

Concrete Aspects Regarding the Imputation of Current Tax Receivables in Insolvency Proceedings

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Abstract

This paper captures the practical aspects in terms of tax treatment of the receivables arising subsequent to the initiation of insolvency proceedings, during the observation period, in judicial reorganization or bankruptcy proceedings. These issues are treated from a fiscal perspective, as new periods. During the observation, reorganization or bankruptcy period, an insolvent company is subject to the Law on insolvency prevention and insolvency proceedings.

On the other hand, the provisions of the Fiscal Procedure Code, as applied by the tax creditor, govern an individual procedure for the recovery of receivables while the Law on insolvency prevention and insolvency proceedings refers to a collective procedure for the recovery of receivables.

Key words: bankruptcy, reorganization proceedings, observation proceedings, tax creditor

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1. Introduction

In order to ensure a correct analysis of the issues related to the requests for the priority payment of current receivables, representing taxes submitted by the tax representative, we consider it appropriate to make some legislative observations regarding their content. We will refer to the incident legal basis, alleged by both insolvency practitioners and tax creditors, referring to the notices for the extinguishment of receivables, which they deliver.

We will refer to the definition and meaning of certain terms and phrases, as provided by the Law on insolvency prevention and insolvency proceedings (Law 85/2014), namely:

▪ Current activities are those activities of production, trade or services and financial transactions proposed to be made by the debtor during the observation period and during the reorganization period, in the normal course of its business, such as:

a) continuation of the activities contracted and entering into new contracts under the business scope;

b) managing receipts and payments related thereto;

c) providing the financing of the working capital, within current limits (Law 85/2014, Article 5, paragraph 2).

▪ Tax receivables represent the receivables consisting of taxes, fees, contributions, fines and other budgetary revenues and their accessories. The same nature is retained by the tax receivables that are not fully covered by the value of privileges, mortgages or pledges held for the uncovered debt (Law 85/2014, Article 5, paragraph 14);

▪ The creditor with current receivables or the current creditor is that the creditor holding cert liquid and payable receivables, incurred during insolvency proceedings, and holding the right to be prioritarily paid for its receivable, according to documents wherefrom it arises (Law 85/2014, Article 5, paragraph 21).

According to the meanings of these terms and expressions from the legal basis, it is appropriate to point out some observations, namely:

- the tax receivables are defined too broadly, including any amounts owed to the central/ local budget, including those arising from the debtors' activity;
- any tax authority may require the priority regime of tax receivables, even if they result from business activities or from the liquidation operations of secured assets; such priority would create an obvious disadvantage for secured creditors/wage claims, as applicable.

2. Case study no 1: Insolvency Proceedings, Bankruptcy Period

The debtor company is in bankruptcy procedure. In order to guard the secured assets, a security guard is hired. Monthly, the liquidator paid taxes and employee contributions, which resulted from the tax returns and payments made.

The tax creditor extinguished the obligations prior to the initiation of bankruptcy proceedings, under the incident tax legislation - Law 207/2015 regarding the Fiscal Procedure Code (FPC), Article 165, paragraph 6, letter c, which provides for the following extinguishment order, for the debtors who fall under the insolvency law:

- a) tax obligations arising subsequent to the initiation of insolvency proceedings, in order of seniority;
- c) tax obligations arising prior to the initiation of insolvency proceedings, in order of seniority, until their full settlement, if the taxpayers are bankrupt;

For the obligations dating during the bankruptcy procedure, there is formulated a request for the payment of current receivables, representing taxes and fees, pursuant to Article 102, paragraph 6 of Law no. 85/2014.

The incident legal basis of the insolvency procedure (Law 85/2014, Article 102, paragraph 6) provides that the receivables arising subsequent to the initiation date (during the observation period/ the judicial reorganization/ bankruptcy procedure) will be paid according to the documents they arise from and their registration in the creditors' list is not necessary. This provision shall apply accordingly to the receivables arising subsequent to the initiation of bankruptcy proceedings.

