



INTERNATIONAL INSOLVENCY INSTITUTE

GOVERNMENTAL TAX PRIORITIES IN BANKRUPTCY PROCEEDINGS

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March, 2006

(www.iiiglobal.org)

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REPORT ON TAX CLAIMS

REPORTER'S DRAFT OF APRIL 10, 2006

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REPORT ON TAX CLAIMS*

I. INTRODUCTION

As insolvency law reform continues in developed and transition countries, adjustments continue to be made to rules governing treatment of tax claims in liquidation and rehabilitation proceedings. The insolvency reform effort recently gained added impetus when the United Nations General Assembly adopted the “UNCITRAL Legislative Guide on Insolvency Law.”¹ The UNCITRAL Guide describes one of the nine “key objectives” of a strong insolvency regime to be “ensuring equitable treatment of similarly situated creditors.”² This does not mean that all creditors must be treated identically, but instead that creditor treatment should reflect the bargains the creditors have struck with the debtor.³ Taking this into account, another of the key objectives is “recognition of existing creditor rights and establishment of clear rules for ranking of priority claims.”⁴ A clear and predictable ranking system is beneficial because it can help “to ensure that creditors are certain of their rights at the time of entering into commercial arrangements with the debtor.”⁵ To the greatest extent possible, creditor priorities should be based on commercial bargains rather than social and political concerns “that have the potential to distort the outcome of insolvency.”⁶ The UNCITRAL Guide recognizes that two categories of claims afforded priority are particularly prevalent: employee compensation and benefits and tax claims.⁷

The priority afforded to government tax claims has been justified on a number of grounds.

* Prepared by the Committee on Tax Priorities, Hon. James Garrity and Hon. Ralph Zulman, Co-chairs, Barbara K. Day, Overseas Private Investment Corporation, Reporter. The views expressed in this Report are the Reporter’s own and do not represent the views of the Overseas Private Investment Corporation.

¹ UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW (2004) (the “UNCITRAL Guide”), *available at* <http://www.uncitral.org/english/texts/insolven/insolvencyindex.htm> (last visited May 4, 2005).

² *Id.*, at 15.

³ *Id.*

⁴ *Id.*, at 18. “Priority” means “the right of a claim to rank ahead of another claim that arises by operation of law” and “Priority claim” means “a claim that will be paid before payment of general unsecured creditors.”*Id.*, at 10. This is in contrast to a “secured claim” which is “a claim assisted by a security interest taken as a guarantee for a debt enforceable in case of the debtor’s default. *Id.*, at 11. “Security interest” is “a right in an asset to secure payment or other performance of one or more obligations.” *Id.*

⁵ *Id.*, at 337.

⁶ *Id.*, at 17-18.

⁷ *Id.*, at 343.

First, unlike the claims of private commercial creditors, tax claims are for the benefit of the entire community. The priority protects the revenue base for the good, and avoids shifting the burden of the debtor's unpaid taxes to other taxpayers.

Second, unlike private creditors, taxing authorities are involuntary creditors, unable to choose their debtor or obtain security for debt before extending credit. The priority compensates for this disadvantage, giving the taxing authorities an opportunity to assess the amounts due and mobilize their collection remedies.

Third, with regard to taxes for which the debtor acts as the government's tax collector--such as sales tax, value added tax, or employee withholding tax--the argument is made that, if no priority or trust is imposed, the moneys collected by the debtor will increase the estate for the benefit of unsecured creditors. In these circumstances, the tax priority operates to prevent a windfall to general unsecured creditors who have no fair claim to the collected funds.

Fourth, some argue that if the taxing authorities are not reasonably secure they will be discouraged from negotiating payment terms with debtors, thus forcing premature and possibly unnecessary business failures. Affording priority is beneficial to reorganization because it encourages the taxing authorities to delay current collection efforts.

Finally, it has been argued that the priority is needed to effectuate an individual debtor's discharge, where tax liabilities are made non-dischargeable in order to discourage tax evasion through bankruptcy. Granting priority to those non-dischargeable tax debts supports the individual debtor's rehabilitation, making it more likely that the tax claims will be paid in a personal bankruptcy and that the debtor will be left with fewer non-dischargeable debts at the conclusion of the proceeding.

Law reform commissions and commentators have raised a number of policy criticisms of unsecured creditor priorities in general and the tax priority in particular:

First, all priority claims are inconsistent with the concept of equal treatment of creditors in a collective insolvency proceeding to the extent the creditors have not made a separate commercial bargain with the debtor prior to the proceeding. All unsecured creditor priorities should be minimized because: (1) it can foster unproductive debate over which creditors should be afforded priority and why; (2) it can impact the cost and availability of credit which will increase as funds available for distribution to other creditors decreases; (3) the concern that is the basis for the priority may be more readily addressed by non-bankruptcy law such as social welfare legislation; and (4) it can complicate the basic goals of insolvency and make it more difficult to achieve efficient and effective insolvency proceedings.

Second, the tax priority is not needed to protect the community interest because the debt owed to the government is unlikely to be significant in terms of total government receipts, whereas the loss to private creditors – who often receive nothing in a liquidation when there are extensive priority claims - may cause substantial hardship and precipitate additional insolvencies. Moreover, to the extent private creditors receive a higher return on their claims, part of the loss to the taxing authorities can be recouped through additional taxes paid by those

creditors. And, of course, a loss of priority does not prevent the taxing authorities from sharing in an insolvent estate pro rata with general unsecured creditors. While the government is not able to “choose its tax debtor” and must instead deal with all taxpayers, the fact that taxpayers cannot “choose their tax collector” certainly works to the advantage of the government which is in a position to establish tax policy by setting tax rates in ways that diversify its risks and protect the revenue base.

Third, the government is not disadvantaged by being an “involuntary creditor” because there are enhancements to its ability to collect debts, offsetting its involuntary position, that are not shared by private creditors, including (1) the imposition of penalties and relatively high interest rates, (2) third party liability, (3) collection procedures such as statutory lien and levy, and (4) the ability to commence involuntary bankruptcy proceedings against the delinquent taxpayer even though the amount owed still is uncertain. Furthermore, there is no general rule that involuntary creditors should receive priority--several other categories of involuntary creditors are not entitled to any kind of priority.

Fourth, abolishing priority for tax claims should provide a greater incentive to the taxing authorities to collect taxes in a commercially reasonable manner, by removing reliance on an artificial ability to be paid ahead of other creditors. The priority is counterproductive to the rehabilitation process because it provides an incentive to delay collection. Delaying collection also compromises the uniform enforcement of the tax laws and constitutes a state subsidy, which undermines the disciplinary force of an effective insolvency law. Particularly in situations where the debtor is acting as tax collector, the taxing authorities have better information available about the debtor's financial condition than general business creditors. The debtor is required to submit periodic returns in connection with payroll, value added taxes, sales taxes, and taxes withheld from employee wages, and the authorities receiving these returns are likely to know without delay when there is a delinquency. Allowing tax debts to accumulate under those circumstances can unfairly disadvantage other unsecured creditors who go on trading with the debtor not knowing that there is a tax delinquency.

Finally, the argument that a “trust” should be imposed on amounts withheld by the taxpayer on behalf of third persons in order to avoid a windfall to the general unsecured creditors or in order to avoid unfairness to employees obligated to pay income tax on their wages who have only received net-wages, is not persuasive. Unless the withheld amounts have actually been collected and segregated from the debtor's other assets, imposing a trust on the general assets of the debtor arguably is as unfair to the unsecured creditors who have continued to do business with the debtor. Also, with regard to employee income tax withholding, employees are not at risk for double payment as long as the tax law provides that they are allowed a credit against their own tax liability for the amount withheld, regardless of whether it has been remitted to the taxing authorities by the employer.

This report, which describes and compares the priority of tax claims in the insolvency laws in 35 countries, is an outgrowth of a prior study, *Should the Sovereign be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy*, 74 Am. Bankr. L.J. 461 (2000), which examined the origins and justifications of the tax priority rules as well as the criticism of the priority rules and reform efforts in Australia, Canada, France,

Germany, Mexico, New Zealand, the United Kingdom, and the United States. This report updates the earlier study to reflect subsequent changes in the laws of the eight countries covered and expands the earlier work to include the laws of the following additional countries: Argentina, Austria, Brazil, Chile, Peoples Republic of China, Arab Republic of Egypt, Estonia, Finland, Ghana, Greece, Hong Kong, India, Japan, Latvia, Lithuania, Mozambique, Netherlands, Philippines, Poland, Portugal, Russia, South Africa, Spain, Sweden, Thailand, Turkey, and Venezuela. The report complements a report published earlier this year by INSOL International, *Employee Entitlements*, which describes the treatment of wage and benefit claims in the insolvency laws in 24 countries.

The Appendix contains national law summaries describing how tax claims are treated in liquidation and rehabilitation proceedings in the 35 countries covered by this report. These summaries, which also describe the types of taxes imposed in each country and outline the methods available for enforcement outside of insolvency proceedings, are based on information provided by insolvency experts in each country.

