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## SENATE COMMITTEE ON GOVERNANCE AND FINANCE

Senator Anna M. Caballero, Chair

2021 - 2022 Regular

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**Bill No:** SB 1099  
**Author:** Wieckowski  
**Version:** 4/7/22  
**Consultant:** Grinnell

**Hearing Date:** 4/20/22  
**Tax Levy:** No  
**Fiscal:** Yes

### ***BANKRUPTCY: DEBTORS***

*Sets a maximum ten percent interest rate on redemption penalties on any property in a bankruptcy proceeding.*

### **Background**

**Property taxes.** Property taxes are due in two installments: November 1, and February 1, with delinquency for the second installment occurring on April 10. Generally, state law requires county tax collectors to begin imposing penalties for nonpayment of property taxes of 10% of each amount due, plus administrative charges, once taxes become delinquent. The property becomes tax defaulted if taxes remain unpaid as of June 30th, triggering redemption penalties of 1.5% a month until the full amount is paid. After five years, the tax collector with approval by the Board of Supervisors can sell a tax defaulted residential property to satisfy back taxes, penalties, costs, and other liens; for commercial property, the tax collector can do so after three years.

The owner of a property up for auction at a tax sale has the right to pay off all defaulted taxes, penalties, fees, and costs to avoid the sale, called a right to redemption. The right of redemption on a parcel ceases at 5 p.m. the last business day prior to the sale, but can be revived if its purchaser does not finalize the sale. A taxpayer must pay all of the following to redeem their property:

- Total amount of all past-due taxes,
- Delinquency penalties and costs,
- Redemption penalties, and
- Certain fees, usually including a redemption fee.

In 1998, the Legislature clarified that for purposes of a bankruptcy proceeding, the redemption penalty is considered interest (SB 1836, Committee on Revenue and Taxation). Additionally, the Legislature provided that redemption penalties constitute a lien against real property, so are considered secured debts (SB 1494, Ackerman, 2004). SB 1494 responded to a federal Bankruptcy Court ruling stating that redemption penalties were instead unsecured claims that were not payable from proceeds from tax sales of property, and instead treated like other unsecured debts in bankruptcy *In re County of Orange*, 262 F.3d 10149th Cir. (2001).

**Bankruptcy.** In a bankruptcy action, exemptions generally allow a person to protect certain types of assets during the bankruptcy process. If an asset is exempt, the asset can generally not be taken to pay creditors' claims. These property exemptions are designed to ensure that a

debtor maintains the ability to support themselves, as well as dependent family members, after the entry of judgment, and also to facilitate the debtor's financial recovery.

Under the federal Bankruptcy Code, states may either adopt the federal exemptions listed in the Bankruptcy Code or opt out of those exemptions and create different judgment exemptions. California has not authorized the use of the exemptions in the federal Bankruptcy Code, so California residents filing for bankruptcy are limited to the exemptions made available to them under non-bankruptcy law in two parts of the Code of Civil Procedure. Individuals filing for bankruptcy in California can choose between two different sets of exemptions, known as the 703 exemptions and the 704 exemptions. The "703 exemptions," consist of 11 categories modeled after federal bankruptcy law. In comparison, the "704 exemptions," provide 21 different types of exemptions that protect a wider range of property.

The 1.5% per month redemption penalty was set in statute in 1981. Advocates for persons in bankruptcy state that the interest rate is too high for persons in bankruptcy to pay, and want the Legislature to reduce it, among other changes.

### **Proposed Law**

Senate Bill 1099 sets a maximum of ten percent on the rate of interest on redemption penalties on any property in a bankruptcy proceeding.

