



STATE OF CALIFORNIA

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July 26, 1988

CINDY RAMBO  
Executive Director

No. 88/55

TO COUNTY ASSESSORS:

CHANGE IN OWNERSHIP DUE TO BANKRUPTCY

Under the United States Bankruptcy Code, when petitions for bankruptcy are filed under Chapters 7, 11 and 13, a separate and distinct estate, the estate of the bankrupt, is created by operation of law (11 U.S.C. §541). All property owned by the bankrupt automatically comes under the control of the bankruptcy court. Since Property Tax Rule 462(a)(2) indicates that a change in ownership occurs when property is transferred by operation of law, we have previously taken the position that all property owned by the bankrupt undergoes a change in ownership when a petition for bankruptcy is filed. At the urging of county assessors', we have undertaken a review of our previously established position and, after extensive analysis, have revised our conclusion regarding the change in ownership implications of filing a petition for bankruptcy. Although it is not entirely free of doubt, we now conclude that the better view of the applicable law is that a change in ownership does not result from the filing of a petition for bankruptcy, regardless of whether the petition is filed under Chapter 7, 11, or 13.

Chapter 7: The most common form of relief sought by debtors is a petition under Chapter 7 for liquidation resulting in a distribution of assets. Under Chapter 7, as well as under Chapters 11 and 13, the filing of the petition automatically creates a separate entity, the estate of the bankrupt. All of the property owned by the debtor, including exempt property is now controlled by and subject to the disposition of the bankruptcy court. The debtor must file a claim in order to have certain property exempted from this estate.

Once the estate has been created, the estate assets are held for the benefit of the debtor's creditors. Any income from property in the estate accrues to the estate. For example, if a debtor filing a Chapter 7 petition owned an apartment building, that apartment building would become part of the estate. Any rents received because of ownership of that building would belong to the estate and would be held by the estate for the benefit of the debtor's creditors. We believe that the beneficial use of the property remains with the debtor, however, because the assets held in the estate are used to satisfy the debtor's liabilities. Since beneficial use of the assets of the estate is not transferred as a result of filing a petition under Chapter 7, a change in ownership does not automatically result from the creation of the estate.

A change in ownership of all of the debtor's assets which have come under the control of the court will occur, however, if and when these assets are transferred by the court through the process of liquidation to pay the debts of the bankrupt. Property which came within the control of the court, but which was returned to the debtor because of legal exemptions will, of course, not undergo a change in ownership.

Chapter 11: An alternative to liquidation is provided for debtors under Chapter 11. This chapter provides a means by which financially distressed businesses, including sole proprietors, partnerships, and corporations, may restructure their finances to continue their operations and avoid liquidation. The filing of a Chapter 11 petition automatically institutes a stay of debt collections and lien enforcement. Like Chapter 7, the filing of a petition under Chapter 11 automatically places all property of the bankrupt under the control of the court.

Under a Chapter 11 reorganization the debtor will ordinarily remain in control of its business, unless the court finds it necessary to appoint a trustee. The debtor remaining in control is called a "debtor in possession."

A debtor in possession has an exclusive right to file a reorganization plan during a specified period. The purpose of this period is to give the debtor enough time to formulate the reorganization plan by negotiating with creditors and by predicting the future capacity of the enterprise. When the plan is confirmed by the court, the estate of the bankrupt is automatically terminated. By operation of law, all property of the estate returns to the control of the reorganized debtor, unless otherwise provided in the plan or in the confirmation order.

The whole purpose of a Chapter 11 reorganization is to encourage and facilitate the rehabilitation of businesses in financial trouble and to avoid liquidation. Therefore, the creation of the estate does not result in the transfer of beneficial ownership but permits the assets of the bankrupt to be used in its ongoing operations for the benefit of the debtor but free of debt collection and lien enforcement. Since the beneficial ownership of the assets of the estate are not transferred as a result of filing a petition under Chapter 11, a change in ownership does not result from the creation of the estate.

Chapter 13: Chapter 13 of the Bankruptcy Code is designed to enable individual debtors who wish to pay their debts to receive protection from creditors while a plan of repayment is developed and carried out. Under Chapter 13, the debtor may remain in possession and may continue to use the property in the estate.

Under Chapter 13, the debtor must file a debt adjustment plan which the court must confirm. Upon confirmation of the plan, the property of the estate returns to the control of the debtor.

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Since the essence of a bankruptcy under Chapter 13 is the debt adjustment plan, and the debtor retains use of the property in the estate, the creation of the estate does not result in the transfer of beneficial ownership. Consequently, a change in ownership does not occur when an estate is created by the filing of a petition under Chapter 13.

In summary, although the filing of a petition for bankruptcy under Chapter 7, 11, or 13 creates a separate and distinct estate, the estate of the bankrupt, beneficial use of the bankrupt's assets is not transferred upon the creation of the estate. Since beneficial use of the bankrupt's assets is not transferred, the assets do not undergo a reappraisal change in ownership upon the creation of the estate.

While the Board of Equalization is not authorized to demand bankruptcy information, such information often is found in conjunction with the Assessment Standards Division's Legal Entity Ownership Program. When such information is discovered it will be mailed to your office for your decision as to the specific properties that require reappraisal.

Sincerely,



Verne Walton, Chief  
Assessment Standards Division

YW:wpc  
AL-24-0138F