The observations on the Tax Procedure show that the payment of the receivables arising prior to the initiation of the procedure and registered in the receivables table is possible in bankruptcy following the order established by Article 159, paragraph 1 of Law 85/2014 (taxes, postage and other expenses related to the sale of goods, including the expenses necessary for the preservation and management of those goods). The text exclusively regulates the distribution of the funds from the sale of goods and of the rights from the debtor's property, encumbered by causes of preference.

In this procedure, there are covered the obligations dating from bankruptcy procedure and after their coverage, funds can be distributed in order to settle the receivables from the table; in other words, the tax authority shall extinguish the obligations from the bankruptcy procedure under the FPC, article 165, paragraph 6, letter a, and only afterwards it shall be able to settle them according to Article 165, paragraph 6, letter c.

The conclusion is clear, i.e. insolvency proceedings, namely the observation, reorganization or bankruptcy periods are treated, from a fiscal perspective, as new periods.

The insolvency proceedings are analyzed according to two categories, i.e. current obligations, dating from bankruptcy proceedings, and obligations dating prior to the initiation of bankruptcy proceedings.

What happens in the practice of the fiscal body, and rather what happens in the program used by it? For a bankrupt company, the program applies the provisions of article 165, paragraph 6, letter c of the FPC, which contravenes the provisions of the insolvency law, as it extinguishes obligations dating prior to the initiation of the procedure, by current payments, thereby ignoring the provisions of article 165, paragraph 6, letter a of the FPC. Thus, the tax creditor has erroneously extinguished the obligations dating prior to the initiation of bankruptcy proceedings.

3. Case study No. 2: Insolvency Proceedings, Bankruptcy Period in 2008

The debtor company is in bankruptcy proceedings since 2008. Until 31.12.2015, five

distributions had been made, by reports on funds, in the amount of 100,000 RON.

In 2016, the tax creditor filed an application for the priority payment of current receivables, representing taxes and fees, under art. 64, paragraph 6 of Law no. 85/2006 - amounting to 50,000 RON. The receivable resulted from the debtor's activity subsequent to the initiation of the bankruptcy proceedings, i.e. from the period 11.2007-02.2008.

Currently, the remained asset (that is to be capitalized) is lower than the current receivable of the tax creditor.

Analyzing this case, we find the following:

- the level of the current obligations required by tax authorities is lower than the distributions performed in the proceedings;
- the settlement of obligations was performed under art.115 paragraph 3, letter c of the FPC, dating prior to the initiation of bankruptcy proceedings;
- there were distribution reports.

There are discussed:

- The tax body's error regarding the method for extinguishing its receivable; in our opinion the tax authority should make use of the provisions of art. 165, paragraph 6, letter a, of the FPC and, after full coverage, the payments should be allocated to the debts stipulated in table, arising prior to the initiation of the procedure, under art. 165, paragraph 6, letter c of the FPC;
- The lack of any diligence from the tax authority to appeal the 5 distribution reports;
- Currently, the valued asset is lower than the current receivable of the tax creditor; thus, no receivable can be covered at present;
- The prescription of the tax receivable. Namely, the tax receivable was incurred in November 2007 - February 2008 and the prescription period began to run on 01.01.2008 and 01.01.2009, respectively and it was reached on 01.01.2013 and 01.01.2014, respectively.

4. Case Study no 3: Insolvency Proceedings, Reorganization Period

The debtor company is in reorganization proceedings. In the third quarter of the reorganization plan, at the date of the creditors' committee meeting, the tax creditor forwarded the view that the debtor had unpaid current obligations in the amount of 500 RON and obligations resulting from the reorganization plan of 300 RON.

Previously, at the creditors' committee meeting convened for the 2nd quarter of the reorganization plan, the tax creditor's vote was in majority, the financial situation related to this quarter was approved and notified to the other creditors.

