its taxes last year when due. I understand that the company is in the process of a receivership.

Recently they tendered to the Collector of Platte County the amount of such delinquent taxes (state and county) without any penalty, and insisted that he receive the same.

Our Collector has requested me to ask your opinion as to his liability to the state for such penalty should he accept such payment as tendered. His idea has been that he has no authority to accept payment of delinquent taxes without penalty without making himself personally liable therefor.

You may send your opinion on this matter either to Mr. John W. Walker, Collector of Platte County, or to this office."

I.

TRUSTEE IN BANKRUPTCY OF TAXPAYER NOT LIABLE FOR PENALTY.

The Chicago, Rock Island and Pacific Railroad Company is at present in Bankruptcy under the provisions of the recently enacted Reorganization Bankruptcy Law. The particular section allowing reorganization in bankruptcy of railroad companies is Section 205 of Title 11, U.S.C.A. This law was adopted March 3, 1933 and is designated also as C.204, Sec. 1, 47 Stat. 1474. The claims against this debtor are therefore governed by the General Bankruptcy Statutes. Section 93, Subdivision J of Title 11, U.S.C.A. provides:

> "Debts owing to the United States, a state, a county, a district, or a municipality as a penalty or forfieture 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."

Accordingly, under the provisions of this section no penalties may be allowed against or required to be paid by the trustee or conservator. This is not true however and does not apply to interest or actual costs occasioned thereby. The question then confronting you is whether or not the charges denominated in your letter as "penalties" are penalties and forfeitures as contemplated by this federal statute.

The local property of all railroad companies is to be assessed locally as other property. Section 9025, R. S. Mo. 1929. Railroad taxes are delinquent January 1 of the year after they have become assessed and levied and

> "The company shall forfeit and pay in addition to the taxes with which said company may order charged on the taxbooks of such county, such penalty as is provided by law for the non-payment of other delinquent taxes."

Therefore, all delinquent railroad taxes are subject to the provisions of Section 9952, page 429, Laws of Missouri 1933, reading in part:

> Between the first of January and the first of July in the year 1934 and annually thereafter, and immediately upon the effective date of this act, the county collector shall make out and record, in a book to be provided for that purpose, a list of lands and lots, returned and remaining delinquent for taxes, including therein the delinquent taxes of all

> cities and incorporated towns having authority to levy and collect taxes under their respective charters or under any law of this state returned delinquent to the county collector, separately stated, describing such lands or lots as the same are described in the tax books and said delinquent returns, as corrected under sections 9938 and 9942, and charging them with the amount of delinquent tax and naming the years delinquent, separately stated, and in addition thereto a penalty of ten per centum on such tax delinquent for the preceding year and an additional annual ten per centum on taxes for each year prior to the preceding year, and shall certify to the correctness thereof, with the date when the same was recorded, and sign the same by himself, or deputy, officially; provided however, if taxes are paid on land or lots delinquent for the preceding year at any time prior to sale thereof as in this act provided, the per centum of penalty added shall not exceed one per centum per month or fractional part thereof or ten per centum annually.* * * *"

While it is true that this charge of "Ten per centum" and "one per centum per month" is denominated in this Section as a penalty, the same sums are referred to in Section 9945 of the same bill, page 426, Laws of Missouri 1933, as follows:

> "* * *all taxes hereafter becoming delinquent shall bear <u>interest</u> until paid as provided by section 9952.* * *"

Various other provisions of our general tax law refer to this charge both as a penalty and as interest. However, our Supreme Court has definitely classified this charge as a "penalty", so far as the taxpayer is concerned. State ex rel. Cutcher vs. Koeln, 61 S. W. (2d) 750; State ex rel. McKittrick vs. Bair, 63 S. W. (2d) 64. Also, the United States Circuit Court of Appeals for the Eighth Circuit, in which Missouri lies, has, by obiter dictum, held such charge to be a penalty. Horn v. Boone County, Nebraska, 44 Fed. Rep. (2d) 920. In this decision the Court considered the case of Swarts vs. Hammer, 120 Fed. 256, 194 U. S. 441, 24 S. Ct. 695, 48 L. Ed. 1060. The Court in construing the Swarts case stated, l. c. 921:

> "The referee had directed the payment of the tax, 'together with the accrued penalties and fees provided by law.' The District Court disapproved the allowance of the penalties and fees, and the Supreme Court in Swarts v. Hammer, supra, affirmed the District Court. We think this case not an authority in support of the contention of the appellant here. The Missouri Legislature having specifically declared the 10 per cent per annum to be a penalty, it is reasonable to suppose that such Legislature intended the charge to be subject to the application of the principles and rules applicable to penalties."