SB 1099 also makes several other changes to Code of Civil Procedure exemptions, including:

- Exempting any appreciation in the value of a homestead after the bankruptcy filing;
- Prohibiting the seizure of a vehicle based on the fact of filing for bankruptcy alone;
- Increasing the vehicle exemption from \$5,850 to \$9,500;
- Eliminating the requirement for spouses to obtain a waiver of the alternative exemptions from the other spouse if they are legally separated;
- Exempting vehicles customized for a disability;
- Making vacation, sick pay, and other wages up to \$7,500 exempt;
- Treating payments from an employment dispute settlement agreement as exempt if needed for support;
- Exempting wrongful death/life insurance payments for a spouse exempt if needed for support; and
- Exempting maintenance and support to the extent reasonable and necessary.

### **State Revenue Impact**

No estimate.

### **Comments**

1. Purpose of the bill. According to the author, "SB 1099 caps the interest rate charged on back-due property taxes at ten percent in a bankruptcy case. The 18 percent currently charged is excessive and usurious – especially for a first priority claim – and it frustrates the 'fresh start' purpose of the bankruptcy process for the homeowner."

2. Tradeoffs. SB 1099 would reduce the interest rate on redemption penalties for taxpayers in bankruptcy to redeem tax-defaulted property. As a result, taxpayers in bankruptcy plans will pay less when redeeming their properties pursuant to their reorganization plans, leaving more money to support themselves and their families. However, doing so may reduce property tax revenues used to support local public services provided by cities, counties, and special districts. Additionally, tax collectors will have to recalculate interest for taxpayers who enter bankruptcy to a lower interest rate, which can create an administrative burden, especially for counties who advance property tax payments to other local agencies under Teeter plans.

3. Equal treatment. The Bankruptcy Code requires the payment of interest on a tax claim, which allows tax enforcement agencies to receive the present value of the allowed amount of a tax claim, and allows states to set the rate by applicable non-bankruptcy law. Section §4103(a) of the Revenue and Taxation Code currently sets the rate at 1.5% per month, or 18% per year, for all taxpayers. Section §4103(b) states that redemption penalties constitute the assessment of interest in a bankruptcy proceeding, which ensures that interest that accrues after a Bankruptcy petition is included as a secured claim. SB 1099 amends subdivision (b) to specify that the interest rate in bankruptcy proceedings cannot exceed 10%, which could be interpreted as better treatment than redemption penalties imposed on taxpayers not in bankruptcy proceedings. Courts have previously considered legal challenges to state statutes providing different treatment for persons in bankruptcy as preempted by federal law. In California, a taxpayer in bankruptcy challenged §4103(b), stating that this subdivision's treatment of the penalty as interest only in cases of bankruptcy was preempted, and he should instead be able to pay the lower interest rate proposed in his initial Bankruptcy plan. In addition to declaring that §4103(b) was valid non-bankruptcy law, the Court stated that Congress has expressly and concurrently authorized state legislation with respect to the calculation of interest on secured claims for unpaid taxes. (*In re Fowler*, 493 B.R. 148)

4. More tradeoffs. As noted by the Committee on Judiciary, “expanding exemptions involves some policy tradeoffs. Broader exemptions usually mean that debtors will be able retain more of their money, assets, and belongings as they emerge from the bankruptcy process. However, whenever exemptions expand, there is less left in the bankruptcy estate for distribution to creditors. Lenders often assert that this not only leaves them with less money in any given bankruptcy case, but also may dissuade them from extending credit as easily in the future, thus potentially shrinking overall access to credit.” Several judgment enforcement professionals oppose SB 1099's changes to the Code of Civil Procedure, stating that the measure fails to protect the dignity of court-ordered judgments.

5. Incoming! The Committee on Judiciary approved SB 1099 by a vote of 10 to 0 on April 5<sup>th</sup>. The Committee on Governance and Finance is hearing the measure as the Committee of second reference.

6. Technical amendment. Committee staff recommend specifying that the bill's interest rate cap of ten percent should apply per year (Page 15, Line 36).

### **Support and Opposition** (4/18/22)

#### **Support:**

Consumer Federation of California  
National Association of Consumer Bankruptcy Attorneys  
Several Individuals

Opposition:

The California Judgment Preservation Alliance  
Trustees for Reasonable Homestead Exemption Limits  
Several individuals

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