By analyzing the tax creditor's vote and the debtor's records, we found that:

- the debtor's current obligations accumulated between the two quarters amount to 100 RON;
- in order to settle the obligations resulted from the reorganization plan, the debtor proved the payment by payment orders (the amount of the payments made correspond to the payment schedule).

We analyzed the reorganization proceedings in terms of:

- The current obligations resulting from the company's activity in the reorganization procedure (subsequent to the confirmation of the reorganization plan);
- The current obligations resulting from the execution of the reorganization plan/ program of payments (obligations dating prior to the initiation of the procedure).

The rule is that the debtor shall cover the current obligations resulting from its activity and, if they are covered, it shall also settle the payments withheld in the program of payments under the reorganization plan. If a financial situation was approved in by creditors' committee, the debtor enters into the next quarter of the plan. According to article 144 of Law 85/2014, the legal administrator shall also present the statement of the expenditure incurred for the progress of work, in order to recover them, which shall be approved by the creditors' committee. The debtor, by the special administrator, or, where applicable, the legal administrator shall submit quarterly to the creditors' committee reports on the financial situation of the debtor's assets. Subsequent to the approval by the creditors' committee, the reports shall be recorded at the court

and the debtor or, where appropriate, the legal administrator shall notify all creditors, for the consultation of reports.

The legal administrator shall also present the statement of the expenditures incurred for the progress of work in order to recover them, which shall be approved by the creditors' committee.

The basis of tax legislation, i.e. FPC, article 165, paragraph 6 regulates the order for the settlement of current obligations and of those from the payments program, as follows:

- a) tax obligations arising subsequent to the initiation of insolvency proceedings, in order of seniority;
- b) amounts due as installments from the payment program of tax obligations, contained in the confirmed legal reorganization plan, and ancillary tax obligations due during the reorganization period, if the plan provided for their calculation and payment.

In conclusion,

- The financial situation for the 2nd quarter of the plan was approved, but the creditor has not filed an appeal, although it is revealed that the vote for the 2nd quarter was not in accordance with the reality because, at that time, the debtor company figured with unpaid current obligations, fact omitted by the tax creditor;

- It is noteworthy that, although the debtor made proof of the payment of the obligations resulting from the reorganization plan, the tax body imputed the correct amounts, covering the current obligations from the reorganization procedure (FPC, article 165, paragraph 6, letter a and the ones resulting from the execution of the reorganization plan, under article 165, paragraph 6, letter b).

According to this case, in reorganization proceedings, the interpretation of the FPC is identical to that of insolvency laws; thus, the tax authority requires the payment of current obligations at the time when the debtor convenes the creditors for the approval of financial statements and only after fulfilling this condition, it approves the financial situation.

5. Case Study no 4: Insolvency Proceedings, Observation Period

The debtor company is in observation proceedings. The appeals from the receivables table were completed and it prepares for the reorganization plan.

In terms of the tax receivables subsequent to the initiation of the insolvency procedure, the debtor has complied with the provisions of article 143 of Law 85/2014, according to its tax records. It receives a request from the tax creditor to pay its current receivables, accounting for taxes and fees, based on legal grounds incident to insolvency proceedings, under article 102, paragraph 6 of Law 85/2006.

It should be noted that article 143 of Law 85/2014 provides for the debtor's obligation of not causing loss incurred by its activity and gives the creditor the right to request the initiation of bankruptcy proceedings if the debtor fails to fulfill its obligation. According to this article, if the debtor does not comply with the plan or if its activity brings losses or accumulates new debts to the creditors in the procedure, any of the creditors or the legal administrator can demand the bankruptcy judge to order the debtor's bankruptcy. The application is examined urgently and preeminently (Law 85/2014, article 102, paragraph 1).