However, I believe that the same Court in the earlier case of Stanard vs. Dayton, Dayton vs. Stanard, 220 Fed. 441, has more properly construed the Swarts case. Of the Swarts case the Eighth Circuit Court of Appeals stated, l. c. 444:

> "In the case of Swarts v. Hammer, 194 U. S. 441, 24 Sup. Ct. 695, 48 L. Ed. 1060, it is said that the referee allowed a tax bill, 'together with the accrued penalties and fees provided by law.' On review the District Court affirmed the order as to the amount of taxes, but disapproved it as to penalties and fees. It does not appear that exception was taken to that portion of the order disallowing penalties and fees. Neither the Court of Appeals nor the Supreme Court was called upon to consider that question."

A reading of the reports of the Swarts case plainly indicates that the allowance or disallowance of the "penalties and interest" was not considered by the Appellate Court as a live issue in the case. This issue was swallowed up by the more potent question of the liability of property in the bankruptcy court's custody for taxes accruing, pending the disposition of the estate.

Be that as it may, in view of these decisions of our Supreme Court and of the Circuit Court of Appeals of this Circuit, it appears exceedingly doubtful that the Federal Court would hold this charge to be other than a penalty. The remaining question is what charge can be made by the State conceding that the statutory charge is a "penalty".

II.

TRUSTEE IS LIABLE FOR LEGAL INTEREST ON DELINQUENT TAXES.

One of the most oft cited cases in respect to liability of trustees in bankruptcy for taxes is that of People of New York vs. Jersawit, 68 L. Ed. 405, 263 U. S. 493. This case is found entitled In Re Ajax Dress Company in the lower court and is reported at 290 Fed. 950. The State of New York had filed a claim for franchise tax against the bankrupt and for interest at one per centum per month. Under a state law requiring delinquent to pay.

> "in addition to the amount of such tax, ten per centum of such amount, plus one per centum for each month the tax remained unpaid"

the United States Circuit Court of Appeals stated, l. c. 952:

> "So far as the state's second demand, for penalties and interest, is concerned, the matter is covered by our opinion in Re Menist, 290 Fed. 947, filed to-day. That decision relates to a claim for interest at 1 per cent. per month, made by the United States in respect of its demand for lawful and unpaid taxes; but whatever is there said is applicable with equal force to the demand of the state of New York, not only for 1 per cent. a month, but for what is confessedly a penalty and called by that name.
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> Order affirmed, with costs."

In the Menist case the Court had stated, 290 Fed. l. c. 949:

> "A tax being then a preferred debt, neither interest nor any other derivative or appended claim can rise higher than the tax debt which gives it birth and being, and it is provided in respect of all debts 'owing to the United States, a state, a county, etc.' as a penalty, shall not be allowed, except for the amount of the pecuniary loss sustained in the proceeding out of which the penalty arose. Section 57j (Comp. St. Sec. 9641 (j)). It is a matter almost

too plain to require citation that an exaction may be a penalty without being called by that name. Fontenot v. Accardo (C.C.A.) 278 Fed. 871, at page 874. The question is often one of degree, for no one would doubt that, if the statutory rate for withholding a tax was 1 per cent. a day, the requirement would be treated as a penalty.

Subject to statutory limitation, the rate of interest or, what is the same thing, compensation for the use of money, is ordinarily fixed by agreement of parties. But in tax matters there is no such agreement; one party commands and the other must obey, and again subject to constitutional limitations the commanding party may impose any terms of payment that it pleases, and it makes no difference whether the price of delayed obedience is called interest, or penalty, or fine, or additional tax; every increase over the amount that satisfies the tax, if paid the moment it is levied, is merely an additional exercise of the power of the taxing authority.