The laws described in this report fall into four basic categories: (1) countries that afford no priority to any kind of pre-bankruptcy claims, (2) countries that afford priority to no pre-bankruptcy tax claims but retain priority for another type of claims (most often employee claims), (3) countries that provide limited priority for tax claims (priority may be based on type of tax, duration of tax or percentage of tax), and (4) countries that retain unlimited priority for taxes in insolvency proceedings. Section III compares the treatment of tax claims in liquidation and rehabilitation proceedings in the countries covered by this study, and Section IV offers some conclusions that can be drawn from the comparison.⁸

The contributions of the following participants, who have made this report possible by providing information about the tax and insolvency laws in their countries, are gratefully acknowledged:

Argentina	Ricardo Beller Marval, O'Farrell & Mairal
Australia	Richard H. Fisher/Johnathan Scott/Hilary Allen Blake Dawson Waldron
Austria	Dr. Christof Stapf Neudorfer Rechtsanwälte
Brazil	Troy Petit/Luiz Rogeiro Sawaya Batista Felsberg, Pedretti, Mannrich e Aidar

⁸ The main focus of this Report is on the priority afforded to unsecured tax claims that arise prior to the initiation of formal insolvency proceedings. Claims for taxes that arise after formal proceedings are commenced may be entitled to priority along with other expenses and costs of administration. Also, taxes that become secured claims, whether as unavoidable statutory liens or consensual security interests, may also be entitled to priority over other creditors on that basis.

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II. SUMMARY OF TAX PRIORITIES UNDER NATIONAL INSOLVENCY LAWS

<p>A. NO PRIORITY CLAIMS</p>	<ul style="list-style-type: none"> • Austria • Estonia • Finland • Germany
<p>B. NO PRIORITY FOR TAXES</p>	<ul style="list-style-type: none"> • Australia • Sweden • Turkey • U.K.
<p>C. LIMITED PRIORITY FOR TAXES, BASED ON:</p> <p>(1) TYPE OF TAX (2) DURATION OF TAX (3) PERCENTAGE OF TAX</p>	<ul style="list-style-type: none"> • Canada (1) • Chile (1) • Egypt (2) • France (1), (2) • Ghana (1), (2) • Hong Kong (2) • India (2) • Mozambique (2) • Poland (2) • Portugal (2) • New Zealand (1) • Spain (3) • Thailand (2) • U.S.A. (1), (2)
<p>D. UNLIMITED PRIORITY FOR TAXES</p> <p>*LIMITED TO PERCENTAGE OF ESTATE</p>	<ul style="list-style-type: none"> • Argentina* • Brazil • China • Greece • Japan • Latvia • Lithuania • Mexico • Netherlands • Philippines • Russia • South Africa • Venezuela

III. TREATMENT OF TAX CLAIMS IN LIQUIDATION PROCEEDINGS

A. No Priority Claims

Austria, Finland, Germany, and Estonia afford no priority to unsecured claims of any type arising before the opening of insolvency proceedings.

Austria was the first country to take this approach. In 1982, Austria abolished priority for all pre-bankruptcy claims, including tax claims, in order to enhance the principle of equal treatment among creditors.

Ten years later, in 1992, Finland eliminated all priority claims in commercial insolvency cases. Again, the reason for the change was to strengthen the principle of equality among creditors, as unsecured creditors often received nothing in insolvency cases. Finland also limits the scope of the floating charge to 50% of the mortgaged property, which increases the estate available for payment of unsecured creditors.

Germany eliminated all priorities for pre-bankruptcy claims as part of sweeping insolvency reforms that went into effect in 1999. This was an enormous change from prior law which included an extensive priority scheme. Germany's law was heavily influenced by the writings of Professor Thomas Jackson and in particular his view that insolvency laws should not create any special entitlements because such priorities revalue or re-inflate depreciated claims by the very fact of insolvency.⁹ According to this view, the only priorities granted should be those found in the non-bankruptcy laws because bankruptcy priorities undermine the goal of collectivization. Consequently, the German law contains no special priorities of any kind for pre-bankruptcy claims. Germany adopted this approach with the hope of increasing the average distribution to unsecured creditors when a business fails.

Most recently, Estonia followed this model and abolished all priority claims, including tax priorities as part of the enactment of a new Bankruptcy Act which became effective January 1, 2004. The tax priority was abolished in order to treat all creditors equally in bankruptcy proceedings, regardless of whether the claimant is a private company or the state. The Bankruptcy Act is part of ongoing reform of the judicial procedures in Estonia and is intended to shorten the duration of bankruptcy proceedings.

The taxing authorities in each of these countries have significant enforcement tools outside of bankruptcy proceedings. They also have the ability to commence involuntary insolvency proceedings against the taxpayer. Enforcement tools include the ability to impose interest and

⁹See Manfred Balz, *Symposium Commentary, Market Conformity of Insolvency Proceedings: Policy Issues of the German Insolvency Law*, 23 BROOK. J. INT'L L. 167, 174 & 174 n.34 (1997). See also, THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* (1986), at 21 ("The establishment of new entitlements in bankruptcy conflicts with the collectivization goal. Such changes create incentives for particular holders of rights in assets to resort to bankruptcy in order to gain for themselves the advantages of those changes, even when a bankruptcy proceeding would not be in the collective interest of the investor group. These incentives are predictable and counterproductive because they reintroduce the fundamental problem that bankruptcy law is designed to solve: individual self-interest undermining the interests of the group. These changes are better made generally instead of in bankruptcy only.") (emphasis in original).

penalties, seize and sell property through administrative proceedings, collect amounts owed to the taxpayer by third parties, obtain non-judicial liens on the taxpayer's property, and impose liability on certain third parties, such as managing directors. Each of these four countries has established a statute of limitations on enforcement actions but also has the ability to agree to a moratorium on collection or an installment plan for payment of delinquent taxes in appropriate circumstances, such as financial hardship. In each of these countries, certain pre-bankruptcy wage claims are given protection outside the insolvency proceedings through payment by an insolvency fund or the government agency.

B. No Priority for Taxes

Australia, the United Kingdom, Sweden and Turkey have abolished all general tax priorities, but retain a priority for employee wage claims.

At the time Australia eliminated the tax priority in 1993, it strengthened its tax administration rules. Specifically, it now allows the taxing authorities to initiate involuntary insolvency proceedings even though the tax is still an "uncertain amount," whereas previously taxing authorities could only initiate proceedings when the amount owed had been fixed. Second, it imposes personal liability on company directors for unremitted withholding taxes. Finally, it recognizes that certain taxes, such as real estate taxes, may become liens by statute and obtain priority through their secured status. Unless the tax claims become liens, they are paid after claims owed to the holder of a floating charge as well as wage claims.

In the Enterprise Act 2002, the United Kingdom eliminated its remaining tax priorities for PAYE (income tax withheld), VAT (value added tax) and customs and excise duties as part of more general insolvency law reform intended to promote a rescue culture. The only remaining pre-insolvency claims entitled to priority in U.K. proceedings are the employer's contributions to occupational pension schemes and a limited amount of employee remuneration.¹⁰ At the same time, limitations were placed on the claims of the holder of the floating lien. Specifically, a prescribed part of the recoveries from the assets subject to the floating lien must be set aside for the benefit of unsecured creditors: 50% of recoveries up to £10,000 and 20% of recoveries in excess of that amount up to £600,000 (not applicable in certain cases where the net assets are less than £10,000). The purpose of abolishing the crown preference and limiting the extent of the floating lien is to benefit unsecured creditors. It is anticipated that losses to the government from abolition of the crown priority will be offset by increased taxes received from the continued trading of the surviving companies.

Sweden abolished priority for tax claims in insolvency effective January 1, 2004, as part of a package of legal reforms relating to priority legislation first recommended in 1992. In addition to eliminating the tax priority, the reforms reduced the floating charge on the debtor's assets to 55% of the value of the assets. In combination, these measures ensure that some amount of assets will be available for unsecured creditors of insolvent debtors. Employee claims continue to be accorded priority, although the amount is restricted, and it is believed that the State's

¹⁰ Employees of an insolvent company may also be paid by the Redundancy Payment Services which then takes over the employee claims in the insolvency proceeding through subrogation and is entitled to the same priority status the employees would have had.

losses as a result of the abolition of the tax priority will be neutralized by the increased dividends on prioritized wage claims.

Turkey abolished the general priority for tax claims in insolvency proceedings in July 2003, so that tax claims now rank the same as other unsecured debts. The amendment ranking unsecured tax claims the same as other unsecured claims is aimed at protection of rights of the ordinary unsecured creditors of the failed business. At the same time, Turkey amended the Law on Procedure of the Collection of Public Claims to post-pone all execution proceedings against the debtor upon commencement of the bankruptcy proceedings except for foreclosure of security interests and levy and garnishment. There is an exception for taxes and claims arising *in rem* and customs tax for related property. Also, tax authorities can establish a lien to secure tax claims that puts them in the position of a secured creditor with regard to the property.

Tax administration and enforcement procedures in the U.K., Sweden and Turkey are similar to those of Australia. In addition, from time to time, the Turkish Parliament passes “Tax Peace” laws, which provide for general dismissals and exemptions from certain taxes.

C. Limited Priority for Taxes

Canada, New Zealand, Chile

Canada, New Zealand, and Chile agree that no special priority should be granted for direct income taxes. They continue, however, to adhere to the view that taxes collected from and withheld on behalf of third parties should be entitled to a special bankruptcy priority when a business fails.

Employee income taxes withheld from employee wages by employers as well as Canada pension plan and employment insurance taxes are entitled to priority in Canada, where they are granted priority over secured as well as unsecured claims, except for preexisting liens on real property. Priority is based on the theory that funds withheld from employee wages are not the employer’s property and in the event of bankruptcy should not be divisible among the employer’s creditors. Instead these amounts are held in “deemed trust” and protected by statute, even if the deemed trust does not in fact satisfy the general principles of trust law.