The payment of the receivables arising prior to the initiation of the procedure and registered in the receivables table is possible, either during the reorganization, subsequent to the confirmation of a reorganization plan in accordance with the proposed schedule of payments, or in bankruptcy, observing the order established by Law 85/2014, article 159, paragraph 1 and article 161, paragraph 1 and 5 (paragraph 1 - fees, stamps or any other expenses related to the proceedings under this title, including the expenses necessary for the preservation and administration of the debtor's assets, in order to continue its activity, or paragraph 5 – tax receivables).

During the observation period, the extinguishment of the tax receivables arising prior to the initiation of the procedure is not possible under articles 84 and 87 of Law 85/2014. Exceptionally, for the capitalization of the goods encumbered by obligations, the distribution of the amount obtained shall be made to the creditor in whose guarantee the good had been during the observation period.

Regarding the order of debt extinction, the tax authority shall apply only the provisions of article 165, paragraph 6, letter a.

The problem is that the debtor did not take into account that the current payments, although made, can be found in the unique accounts under distribution (state budget and social insurance budget). The tax body has not made the imputation of the payments in the observation period; therefore it appears with an uncovered receivable (under the Order no. 3637/2015 on the methodology for the distribution of the amounts paid by taxpayers in the unique account and the settlement of the tax obligations recorded by them).

In order to prevent a possible negative vote on the reorganization plan from the tax creditor, a written correspondence is recommended subsequent to any payment made in the proceedings, by which the legal administrator communicates to the tax body the nature of the payment made or possibly an adjustment of the sheet by the payer.

It points out that there are cases when, subsequent to the initiation of the proceedings, the tax authority does not make the imputation of payments automatically. It is therefore necessary that the debtor with the right to administrate/ the legal administrator make a request in this regard.

This case has repercussions if the bankruptcy proceeding is initiated in the observation period, when a statement of receivables shall be formulated.

6. Conclusions

The respective insolvency proceedings, namely from the observation, reorganization or bankruptcy period are treated from a fiscal perspective, as new periods.

When a company enters the insolvency proceedings, the current payments are intended to cover its current debt, observing the order and the legal provisions of previous debts.

The current receivable dating from the insolvency proceedings becomes a prior receivable, which will be introduced in the receivables table.

The law on insolvency proceedings addresses in competition the debtor's insolvency, prohibiting the creditors to individually pursue the receivables that they hold on the debtor's property.

With reference to the competition principle of insolvency proceedings, the imputation of current payments by a certain creditor on the debts incurred prior to the initiation of the procedure and not on the current debt to the same creditor represents void transactions, individual ways of debt recovery.

An insolvent company (observation, reorganization or bankruptcy period) is subject to the provisions of the Law on insolvency proceedings.

The debtor's creditors, regardless of the nature of their receivables, should refer to the special provisions on debt recovery; since the insolvency procedure is a collective one, based on competition, all creditors, including the budgetary ones, participate in it.

On the other hand, the provisions of the Fiscal Procedure Code (FPC), as applied by the tax creditor, regulates an individual procedure of debt recovery and the Law on insolvency proceedings refers to a collective debt recovery procedure.

The Law on insolvency proceedings is mandatory, and, once triggered, the creditors involved in the respective case observe the rules established for the recovery of their receivables and, to the extent that the provisions of the FPC would prevail, the tax creditor would recover the receivables prior to the initiation of the procedure, with priority to other creditors, violating the essence of the insolvency Law.

The FPC provisions on the order of debt extinguishment are identical to the extinguishment order regulated by the Insolvency Law; only the method for the application and interpretation of the law differs.

7. References

Law 85/2014, on insolvency prevention and insolvency proceedings, updated and published in the Official Gazette no. 920 of 11 December 2015

Law 207/2015 regarding the Fiscal Procedure Code published in Official Gazette no. 547 of 23 July 2015

Order no. 3637/2015 regarding the methodology for the distribution of the amounts paid by taxpayers in the unique account and the extinguishment of the tax obligations recorded by them