Since in bankruptcy (and we are solely concerned with bankruptcy) the power of ascertaining the amount or legality of any tax is vested in the court (section 64a), and penalties are not to be allowed, except for the amount of pecuniary loss sustained by the delayed payment, the only question here is whether an exaction of 1 per cent. a month as the price of delay amounts to a penalty. As to nature of interest generally see Agency, etc., Co. v. AmericanCo. 258 Fed. 363, at page 372, 169 C. C.A. 379, 6 A.L.R. 1182. On the point at bar we are in accord with In re Ashland, etc., Co. (D. C.) 229 Fed. 829, and hold that, there being no evidence of any injury or damage to the government by the withholding of this tax, except that which flows from the nonpayment of a just debt, anything in excess of the legal rate of interest is to be treated as a penalty and not allowed.

> The point seems not to have been argued in Re Kallak (D. C.) 147 Fed. 276, in Re Scheidt (D. C.) 177 Fed. 599, or in Re Quinones, 39 Am. Bankr. R., 320; but in the implications of these cases we cannot concur. As the question here arises under the Bankruptcy Act, United States v. Guest, 143 Fed. 456, 74 C. C.A. 590, does not apply; there being no reason why a penalty, by whatever name called, may not be enforced against an individual, if properly expressed in agreement or statute.
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> The question remains whether a tax demand, duly proved, should continue to draw interest at the legal rate after the filing of petition for adjudication. The general rule is, of course, that interest stops with petition filed (Sexton v. Drefus, 219 U. S. 339, 31 Sup. Ct. 256, 55 L. Ed. 244), but a tax debt, due to any of the taxing authorities enumerated in section 64a, is not only a highly preferred debt, but the section contains specific directions that the trustee shall pay 'all taxes legally due and owing.' That means legally due and owing in accordance with the provisions of the Bankruptcy Act, and under that statute section 57j requires penalties due to the United States, or a state, etc., to be allowed to the extent of the pecuniary loss suffered. The loss continues as much after petition filed as before."

So it appears by combining these two decisions that it was the Circuit Court of Appeals' judgment that the State should receive interest at the legal rate of six per centum per annum on this tax regardless of the provisions of the taxing act. When this case reached the Supreme Court the decision in this respect was affirmed, the Court stating l. c. 496:

> "The courts below held that that this latter liability was a penalty (referring to the ten per cent plus one per cent per month) and therefore not to be allowed, but allowed 6 per cent upon the tax as apportioned, to the date of payment. The state says that it is entitled to the statutory interest or none."

Upon this the Court held, l. c. 497:

> "As the 1 per centum is more than the value of the use of the money, and is added by the statute to the 10 to make a single sum, it must be treated as part of one corpus and must fall with that. We presume that, in this event, the state does not object to receiving the simple interest allowed. That part of the order will stand."

So that it appears that the Supreme Court in this case held proper the allowance of legal interest on the tax claim irrespective of the fact that the taxing act did not provide for the payment of such interest in such amount.

Another Federal case of interest on this problem is In Re Ashland Emery and Corundum Company, 239 Fed. 829. In this case the State of New Jersey had made claim for franchise taxes due from the bankrupt together with "interest at the rate of one per cent for each month until paid." This claim precisely followed the State tax act and the question arose as to whether or not the interest provided for in the law should be allowed. The Court stated, l. c. 831:

> "The final question then is whether the 1 per cent per month is interest on the tax, or a penalty for nonpayment of it. That it is called interest in the statute is not, of course, conclusive upon the bankruptcy court, which will examine and decide the question for itself. New Jersey v. Anderson, 203 U. S. 483, 27 Sup. Ct. 137, 51 L. Ed. 284."