Withheld employee income taxes is also the single category of tax priorities that the New Zealand Law Commission recommended in 1999 be retained.¹¹ After reviewing in depth the policy arguments for and against the tax priority, the Law Commission concluded that although there were insufficient grounds for retaining most tax priorities it would be unfair to the persons whose entitlements are withheld not to assure payment of these amounts because such persons have ordered their affairs on the assumption that the taxes have been paid and because would be unfair to allow the assets of the insolvent's estate to be increased through the use of monies the debtor ought to have paid on behalf of third parties.

¹¹NEW ZEALAND LAW COMMISSION, STUDY PAPER 2, PRIORITY DEBTS IN THE DISTRIBUTION OF INSOLVENT ESTATES ¶ 249, at 62 and ¶ 146, at 40 (1999).

Some recommendations contained in the New Zealand Study Report, have been addressed through subsequent changes to the law such as the impact of the floating charge on unsecured creditors. Thus, legislation has been passed limiting the secured claim of the holder of a purchase money security interest to assets actually financed rather than also extending to a company's inventory and accounts receivable. The Law Commission's recommendations regarding the tax priority, however, were not accepted by the lawmakers who continue to be persuaded that the tax priorities should not be ended due to the government's status as an involuntary creditor. Thus, the priority continues for employee withholding taxes, goods and services taxes, customs duties and associated levies, and withholding taxes for interest and dividends. Some sectors of the commercial community in New Zealand have criticized this position as providing insufficient incentive for tax authorities to act more swiftly in dealing with the potential insolvency of taxpayers.

In Chile, the tax claims entitled to priority treatment are those where the bankrupt is acting as tax collector on behalf of the taxing authorities, such as VAT, employee withholding and other special taxes). As in Canada, these taxes are entitled to priority not only over unsecured claims but also over secured claims. All other direct tax obligations of the debtor, such as income and business profits taxes, are general unsecured claims.

The remaining 24 countries and regions covered by this study retain at least some priority for all types of tax claims and social security contributions, as well as employee wage and benefit claims.

Poland, Portugal, Spain, Thailand

Within the last eight years, however, six of these countries, Poland, Portugal, Argentina, Spain, Japan, Brazil, and Thailand have taken steps to limit the impact of tax priorities in the context of insolvency law reform. In the case of Poland, Portugal, and Spain, the changes in the law have benefited unsecured creditors.

The 2003 Law on Bankruptcy and Reorganization in Poland narrows the scope of the tax privilege found in its 1934 law. The new Polish bankruptcy law provides second priority for all taxes and public charges, after payment of costs of administration, payments under contracts assumed by the administrator, and premiums for pensions, disability and sickness benefits and dues for work, but limits the priority to amounts due for a year immediately prior to the declaration of bankruptcy.

Similarly, the new Portuguese Insolvency Code continues to provide states and municipalities with special, immovable and general creditors preferences for tax claims owed to states and municipalities, but limits all of these preferences to amounts due for 12 months prior to the beginning of the insolvency proceeding.

Spain's 2004 Insolvency Act provides a general privilege for income tax and social security withholding on behalf of employees that ranks prior to all claims except employee wage claims and registered secured claims, but has limited the priority afforded to all other tax claims to 50% of the amounts owed. The remaining 50% of the tax claims are treated as general unsecured

debts. One of the goals of the new law is to minimize the impact of the bankruptcy on other market agents such as suppliers and creditors and the limitation on the tax priorities serves this goal.

Thailand amended its Bankruptcy Act in 1998 after the 1997 Asian economic crisis, to include a rehabilitation procedure as well as liquidation provisions. Under the amended Bankruptcy Act, in a liquidation, tax claims due within six months prior to the commencement of the bankruptcy proceedings are entitled to priority along with four months of employee wages, after payment of secured claims and costs of administering the proceeding. The balance of any tax claims are general unsecured claims.

United States, France

While the United States and France each have amended their insolvency legislation within the last year, unlike many other countries, neither has reevaluated or modified the system of priority rules for tax claims,¹² and both provide some level of priority for all types of taxes.

In both the United States and France, different types of taxes are entitled to priority for different periods of time, but in each case the priority tax claims rank behind a limited amount of employee wage and benefit claims.

In the United States, the priority periods generally are longer for taxes where the administration and collection process is more complex and time consuming, or where the taxes are of a quasi-trust nature. For example, there is no specific limit on the priority period for withholding taxes. Also, a longer priority period is allowed for income taxes (three years) where self-assessment is required, whereas a shorter period applies for ad valorem taxes on property such as property taxes and customs duties (one year), where the taxing authorities can readily impose liens on or detain the property subject to tax. The tax priority can extend to any unencumbered assets of the bankruptcy estate, either real or personal.

In France, for taxes entitled to the general tax preference, there is no specific limitation for social security, agricultural security and holiday insurance contributions, and there is a longer period for income and wealth taxes (four years) and a shorter period for customs duties (three years). The general tax preference entitles the government to priority with regard to movable assets but not real estate (except for real estate taxes).

¹² The U.S. tax priority was not questioned in the 1997 Report of the National Bankruptcy Review Commission. NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS, NATIONAL BANKRUPTCY REVIEW COMMISSION FINAL REPORT 943 (1997), available at <<http://www.nbrc.gov>> (recommendations regarding tax issues). In the United States, 1966 legislation reduced the priority for tax claims to three years. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES (the "Bankruptcy Commission"), H.R. DOC. NO. 93-137, AT 216 (1ST SESS. 1973), reprinted in B Collier on Bankruptcy, app. pt. 4(c), at 484 (15th ed. rev. 1999). The Bankruptcy Commission recommended that tax priorities generally be limited to one year and that the statutory tax lien be limited. Congress rejected the Bankruptcy Commission's recommendation that tax priorities generally be limited to one year. Statutory tax liens confer secured status on the taxing authorities, but are subordinate to all priority claims in liquidations.

Hong Kong, India, Ghana, Egypt, Mozambique

Tax claims and other statutory debts owed to the Hong Kong government, that are due and payable 12 months before the appointment of a liquidator, are entitled to priority in liquidation after payment of secured claims and a limited amount of wages, salaries, severance pay, and other employee related contributions, but before payment of amounts owed under a floating charge. In reviewing the Companies Ordinance in 1998, the Law Reform Commission recommended that all government priorities, including the tax priority, be abolished and that such claims be treated as ordinary creditor claims in a winding up proceeding. Although the Commissioner of Inland Revenue expressed his support for the principle of *pari passu* distribution of assets of an insolvent company unless there were compelling reasons to do otherwise, the Law Commission proposal was rejected as far as government taxes and duties were concerned based on the idea that there was a compelling reason for affording priority to such claims as they represent a civic obligation owed to the country and there is a strong public interest in seeing that such dues are fully paid.

India also affords priority to 12 months of tax claims owed to central, state, or local governments, along with a limited amount of employee wage, salary and benefit claims after payment of secured claims and claims of “workmen” providing work for hire under the Industrial Disputes Act.

Similarly, in Ghana, all taxes due within one year preceding the commencement of winding up proceedings and a limited amount of employee claims are entitled to priority over the holder of a floating charge. The balance of tax claims are paid with unsecured claims, except pursuant to statute as in Canada, taxes withheld by a withholding agent are not part of the debtor’s estate and therefore have priority before any distribution is made to other creditors.

In Egypt no distinction is made among types of taxes, all of which rank as second priority after payment of the administrative court and judicial expenses related to the proceedings, but the priority is only for taxes owed for the two years preceding the bankruptcy. The balance of taxes are paid as general claims after a limited amount of employee claims are recognized.

In Mozambique, all taxes have priority over immovable assets for 15 years. Indirect taxes such as VAT, have priority over immovable assets for 15 years and over movable assets for 2 years. These priorities are payable after court fees, but before employee wages and social security contributions which in turn rank ahead of general claims.

D. Unlimited Priority for Taxes

In the remaining countries, no distinctions are made with regard to the duration or types of taxes in the priority rules and all retain some priority for all taxes vis-à-vis general unsecured creditors, subject only to applicable statute of limitations for collection. In a liquidation, however, tax claims may rank below other pre-liquidation priority claims, the most notable being employee wage claims. Also, some types of taxes may be paid in priority to other types of taxes.

Argentina, Japan, Brazil

Recent amendments to the insolvency laws in Argentina, Japan, and Brazil have affected the order of priorities among tax and other claims, although these countries continue to retain some priority for all types of taxes vis-à-vis general unsecured creditors.

The 2002 Argentine Bankruptcy law provides a general preference for the principal amount of any taxes and duties, labor credits, the principal amount of social security debts, certain personal expenses of individuals, and certain credit invoice amounts, but requires that all such claims entitled to the general preference not take more than 50% of the debtor's total assets after special preferences, such as claims secured by mortgages, are paid. Thus, unsecured creditors are assured of some recovery as long as the debtor's assets are sufficient to pay the claims entitled to special preference.

