SENATE COMMITTEE ON APPROPRIATIONS
Senator Anthony Portantino, Chair
2021 - 2022 Regular Session

SB 1099 (Wieckowski) - Bankruptcy: debtors

Version: April 26, 2022
Urgency: No
Hearing Date: May 16, 2022

Policy Vote: JUD. 10 - 0, GOV. & F. 5 - 0
Mandate: No
Consultant: Robert Ingenito

Bill Summary: SB 1099 would (1) expand the list of exemptions that a debtor may protect from distribution to creditors in the bankruptcy process, as specified, and (2) set a maximum interest rate of ten percent per year on redemption penalties on any property in a bankruptcy proceeding.

Fiscal Impact: By reducing the maximum annual penalty interest rate by 8 percentage points, this bill would result in reduced property tax revenue relative to current law, by an unknown magnitude. Reductions in local property tax revenues, in turn, can increase General Fund Proposition 98 spending by up to roughly 50 percent (the exact amount, if any, depends on the specific amount of the annual Proposition 98 guarantee, which in turns depends upon a variety of economic, demographic and budgetary factors). See Staff Comments.

Additionally, by requiring county tax collectors to reprogram their tax software systems to reflect the new interest rate, this bill could create a state-mandated local program. To the extent the Commission on State Mandates determines that the provisions of this bill create a new program or impose a higher level of service on local agencies, local agencies could claim reimbursement of those costs (General Fund). The magnitude is unknown.

Background: When bankruptcy is declared, current law allows that individual to shield a portion of income, assets, and belongings from being sold off to satisfy the person’s creditors. These categories of shielded property are known as exemptions. The idea behind exemptions is to ensure that debtors maintain sufficient resources to meet the needs of themselves and their dependents. The exemptions also serve to help the debtor launch the fresh start that bankruptcy is supposed to offer. Though bankruptcy law and courts are federal, states can elect to design their own set of exemptions.

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,” located in Code of Civil Procedure Section 703.140(b), consist of 11 categories that are modeled after federal bankruptcy law. In comparison, the “704 exemptions,” contained in Code of Civil Procedure Sections 704.010 through 704.210, provide 21 different types of exemptions that protect a wider range of property. The 704 exemptions allow for a much more substantial homestead exemption, which generally seeks to protect a debtor against forced sale of their home to satisfy debts. The 703 exemptions are specific exemptions that a bankruptcy debtor may elect in lieu of all other exemptions while the 704 exemptions are available to all debtors in California seeking to exempt specified property from enforcement of a money judgment.

Under current law, 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 percent 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 percent per month until the full amount is paid; the 1.5 percent redemption penalty was set in statute in 1981. After five years, the county 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. A taxpayer must pay all of the following to redeem their property: (1) the total amount of all past-due taxes, (2) delinquency penalties and costs, (3) redemption penalties, and (4) 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).

Proposed Law: This bill would, among other things, do the following:

- Set a maximum of ten percent per year on the rate of interest on redemption penalties on any property in a bankruptcy proceeding.

- Make specified changes to Code of Civil Procedure exemptions, including: (1) exempting any appreciation in the value of a homestead after the bankruptcy filing, (2) prohibiting the seizure of a vehicle based on the fact of filing for bankruptcy alone, (3) increasing the vehicle exemption from $5,850 to $9,500, (4) eliminating the requirement for spouses to obtain a waiver of the alternative exemptions from the other spouse if they are legally separated, (5) exempting vehicles customized for a disability, (6) making vacation, sick pay, and other wages up to $7,500 exempt, (7) treating payments from an employment dispute settlement agreement as exempt if needed for support, (8) exempting wrongful death/life insurance payments for a spouse exempt if needed for support, and (9) exempting alimony, support and separate maintenance and the extent reasonable and necessary.

Staff Comments: This bill's proposed changes to current bankruptcy exemptions are not expected to have a fiscal impact to the State. Thus, the fiscal driver of this bill centers on its proposed reduction in the interest rate for redemption penalties on property in a bankruptcy proceeding; specifically, the resulting impact on Proposition 98 General Fund education spending.

Proposition 98 is a complex set of formulas for setting a minimum annual funding level for K-12 schools and community colleges. While the formulas get rather complicated at times, the goal of Proposition 98 is relatively straightforward one: it provides K-14 schools with a guaranteed funding source that grows each year with the economy and the number of students. The guaranteed funding is provided through a combination of state General Fund and local property tax revenues.

Under Proposition 98, in some years, but not all, changes to local property tax revenues impact General Fund spending. During such years, lower property taxes result in higher General Fund Proposition 98 spending, and higher property taxes result in lower state spending. The specific Proposition 98 funding formula expected to be used for the next few years does not utilize property tax revenue in setting the amount of K-14 education spending. Thus, this bill's anticipated reduction in local property tax revenue would not have an impact on State spending in the near term. At some point in the future, however, it is likely that the Proposition 98 funding formula will switch; at that time, the bill's reduced property tax penalty revenue would result in higher General Fund K-14 spending.

Based on data provided by the California Association of Treasurers and Tax Collectors, the reduction in local property tax revenue resulting from this bill would likely be in the tens of millions of dollars annually across all 58 counties. Additionally, counties would incur costs for IT programming, as they have tax systems which only allow calculations of the statutory interest penalty of 1.5 percent per month (18 percent per year). Under the bill, counties would need to rewrite their tax systems in order to apply different tax rates to different groups, as the redemption penalty rate imposed on taxpayers not in bankruptcy proceedings would remain at 18 percent.

-- END –