And in ordering the Referee to allow interest at six per cent on the face of the tax from its due date until it was paid stated l. c. 832:

> 'The test by which such determination is to be made in actions ex contractu is established.
>
> 'It may, we think, fairly be stated that, when a claimed disproportion has been asserted in actions at law, it has usually been an excessive disproportion between the stipulated sum and the possible damages resulting from a trivial breach apparent on the face of the contract, and the question of disproportion has been simply an element entering into the consideration of the question of what was the intent of the parties, whether bona fide to fix the damages or to stipulate the payment of an arbitrary sum as a penalty, by way of security.' White J., Sun Printing Association v. Moore, 183 U. S. 642, 672, 673, 22 Sup. Ct. 240, 252, (46 L. Ed. 366.)

There may be doubt under New Jersey v. Anderson, supra, whether this court is restricted in determining the question under discussion to the face of the statute.

Assuming, however, that it is, it seems to me plain, and I accordingly find, that 1 per cent. a month exceeds what is fairly required to make good loss to the state from mere delay in payment of the tax, and as to such excess is not interest, but constitutes a penalty imposed for failure to pay promptly. The actual damages sustained by the state of New Jersey from the delay are not obscure nor difficult to estimate. What the state lost was the use of the money. Its damages therefor are the commonest form known to the law, and the most certain of estimation. They are established by statute in New Jersey for individuals at 6 per cent. per annum. Gen. Stats. of N. J. p. 3704. It is difficult to see how, as damages, they can be larger in the case of the state.

"* * * It is sufficient to say that all damages for delay in the payment of money owing upon contract are provided for in the allowance of interest, which is in the nature of damages for withholding money that is due. The law assumes that interest is the measure of all such damages.' Waite, C.J., Loudon v. Taxing District, 104 U.S. 771, 774 (26 L. Ed. 923).

The sum here claimed is double the statutory interest and almost double the highest rate of interest which national banks are allowed to charge under United States statutes. Rev. Stats. U. S. Sec. 5197 (Comp. St. 1913, Sec. 9758). Nor is this imposition made for the purpose of reimbursing the state for expense incurred in collecting the tax." * * *

A similar holding is to be found in the case of In Re. Brown, 41 Fed. (2d) 238, a decision by the District Court of the Southern District of Ohio.

The case of Stanard vs. Dayton supra, found its way to the Supreme Court of the United States and is reported at 80 L. Ed. 1190, 241 U. S. 588. The Circuit Court of Appeals had held that the trustee was required to pay the amount of tax together with the penalty interest provided for by the State law, and upon review the Supreme Court reversed that part of the decree, only requiring the trustee to pay the legal rate, l. c. 1192:

> "And while we are of opinion that the certificate holders were entitled to interest upon the amounts paid, at the ordinary legal rate, applicable in the absence of an express contract, we think they were not entitled to the larger interest required to be paid on redemption from tax sales. They were not in a position to stand upon the terms of the redemption statute, for the sales were invalid, and the only recognition which they could ask was such as resulted from an application of equitable principles to their situation. The decree of the Circuit Courtof Appeals is modified to conform to what is here said respecting the allowance of interest. In other respects it is affirmed."

Following this decision our own United States Circuit Court of Appeals in the case of Horn vs. Boone County supra, held the trustee liable for ten per cent interest under the Nebraska law.

Section 2838 R. S. Missouri 1929, is in part as follows:

> "Creditors shall be allowed to receive interest at the rate of six per cent per annum, when no other rate is agreed upon, for all moneys after they become due and payable," * * * "

By this decision six per cent interest per annum is allowable on all contracts in this state and under the foregoing decisions must be construed as being the minimum amount for which the trustee is liable.

Insofar as other charges are concerned such as collectors' commissions, clerks fees etc., it is difficult, if not impossible, to place these within the provisions of Subdivision J of Section 93, Title 11, U.S.C.A. as being penalties and forfeitures, as they are certainly compensations allowed others who are required to perform duties by virtue of the failure of the taxpayer to pay the tax when due, and if the acts have actually been performed, the costs allowed by law should be paid by the Trustee in Bankruptcy.

CONCLUSION.

It is therefore the opinion of this office that the Trustees of the Chicago, Rock Island and Pacific Railroad Company are liable to the State of Missouri as interest on delinquent taxes six per cent per annum on such taxes from the date of delinquency until paid.

Respectfully submitted,

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APPROVED:

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