Changes were made to the priority for tax claims in the Japanese Bankruptcy Code, effective January 1, 2005. Previously, all tax claims were granted first priority treatment and all employee wage and benefit claims were second priority. Now only claims for taxes and public dues incurred within one year before the bankruptcy are entitled to first priority along with the costs of administering the bankruptcy proceedings. Other tax and public claims are second priority claims but rank ahead of wage and private second priority claims. General unsecured claims rank behind second priority claims. The rules regarding priority of tax claims were changed in order to provide more protection for employee wage and benefit claims because such payments will assist the employees whose work contributed to the creation of the company.

The new Brazilian Bankruptcy and Corporate Recovery Act, which went into effect on June 9, 2005, amends provisions of the National Tax Code that previously afforded tax credits priority over both secured and unsecured credits, subject only to labor credits. Under the new law, tax claims will rank in 6th position, behind certain wage claims, credits related to export transactions, post-bankruptcy credits, and secured claims, but ahead of special privileged, generally privileged, and unsecured creditors. In addition, the National Tax Code has been amended to provide that in any judicial sale of assets, the buyer will not assume the seller's tax liabilities, which previously was the case. The historical reason for the structure of priorities was based on the principle of supremacy of the public interest over private matters. The new bankruptcy law represents a significant change and is designed to maintain and encourage the continuity of the business and stimulate economic activity.

South Africa, Latvia, Lithuania

South Africa's attempts to eliminate tax priorities was unsuccessful. In 1984, the South African Law Commission recommended that the preference for employee claims in insolvency proceedings be limited and that all other preferences be abolished. The Law Commission's report and recommendation were based on the reasoning similar to that in reports recommending limits on the crown priority in the other commonwealth countries. In 1989, the Cabinet of the Government of South Africa rejected these recommendations and endorsed the

view taken by the Cabinet Committee for Economic Affairs that the abolition of preferences could not be supported because it would have unacceptable cost implications for the State.¹³

As a result, in South Africa, as in Latvia and Lithuania, certain types of taxes are granted priority over other types of taxes, although the preferred taxes in each country are different. In South Africa, withholding, customs, excise, and sales taxes rank in a tier along with certain wage and employee claims, ahead of income and profits taxes. Latvia ranks individual income tax payments, and compulsory state social insurance contributions, in the first tier with wage claims after payment of administrative expenses of insolvency, but ranks certain payments for farm and agricultural undertakings and state claims for repayment of state guaranteed loans ahead of other tax and state social insurance claims. In Lithuania, all taxes and other payments to the budget, social taxes, and loans received from the state or guaranteed by the state are entitled to second priority after payment of secured claims and employee claims and payroll taxes.

Netherlands, Philippines, Russia, Mexico, Greece, China, Venezuela

In the Netherlands, the Philippines, Russia, Mexico, Greece, China, and Venezuela, a bankruptcy filing has very little impact on tax collection.

In the Netherlands, enforcement of tax claims is not stayed in liquidation proceedings and all tax claims are entitled to priority (“super preference”) over employee wage claims. Tax claims rank only behind claims secured by mortgage or pledge and administrative costs. Employee wages are protected by a statutorily required wage guaranty scheme operated by the social security authorities which implements an European Union Directive.

The Philippines insolvency law provides that all taxes owed to all levels of government are entitled to priority. Taxes that constitute liens, like secured claims, take precedence over other claims with regard to the property to which they attach. Taxes on specific property (e.g., basic real property tax) take precedence over all other claims with respect to the property even without need for registration of the lien.

In Russia, tax and other fiscal claims are paid after the administrative costs of the proceedings, employee wage and benefit claims, and claims of creditors secured by a pledge, but before general creditor claims.

Prior to adoption of the Commercial Insolvency Law in Mexico in 2000, the bankruptcy and tax enforcement systems were completely separate. The tax authorities were not required to participate in the bankruptcy proceedings and their enforcement actions were not affected by the commencement of a bankruptcy proceeding. Under the current law, upon commencement of insolvency proceedings, the bankruptcy court must give notice to the taxing authorities in order for them to decide whether to demand payment through an independent administrative proceeding. From the time the insolvency judgment is rendered, however, the amount of tax

¹³SOUTH AFRICAN LAW COMMISSION WORKING PAPER 61, REVIEW OF THE LAW OF INSOLVENCY: STATUTORY PROVISIONS THAT BENEFIT CREDITORS (1995).

debts will continue to be updated as well as penalties and other charges related thereto. In commercial bankruptcy, the taxing authorities may partially waive tax claims accrued pre-bankruptcy, provided that the debtor enters into an agreement with creditors in accordance with the following: (1) if tax debts are less than 60% of the aggregate debts in the proceeding, the waiver shall not exceed the minimum benefit granted to unrelated creditors who represent at least 50% of the recognized non-tax creditors; or (2) if the tax debts exceed 60% of the aggregate debts recognized in the proceedings, the waiver shall not exceed the surcharges related to the outstanding tax credits. If no agreement is reached with creditors and the debtor's business is liquidated, the taxing authorities can enforce tax claims unimpeded by the pendency of insolvency proceedings.

In Greece, tax claims enjoy a general preference regardless of whether in insolvency, non-insolvency, or foreclosure. Administrative enforcement is not stayed on the debtor's insolvency. Joint and several liability with debtor of directors, board members and managers for payment of taxes, wages and social security, as well as criminal penalties for failure to fulfill these obligations. Prosecution and indictment are not suspended because of insolvency, but generally such persons are acquitted at trial, with various constructs based on their inability to make payments due to the bankruptcy. There is no formal "priority" between tax and secured claims, but rather the product of liquidation is divided into 1/3 for tax claims and 2/3 for secured (and other preferred claims), and each category of claim is paid preferentially from the respective parts of the proceeds. Wage claims for up to two years preceding bankruptcy have general preference over both tax and secured claims.

Under the liquidation regimes in China (currently only available for state owned enterprises and enterprises where at least 25% of the equity is held by foreign investors), tax claims take priority over unsecured claims and secured claims arising after the occurrence of the tax claim. Under a proposed draft bankruptcy law submitted to the National People's Congress for deliberation in June 2004 tax claims would continue to rank before unsecured claims but after secured claims (whether arising prior to or after the tax claim), bankruptcy expenses, and employee claims.

Venezuela is the only country in the study that recently has added to rather than diminished the privilege for tax claims. Prior to 2001, taxes claims (excluding interest or penalties) for the current year and the preceding two years were privileged and ranked after claims secured by mortgage or pledge and social security and wage claims, but ahead of unsecured claims. In 2001 these limitations were eliminated so that currently all tax credits (without a limitation as time, and including interest and penalties) are entitled to priority. In addition, the commencement of liquidation proceedings does not stay the enforcement of tax claims, such as foreclosure.

IV. TREATMENT OF TAX CLAIMS IN REHABILITATION PROCEEDINGS

The type of reorganization or rehabilitation procedure available varies widely among the countries covered by this study. In the U.S. where reorganization is favored, Chapter 11 provides detailed rules for business reorganizations. Most countries that have modernized their insolvency laws within the last 10 years, provide a statutory basis for court supervised business

reorganization. Some countries provide for a more limited “scheme of arrangement” which supports a consensual agreement among creditors. A few of the countries have no statutory basis for businesses to reorganize. These variations make it difficult to generalize about the treatment of tax claims in rehabilitation proceedings.

Most of the countries that have insolvency laws providing for some kind of generally available rehabilitation or reorganization provide for a stay, either automatic or at the discretion of the presiding official, of further collection efforts by tax authorities upon the commencement of a proceeding for some period of time to permit reorganization efforts. In New Zealand, where there is no generally available reorganization procedure, collection efforts by taxing authorities may be subject to a moratorium only in the government-imposed statutory management procedure. In Venezuela, Brazil, and the Netherlands, insolvency proceedings do not stay administrative enforcement of tax claims. In the Philippines, the law is unsettled as to whether tax liens are affected by a stay order or court mandated rehabilitation plan.

Many of the countries that have modernized their reorganization laws have rules that authorize or require the tax authorities to accept payment of their tax claims in installments over time. The laws of the United States, Japan, and Canada provide that payment of priority tax claims can be forced to accept payment over time (over six years in the United States, over three years in Japan, and over six months in Canada), but that interest must be paid on these claims, and that the taxing authorities must agree to any reduction in the principal amount of the claims.

In countries such as Finland, Germany, Australia, Estonia, Sweden, Turkey, and the United Kingdom, where taxes are treated as unsecured claims, the taxing authorities are entitled to vote on an arrangement or reorganization plan, but are bound to accept the same treatment as other unsecured creditors, unless their claims have risen to the status of enforceable and non-avoidable liens. The same is true of the non-priority portion of tax claims in Canada, the United States, and Thailand. While tax claims are not entitled to priority in a liquidation in Austria, in a reorganization, tax claims can only be paid over time with the agreement of the taxing authority.

In Argentina, taxing authorities may or may not, like any other creditor, accept the debtor’s proposed debt restructuring including the restructuring of tax payments. A reorganization plan must create three categories of creditors: special preference, general preference, and non-preference, but the debtor may offer more than one alternative for each category. Because taxing authorities usually do not accept the release of tax credits, debtors usually create a separate category for unpaid taxes in reorganization plans.

In Poland, tax claims are subject to arrangement proceedings and may be subject to any arrangement agreed in such proceedings among the creditors, including deferral for the fulfillment of obligations, an arrangement for the repayment of debt in installments, the reduction of the amount of debts, the conversion of claims to shares or stock, or the change, exchange or annulment of a right securing specific claims. Tax authorities do not enjoy any special privileges in voting on a plan of arrangement. The situation appears to be the same in Portugal.

In Latvia, taxing authorities can be compelled to accept payment over time if the creditors accept the reorganization plan containing such a requirement. Tax claims are classified together with other claims in terms of voting on a settlement. In voting on a plan the claims are divided into three groups and the rehabilitation plan must be accepted by at least two groups.

In Hong Kong, taxing authorities are separately classified from unsecured creditors for purposes of voting on a scheme of arrangement, but where the scheme for preferential creditors has been passed and sanctioned by the court, it binds the taxing authorities. The same is true with regard to priority tax claims in rehabilitation proceedings in India and court sanctioned arrangements in South Africa.

In New Zealand, which as noted, really does not have a modern reorganization law, the government must agree to any delayed payment of its taxes. Similarly, in Mexico, the law does not require the taxing authorities to accept delayed payment and does not require the taxing authorities to consent to a reorganization plan. It does, however, contemplate that an agreement for payment of taxes may be negotiated. Taxing authorities in Mexico may permit payment on terms not to exceed 48 months provided that there is a guaranty of payment, although this is not allowed for taxes withheld, transferred or collected. Surcharges and fines continue to accrue during the conciliation phase of an insolvency proceeding but if the reorganization plan is approved, such fines and other charges are cancelled. The amount owed to the taxing authorities is determined by the tax agency, not by the insolvency court.

In Spain, the taxing authorities have the right to decide whether tax claims will be included in an insolvency agreement or not. If they are included, the taxing authorities are bound by the agreement like other creditors.

In Lithuanian restructuring proceedings, the debtor company must settle claims with current payments unless the creditors have consented to different treatment. Disputes regarding settlement of current payments generally are heard by the court, but the court is not competent to decide on execution of and payment terms for taxes and other statutory payments, so these issues are not affected unless an installment plan is negotiated and agreed that provides for payment.

In Greece, administrative enforcement of tax claims generally is stayed in reorganization and the reorganization agreement, is binding on all, including dissenting and non-participating creditors and the State if approved by the required votes. On a practical basis, however, debtors heavily indebted for taxes and social security dues are unlikely to enter reorganization. One third of the estate is reserved for tax claims and two third for secured and other preferred claims. Because reorganization agreements must make express payment for all social security dues, and social security dues are preferred claims, if taxes and social security dues are expected to exhaust the going concern liquidation value, there is little incentive for creditors to reorganize the company.

In Brazil, tax creditors are not included in the reorganization plan and tax foreclosures are not stayed by the proceedings, in order to force the debtor to negotiate. Currently, there is no ability for a debtor to pay delinquent taxes through an installment plan, although it is anticipated

that the National Tax Code will be amended to permit installment payments of tax credits. It is not anticipated that the rule on tax foreclosures will be modified.

Tax claims are subject to the same rules in Venezuelan moratorium as well as liquidation proceedings: neither type of proceeding stays enforcement of the tax claims.

China does not currently have a law that permits reorganization of an enterprise, although legislation that would permit reorganization has been submitted to the legislature for deliberation. It appears that tax claims would be treated the same in reorganization as in liquidation under the proposed law.

There are no rehabilitation or reorganization proceedings under Egyptian, Ghanaian or Mozambican law. In Egypt there are guidelines in the commercial code that provide for receiverships and in Ghana and Mozambique there have been discussions about possible insolvency law reform. In all three countries, the tax laws provide that tax authorities can agree to payment of taxes in installments and provide some relief from payment of interest and penalties.

V. CONCLUDING OBSERVATIONS

The different treatments of tax claims in the national laws described in this report and the recent history of their revisions reflect varying judgments as to how the policy arguments for and against the tax priority should be balanced within the context of different national legal systems. Some conclusions can be drawn from this review:

First, there is an unmistakable trend to reduce tax priorities, both in developed and transition countries as part of more general insolvency law reform efforts, which is in line with the recommendation in the UNCITRAL Guide that insolvency laws minimize the priorities accorded to claims that are not based on commercial bargains.¹⁴

In most cases this rebalancing of priorities has been designed to increase the likelihood that unsecured creditors will receive some payment in the event of a company's liquidation and that a business can be rehabilitated or reorganized. In a number of cases, the reduction in tax priorities has been accompanied by other changes in the insolvency laws designed to increase the dividend to unsecured creditors. In the case of the changes to the Japanese insolvency laws, the intended beneficiaries of the amendments are the employees of the insolvent company.

The trend, however, has not been universal. South Africa rejected Law Commission arguments against the tax priority out of concern for loss of State revenues early on and has not revisited the issue. Hong Kong also rejected efforts of its Law Reform Commission to abolish

¹⁴ UNCITRAL Guide, at 18 and 348. Reasons stated for minimizing unsecured creditor priorities include (1) it can foster unproductive debate over which creditors should be afforded priority and why, (2) it can impact the cost and availability of credit which will increase as funds available for distribution to other creditors decreases, (3) the concern that is the basis for the priority may be more readily addressed by non-bankruptcy law such as social welfare legislation, (4) it can complicate the basic goals of insolvency and make it difficult to achieve efficient and effective insolvency proceedings. *Id.*, at 342.

the tax priority, based on the public interest. New Zealand recently rejected its Law Commission recommendations to further reduce tax priorities, but did make some adjustments intended to benefit unsecured creditors. Although both the United States and France have made significant modifications to their insolvency laws during the past year, neither has reduced the extensive priority schemes for taxes. Venezuela has not modernized its insolvency laws, but it has recently increased the tax claims entitled to priority.

Second, transition countries tend to have more general tax priorities than developed countries. Effective tax administration rules and enforcement are important to equalize the government's "involuntary creditor" disadvantage, particularly where tax priorities are eliminated. Thus, where a country's tax administration rules are not effectively designed or enforced, eliminating the tax priority could place the government in a worse position than other creditors in collecting its revenue claims. Where the government's revenue needs exceed its ability to collect revenues outside of bankruptcy and insolvent companies are significantly in arrears, the choice may be made to retain a bankruptcy tax priority to minimize the losses to the general public.

Third, there appears to be some, but certainly not general, agreement that amounts withheld from third parties which are to be paid over to the government by the debtor should be afforded special treatment, whether through a specific bankruptcy priority, a trust theory, the imposition of third party personal liability, or a combination of the foregoing. Where no priority is afforded to income taxes withheld from employee wages, provisions in the tax administration laws or other government sponsored or mandated funds set up to protect employees of insolvent companies, may be needed to protect the employees from having to pay these amounts twice.

Fourth, as countries seek to encourage rehabilitation of viable businesses, eliminating the priority for tax claims and treating taxing authorities as general unsecured creditors that are stayed from enforcing the claims upon commencement of a proceeding and can be bound by a plan of rehabilitation is likely to further that goal. Where tax priorities are retained, specific rules have been developed for rehabilitation proceedings where reorganization is a goal of the national insolvency laws. Giving the debtor breathing space by staying the collection of taxes, and specifically allowing consensual or non-consensual extended payment of arrearages as part of a plan of rehabilitation, can serve the goal of encouraging viable businesses to reorganize. These developments are in line with the recommendation in the UNCITRAL Guide that "[i]n reorganization proceedings it may be desirable to provide that priority claims must be paid in full as a predicate to confirmation of a plan, unless the affected priority creditors agree otherwise."¹⁵

Fifth, in large part, the legal reforms appear to be based on reason and policy judgments rather than economic or statistical analysis. This may in part be due to the fact that there does not appear to be significant available empirical data on which to base recommended legislative changes or to evaluate the impact of the changes that are being made.¹⁶

¹⁵ *Id.*, at 347.

¹⁶ Exceptions to this include, Lopez-Ibor, Rocio Albert & Artes-Caselles, Joaquin, *Bankruptcy Proceedings and Government: Should Bankruptcy Law Grant Privileges to the Treasury*, Volume 2003 GERMAN WORKING PAPERS

IN LAW AND ECONOMICS, PAPER 9, available at <<http://www.bepress.com/gwp>> (last visited Feb. 28, 2005); Government Bill, proposition 2002/03:49 and Summary of the Right of Priority Committee, SOU 1999:1, at 41; (Sweden)(describing legal-economic studies obtained, including Theodore Eisenberg, *A Review of the Law and Economics Literature on Creditor Priority in Bankruptcy* (1998)); Eger, Thomas, *Bankruptcy Regulations and the New German Insolvency Law from an Economic Point of View*, EUROPEAN JOURNAL OF LAW AND ECONOMICS, 11:1; 29 (2001).

APPENDIX

INTERNATIONAL INSOLVENCY INSTITUTE REPORT ON TAX CLAIMS

NATIONAL LAW SUMMARIES*

* These summaries were prepared by the Committee Reporter using information furnished by the parties noted, in response to a National Law Questionnaire. Completed copies of the National Law Questionnaires are on file with the Committee Reporter. Every effort was made to accurately summarize the information provided. The Reporter apologizes in advance for any errors in summarizing the information and invites corrections to the summaries where appropriate.

ARGENTINA

Taxes: Federal taxes: Income tax, tax on presumed minimum income (assets), tax on credits and debits in bank accounts, personal assets tax, VAT, excise taxes (alcohol, tobacco, fuel, luxury articles), withholding tax on dividends and interest paid to foreign creditors, labor contributions and withholdings (social security, medical services, pension and unemployment benefits), customs duties. Local taxes: turnover tax, stamp tax, property tax.

Enforcement: Interest and penalties, summary judgment to obtain the payment of taxes, interest, fines, etc, owed by taxpayers, non-judicial tax liens, third party liability, installment plan for financial hardship, 5 year statute of limitations.

Insolvency Law: Argentine Bankruptcy Law, which provides for direct bankruptcy, business reorganization, and extra-judicial plan of arrangement. The current Argentine Bankruptcy Law N° 24,522 was published in the Official Gazette on August 9, 1995, and was amended by Laws 25,563 and 25,589 which were published in the Official Gazette on February 15, 2002 and May 16, 2002, respectively.

Tax Claims in Liquidation: Section 241 of the Bankruptcy Law provides a special preference for improvements to assets, employee claims for certain business related assets, taxes and duties applicable to specific property (real estate taxes, excise taxes, certain local taxes), mortgages and pledges over sale proceeds of pledged assets. Section 246 provides a general preference for other labor credits, the principal amount of social security debts, certain personal expenses of individuals, principal amount of any taxes and duties, certain credit invoice amounts. Claims entitled to general preference must not take more than 50% of the debtor's total assets, once credits with special preferences are paid. Clause 241 was included in the Bankruptcy Law 24,522, and was not amended by Laws 25,563 and 25,589. Excess amount loses the general preference and is treated as a general non-preferred credit.

Tax Claims in Rehabilitation: Taxing authorities may or may not, like any other creditor, accept the proposal of the debtor that may consist of refinancing tax debts. A reorganization plan must create at least three categories (special preference, general preference, non-preference). Because taxing authorities usually do not accept release of credits, debtors usually create a separate category for unpaid taxes in reorganization plans.

Other comments: The Argentine Congress continues to analyze new measures to prevent tax evasion such as new ways to protect the fiscal credit in insolvency proceedings and bankruptcy.

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AUSTRALIA

Taxes: Individual and corporate income tax, capital gains tax, sales tax, goods and services tax, stamp duty, stamp duty, land tax, payroll tax (payable by employer), excise duties, gambling taxes, insurance taxes, international trade taxes, motor vehicle taxes, franchise taxes.

Enforcement: Interest and penalties, garnishment of obligation owed by third party, real estate taxes become lien on property, third party liability, file involuntary bankruptcy even though amount of taxes owed is uncertain, installment plan for financial hardship, 5 year statute of limitations.

Insolvency Law: Corporations Act (2001) provides for three types of external administration for insolvent companies: receivership, voluntary administration, winding-up (liquidation).

Tax Claims in Liquidation: Commonwealth tax owed does not constitute a priority debt in receivership. Indirect taxes in the form of employee superannuation contributions are given priority, as are employee wages claims and secured creditors under fixed and floating charges.

Tax Claims in Rehabilitation: Treated as unsecured creditor for principal, interest, and penalties. If the reorganization is such that the creditors are required to accept payment over time, taxing authorities will as well.

Other comments: Insolvency (Tax Priorities) Legislation Amendment Act 1993 (Cth) abolished statutory priority for all tax payable after June 30, 1993. This change was made in response to the Australian Law Reform Commission's report into Debt Recovery and Insolvency (report 36, tabled in Parliament on 21 October 1987), which recommended that a debt to the Crown be accorded the same status as a debt to anyone else. Reference materials: Australian Law Reform Commission's report into Debt Recovery and Insolvency (report 36, tabled in Parliament on 21 October 1987, accessible from www.austlii.edu.au); Australian Law Reform Commission Report No. 45, General Insolvency Law Inquiry (1988).

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AUSTRIA

Taxes: Individual and corporate income taxes, local taxes, contributions to Family Fund, real estate taxes, special real estate taxes, inheritance and gift taxes, real estate transfer taxes, capital transfer taxes/company taxes, taxes on specific legal transactions, income taxes on wages and salaries, taxes on income from capital, value added taxes, consumer expenditure taxes (concerning petroleum, tobacco, beer, sparkling wine, listed alcohol, electric power and natural gas), insurance tax, and motor vehicle tax.

Enforcement: Interest and penalties for overdue taxes, measures for seizing property, collection of amounts owed to debtor by third parties, filing petition for opening bankruptcy proceeding, non-judicial tax liens, third party liability (for managing directors, partners, transferees), possessory lien for customs duties on imported goods, statute of limitations on enforcement. Taxing authorities are authorized to negotiate an agreement for payment of taxes in installments or for moratorium on enforcement to take account of financial hardship.

Insolvency Law: Bankruptcy Act of 1914 governs bankruptcy of commercial entities and private individuals. Reorganizations are governed by the Settlement and Recomposition Act of 1914 or the Business Reorganization Law of 1997.

Tax Claims in Liquidation: Neither tax claims nor wage claims originating before the opening of an insolvency proceeding are entitled to priority and share with unsecured creditors on a pro-rata basis. Tax law provides that some taxes, such as real estate taxes, constitute a lien on the property that is subject to tax. Employee wage claims for employment for 6 months before the opening of insolvency proceedings are satisfied from an Insolvency Fund (IAF-Service GmbH). The Fund has a general unsecured claim in the bankruptcy if it pays the employees.

Tax Claims in Rehabilitation: There are no specific rules for treatment of tax claims in reorganizations. Claims can only be paid over time with the agreement of the taxing authority.

Other comments: Priority for pre-bankruptcy claims, including tax claims, was abolished in 1982. According to the explanatory statement in the government bill, the main reason was to enhance the “principle of equal treatment.”

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BRAZIL

Taxes: FEDERAL - corporate income tax, social contributions on profits, gross receipts taxes, excise tax, social security contribution on payroll, social contribution on fund transfers made by means of bank accounts, tax on financial, exchange, credit and other transactions, customs duties CIDE technology, CIDE oil, tax on rural real estate, and individual income tax; STATE – VAT, tax on donations and on inheritances, and tax on vehicles; and MUNICIPAL – tax on services, tax on transfers of real estate, tax on urban real estate, and contribution for public illumination.

Enforcement: Administrative process – issuance of tax assessments; judicial process – fiscal executions with attachment of assets; amounts collected: outstanding taxes, interest and fines; installment agreements: available in the federal sphere within a 60 month term (a bill of law currently is being discussed to introduce a special installment agreement with a longer term for companies in a judicial recovery process) and should be verified in each State or Municipality; statute of limitations: varies depending on the tax, but is generally 5 years from the taxable event; tax liability: third parties or successors may also be held liable for taxes due by other entities.

Insolvency Law: Bankruptcy and Corporate Recovery Act, Federal Law No. 11,101, effective June 9, 2005, provides for the following proceedings: (1) judicial recovery (court supervised process); (2) extra judicial recovery (previously negotiated plan may be approved in court in order to bind all creditors, provided that 3/5 of all creditors agree to the proposed plan; and (3) bankruptcy (liquidation).

Tax Claims in Liquidation: Tax claims under the new bankruptcy law, except for tax fines, rank in 6th position, behind (i) wage claims related to three months preceding bankruptcy (up to the limit of 5 minimum monthly wages), (ii) restitution claims (e.g., the amount delivered to the debtor, in domestic currency, resulting from an advance on an export exchange contract, (iii) post petition claims; (iv) regular labor credits (limited to 150 minimum monthly wages) and compensation for accidents at work; and (v) claims secured by *in rem* guarantees (up to the value of the encumbered asset). Tax claims under the new bankruptcy law, however, still have priority over special privileged creditors, general privileged creditors, unsecured creditors (including labor credits which exceed the cap referred to in (iv) above, and tax fines.

Tax Claims in Rehabilitation: Judicial or extrajudicial recoveries neither involve tax claims nor stay administrative or judicial processes related to taxes. However, in order to have a judicial recovery approved in court, it is necessary to present clearance certificates issued by tax authorities. Installment agreements are available as mentioned in the Enforcement section above.

Other comments: The historical reason for the structure of priorities is the principle of supremacy of the public interest over private matters. The new bankruptcy law is a significant change and is designed to maintain and encourage the continuity of the business and stimulate economic activity. Under recent amendments to the National Tax Code, there is no successor liability for taxes for a business unit sold in bankruptcy proceedings.

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CANADA

Taxes: Income (or profits) tax; capital gains tax; capital tax (value of corporate assets); realty tax (value of real property owned); withholding for employee wages and salaries, amounts earned by and dividends, interest, rent, royalties, and fees paid to non-residents; employment insurance; pension plans; goods and services/harmonized sales tax; and retail sales tax.

Enforcement: Interest and penalties, seizure of personal property, garnishment of amounts payable by third parties, non-judicial lien, third-party liability of corporate directors and others obligated to withhold or deduct taxes as well as goods and services providers for uncollected goods, services, and sales taxes.

Insolvency Law: Canada's insolvency regimes are set forth in two federal statutes: the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "BIA") and the *Companies' Creditors Arrangement Act* R.S.C. 1985, c. C-36 (the "CCAA"). The BIA provides for both liquidations and reorganizations. The CCAA provides for reorganizations where the debtor's liabilities exceed \$5 million.

Tax Claims in Liquidation: In a liquidation, employee source deductions for income tax, Canada pension plan and employment insurance have a priority over secured creditors pursuant to deemed trusts created by the federal *Income Tax Act* (s. 227(4)) (as well as provincial equivalents), the *Canada Pension Plan Act* (ss. 23(3) and (4)) and the *Employment Insurance Act* (s. 86(2) and (3)). Other tax claims are treated as general unsecured claims.

Tax Claims in Rehabilitation: In a reorganization under either the BIA or the CCAA, the debtor's plan must provide for payment of outstanding employee source deductions within six months of Court approval of the plan (BIA, s. 60(1.1), CCAA, s. 18.2(1)).

In both BIA and CCAA reorganizations, the enforcement of tax claims is stayed (BIA, s. 69(1)(a) and 69(1.1)(a), CCAA, s. 11(3)). Under the BIA, once the debtor files a notice of intention to make a proposal ("NOI") or a proposal, enforcement of source deduction claims is stayed (BIA, ss. 69(1)(c)-(d) and 69.1(1)(c)-(d)). The stay does not apply if the debtor fails to make employee remittances after filing a NOI or a proposal (BIA, ss. 69(3)(a) and 69.1(3)(a)) or if a creditor becomes entitled to realize on security on property claimed by the tax authorities with respect to source deductions (BIA, ss. 69(3)(b) and 69.1(3)(b)).

Other comments: Before 1992, the BIA (and its predecessors) provided that property held by the bankrupt in trust for any other person did not form part of the bankrupt's property divisible amongst its creditors. In the 1989 case of *British Columbia v. Henfrey, Samson, Belair Ltd.* (1989), 59 DLR (4th) 726 (SCC), the Supreme Court of Canada ruled that a deemed trust had to comply with general principles of trust law in order to constitute property that was exempt from distribution to the bankrupt's creditors. The statutory deemed trust in that case did not meet this test. In 1992, the BIA was amended to provide that only trusts that are valid under general trust law principles are exempt from the bankrupt's property (BIA, s. 67(2)). However, the BIA was also amended to provide (in s. 67(3)) that deemed trusts respecting employee source deductions were exempt from section 67(2). On that basis, those claims enjoy priority over secured creditors.

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CHILE

Taxes: Business profits tax, income tax (resident and non-resident), capital gains tax, inheritance and gift taxes, employee withholding taxes, municipal duty for business activities, real estate tax, value added tax, special sales tax on luxury goods, and tobacco, fuel and stamp taxes.

Enforcement: Payment of taxes is not negotiable, but the amount of penalties and interest can be negotiated. The treasury can seize assets and auction them through a judicial proceeding (particularly in the collection of property taxes). Treasury regularly joins other creditors in petitioning for bankruptcy, although it rarely does so alone.

Insolvency Law: Bankruptcy Law No. 1552, October 28, 1982.

Tax Claims in Liquidation: Tax claims where the debtor is the tax collector (VAT, employee withholding, other special taxes) are entitled to priority along with the administrative costs of insolvency proceedings and employee wage claims. These claims have absolute payment priority and are paid out of the proceeds of sale of the debtor's assets, even if the assets are pledged or mortgaged. Other tax claims have no priority in insolvency.

Tax Claims in Rehabilitation: There is only one class of creditors that votes on a composition plan.

Other comments:

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PEOPLES REPUBLIC OF CHINA

Taxes: Income tax (individual and business); turnover tax (business tax, VAT, consumption tax); natural resources and property tax; tax on activities with specific purposes (stamp duty, real property transfer, urban maintenance and construction, vehicle purchase, vehicle license, land appreciation, slaughter); agricultural tax; import and export duties.

Enforcement: Interest and penalties; seizure of property and sale by auction or otherwise; guaranty may be required in case of tax avoidance and if not provided, bank accounts may be frozen or property seized.

Insolvency Law: The current insolvency law regime mainly consists of The Enterprise Bankruptcy Law, effective as of November 1, 1988 (applicable only to state-owned enterprises); The Foreign Invested Enterprises Liquidation Measures, effective as of July 9, 1996 (applicable only to foreign invested enterprises, in which foreign shareholders are generally required to hold an aggregate of at least 25% of the equity); and relevant provisions in The Civil Procedures Law and the Company Law. Liquidation is the only mechanism for bankrupt companies under the current regime. In 1994, China embarked on the task of creating a new unified bankruptcy law. After ten years' of drafting, a proposed draft new bankruptcy law was finally submitted to the National People's Congress for deliberation in June 2004 (the "First Draft Bankruptcy Law"). The new bankruptcy law is currently undergoing several drafts and may come out in 2006.

Tax Claims in Liquidation: Under the current tax and bankruptcy regimes (e.g., the Law on Administration of Tax Collection, effectively May 1, 2001), tax claims take priority over (i) unsecured claims and (ii) secured claims arising after the occurrence of the tax claim. The First Draft Bankruptcy Law places tax claims before unsecured claims but after secured claims and does not appear to make a distinction between secured claims arising prior to the occurrence of the tax claim and those arising after the occurrence of the tax claim. The priorities of different bankruptcy claims are currently being heatedly debated among legislators and significant changes may be made to the final version of the new bankruptcy law.

Tax Claims in Rehabilitation: Currently, only liquidation is available. For the first time in China's legislative history, the First Draft Bankruptcy Law provides for the mechanism of reorganization (in addition to liquidation) for bankrupt companies. Under the First Draft Bankruptcy Law, in the event of a reorganization, tax claims shall be paid before unsecured claims but after secured claims in the manner described above in the case of liquidation.

Other comments: Under the First Draft Bankruptcy Law, both bankruptcy expenses and employee claims get paid ahead of tax claims.

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ARAB REPUBLIC OF EGYPT

Taxes: Individual and corporate income tax, built real estate tax, agricultural land tax, development duty, non-resident withholding tax, agency or brokerage services tax, return payments for treasuries bonds, stamp duty, sales tax, cinema and theatre tax.

Enforcement: Penalties and additional taxes for delayed payment, executory seizure by Tax Authority, administrative seizure, punishments for criminal tax evasion, right of retention and setoff, 5 year statute of limitations following date of acknowledgement (6 years if evading payment), subject to tolling by Tax Authority. Tax Authority can agree to installment payments not exceeding twice the period for which the tax is due and may upon referral to the head of the Tax Authority relieve taxpayer from taxes due and delay penalties, in certain circumstances of financial hardship.

Insolvency Law: Insolvency under Civil Code is available as a preservatory matter to protect persons from actions that have the effect of diminishing patrimony. Bankruptcy is a commercial law matter under the Commercial Code (No. 17/1999) and applies to traders who fail to pay commercial debts regardless of whether debts exceed assets. There is no specific law for reorganization in Egypt, although guidelines in the commercial code provide for setting up receiverships in the case of bankruptcy that are represented by the trustee.

Tax Claims in Liquidation: The Civil Code (reiterated by Article 102 of Tax Law No. 91/2005 and Article 34 of Sales Tax Law No. 11/1991) provide that taxes usually rank in the second position of privileged rights, following court fees and judicial expenses. All types of taxes are entitled to priority; however, pursuant to Article 618 of the Commercial Code, only taxes owed to the treasury for the two years preceding the bankruptcy ruling are entitled to priority ranking vis a vis other creditors and the remaining amounts enjoy a pari passu standing with other claims. Workers salaries for the last 6 months are privileged claims but they are not prior to tax claims.

Tax Claims in Rehabilitation: Voting among creditors is not known in the Egyptian rehabilitation system. Tax authorities may choose to relieve a taxpayer of some or all of the due taxes and penalties and accept payments in installments in the case of financial hardship.

Other comments: The new Tax Law No. 91/2005 gives the Minister of Finance wide discretion in referring tax evasions to the courts and opens the door for negotiations with delinquent taxpayers authorizing him to carry out amicable settlements and to stay court proceedings against taxpayers.

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ESTONIA

Taxes: Income tax, social security contributions, funded pension contributions, unemployment insurance premiums, real estate tax, gambling tax, heavy goods vehicle tax, VAT, customs duties, alcohol, tobacco, fuel excise duties, packaging excise duty.

Enforcement: Interest and penalties, seizure of property, deduction from employee salary, involuntary bankruptcy, non-judicial tax liens, third party liability, installment plan for financial hardship (not customs debt or withholding agents), 7 year statute of limitations.

Insolvency Law: Bankruptcy Act (effective January 1, 2004).

Tax Claims in Liquidation: There are no provisions for priority ranking of tax claims which are submitted in the same manner as other claims of unsecured creditors. If the tax claim was secured by a registered pledge, commercial pledge or mortgage, then it is treated as a secured claim. Secured claims and administrative expenses are paid first. There are no other priorities. Tax debts are discharged for legal persons upon dissolution through bankruptcy or liquidation. Natural persons may be discharged if unable to pay 5 years from bankruptcy

Tax Claims in Rehabilitation: Tax claims can be deferred where a compromise is approved by one half the creditors present whose claims constitute at least two-thirds of the total amount of claims. Tax claims are classified together with other unsecured claims for voting purposes.

Other comments: All priority rules were abolished effective 1/1/04. Prior to that time, tax claims had the third highest ranking. The reason for abolishing priority rules for tax and other claims was to treat equally all creditors in the bankruptcy proceedings, notwithstanding, whether the claimant is a private company or state. Employee wage and holiday claims not received before an employer's declaration of insolvency are paid through the Unemployment Insurance Fund.

The adoption of the New Bankruptcy Act was prompted by ongoing reform of the judicial procedure in Estonia and the desire to shorten the duration of bankruptcy proceedings. In practice, unsecured creditors rarely receive distribution from the bankruptcy estate because secured creditors recover most of assets. As a consequence tax administration also usually does not recover tax debts.

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FINLAND

Taxes: Direct Taxes: individual income and wealth taxes, church tax, corporate income tax, real estate tax, inheritance and gift tax. Indirect Taxes: parts of income tax, interest, non-resident income, foreign employee, health insurance contribution withholding taxes; value added tax and; and different duties and excise taxes.

Enforcement: Assessment of penalties and interest for overdue taxes; property seizure; garnishment by notice to third parties; commencement of bankruptcy proceedings; non-judicial lien based on resolution of execution authority; liability of board of directors and managing director is possible under company law; possessory lien for customs duties; statute of limitations. In certain cases the state can agree to extension of time for payment of tax debts and can leave taxes un-assessed or refrain from collecting assessed taxes.

Insolvency Law: Rules for priority in the event of insolvency are found in the Act on the Priority of Creditors (1578/1992).

Tax Claims in Liquidation: There is no priority for tax claims in bankruptcy. They rank equally with other unsecured claims. Employee wages are protected by the Pay Security Act (866/1998). The State covers up to EUR 15,200 for one employee for a single employer. There are no unsecured priority claims in a commercial bankruptcy case, as the only unsecured priority claim in bankruptcy is for alimony. Secured claims have priority and 50% of the mortgaged property is used for the benefit of the holder of the floating charge.

Tax Claims in Rehabilitation: Taxing authorities are subject to the same conditions as the other unsecured claims in reorganization proceedings. No interest accrues after reorganization proceedings are initiated.

Other comments: Priority rules regarding tax claims were abolished by the Act of Priority of Creditors (1578/1992) which entered into force on January 1, 1993. The reason for the change was that unsecured creditors very often received nothing from estates. Hence, the principle of equality was strengthened. See analysis in Government Bill (HE 181/1992); Jansson-Linna, Elinasisko, *Etuoikeudet konkurssissa ennen ja nyt* (2000); Häkkänen, Petteri, *Etuoikeudet monikansallisessa konkurssimenettelyssä* (1996); Marsio, Mari, *Etuoikeusjärjestelmän uudistuminen erityisesti yrityskiinnitysvelkojan osalta* (1995).

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FRANCE

Taxes: Personal and corporate income, business, turnover, registration, stamp duty, wealth, customs duties; contributions for social security, agricultural security and holiday insurance; taxes on property, including real estate.

Enforcement: Interest and penalties, collection of amounts owed to debtor by third parties (not stayed by commencement of insolvency proceedings where notice is sent prior to commencement, but can be cancelled if Tax Authorities knew the debtor had ceased making payments to creditors), non-judicial tax liens, third party liability.

Insolvency Law: Law No. 2005-845 of July 26, 2005, effective January 1, 2006, overhauled the French insolvency laws including Law No. 85-98 of 25 January 1985, as amended in 1994 (substantive bankruptcy law providing for unified proceeding commenced as reorganization which can become a liquidation) and Law No. 84-148 of 1 March 1984, as amended in 1994 (applicable to voluntary arrangements). The revised law provides new procedures of conciliation and safeguard (Chapter 11 inspired proceeding permitting management to remain in place and providing for stay of creditor actions where the company is not in a situation of suspension of payments) as well as judicial reorganization and liquidation. Under the safeguard and reorganization procedures, where the company has at least 150 employees and turn-over of at least 20 million Euros, two creditors committees (main suppliers and lending organizations) are formed to negotiate a plan for partial or total reimbursement of debts.

Tax Claims in Liquidation: Rules relating to priorities for tax authorities are found in the French Tax Code (art. 1920-1929 septies), not the insolvency law. The Tax Code provides a general preference for four years of income, corporate income, business, turnover, registration, stamp duty and wealth taxes and three years of customs duties, as well as social security contributions, agricultural security contributions and contributions for holiday insurance schemes of unlimited duration. These tax claims are paid after the super preference for 60 days of employee wage claims, legal expenses of the proceedings, and new credits extended during the conciliation procedure. Creditors with general preference have priority over other creditors with regard to proceeds of movable property, but not real estate. Property taxes have special priority over other creditors with regard to specific property taxed (e.g., real estate for real estate taxes).

Tax Claims in Rehabilitation: Enforcement of all claims, including tax claims, is stayed during the new safeguard procedure. During the safeguard procedure public creditors (tax creditors/social security) may grant a reduction of tax debts, interest due for late payments, or tax fines. With regard to VAT debts (indirect tax), the Tax Authorities are only authorized to grant a reduction or waiver for interest and penalties. Ranking of tax claims in safeguard and rehabilitation is similar to liquidation: they are paid after the super preference for 60 days of employee wage claims, legal expenses of the proceeding, new credit extended during the conciliation phase and post-bankruptcy debts, but are entitled to a general preference ahead of unsecured creditors.

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GERMANY

Taxes: Income, wage, corporate, business, real estate, gift, succession duty, tax on acquisition of real estate, interest rebate tax, motor vehicle tax, supplementary taxes, such as solidarity tax contribution as well as other taxes on assets; value added tax, petroleum tax, tobacco, beer, sparkling wine and insurance taxes. Most significant are wages and income tax, value added tax, petroleum tax, and business tax.

Enforcement: Fines, interest, and penalties; personal liability of statutory agent for gross negligence; sequestration of movables, direct payment from third party debtors, lien on land without need for obtaining judgment; and forced administration or judicial sale of immovable assets; right to commence insolvency proceeding.

Insolvency Law: Insolvency Code, effective January 1, 1999.

Tax Claims in Liquidation: There is no priority for tax claims. The tax authorities have a right to preferential satisfaction of claims only if the claims are secured with pledges or property charges prior to the opening of the insolvency proceeding. Penalty payments and interest are subordinated claims if they rate to pre-bankruptcy tax claims.

Tax Claims in Rehabilitation: There are no special rules for taxes in the statutes. They may consent to partial or delayed payment like unsecured creditors. However, the Federal Ministry of Finance has instructed that tax authorities shall apply for and interdict of the insolvency plan by the insolvency court if the plan curtails the rights of the tax authorities in comparison to the rights under the Insolvency Code (pro rata among creditors).

Other comments: Tax priorities were eliminated in the course of the introduction of the 1999 Insolvency Code. The background for the changes was criticism that the insolvency estate was consumed by the huge amount of privileged claims so that the average creditor often received nothing. See Explanatory Statement of the Federal Government for the Introduction of the Insolvency Code BTDR 12//2443 p.81. Recent change to VAT to provide that purchasers of construction works are tax debtor and VAT amounts are therefore paid directly to tax authorities and not to insolvent contractor, ensuring payment of these amounts outside insolvency case.

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REPUBLIC OF GHANA

Taxes: Income, capital gains, gift tax, national reconstruction levy, and stamp duty; withholding taxes on employee salaries, dividends and interest, royalties, natural resource payments and rents, endorsement fees or management and technical services fees, resident and non-resident goods and services; customs duties and sales tax, excise duties, vehicle importation, special tax, value added tax, national health insurance levy.

Enforcement: Assessment of interest and penalties for overdue taxes, distress proceedings against movable property, garnishment of amounts owed to taxpayer, petition for liquidation of corporate debtor, director liability for excise duty, sales tax and VAT, lien on goods subject to customs duties, 12 year statute of limitations, no authority under law to negotiate settlements with tax debtors although often accumulated interest is an area for negotiation.

Insolvency Law: Bodies Corporate (Official Liquidations) Act, 1963 (Act 180) is applicable to the winding up of companies.

Tax Claims in Liquidation: Section 41 of Act 180 provides "Class A" priority for rates, taxes or similar payments to the Republic of Ghana or local authorities that are due and payable within one year preceding the date of the commencement of the winding up proceedings. Four months employee remuneration (not to exceed 150 pounds) is also entitled to Class A priority. Class A claims have priority over the holder of a floating charge. The balance of tax claims are included in Class B, along with general unsecured claims. Section 91 of the Internal Revenue Act, 2000 (Act 592) provides that tax withheld by a withholding agent does not form a part of the estate in liquidation, assignment or bankruptcy, and the tax authorities have first claim before any distribution of property is made. Additionally, it can be argued that section 139(6) of the Internal Revenue Act which provides that any amount notified by the Commissioner as a Class A debt shall have priority over all other debts of the tax debtor, notwithstanding anything contained in any other enactment. This may provide an even greater priority for Class A priority taxes.

Tax Claims in Rehabilitation: Ghana does not have a rehabilitation or reorganization law.

Other comments: There is an Insolvency Act that addresses personal insolvency but it has not been implemented. It has been proposed that a joint Act, which addresses personal insolvency and modernizes the rules on corporate insolvency, should be introduced. It has also been proposed that the Revenue Agencies be merged to constitute a centralized Revenue Agency to implement a unified system of tax collection and enforcement.

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GREECE

Taxes: Corporate and individual income, capital gains tax, special tax on real estate, real estate transfer tax, real estate wealth tax, capital concentration tax, inheritance and gift tax, stamp duty, VAT, excise duties, import duties from non EU, dividends from foreign companies, withholding tax on interest, withholding income tax for employees, social security contributions.

Enforcement: Interest and penalties, involuntary bankruptcy, installment plan for financial hardship, 5 year statute of limitations from assessment. Seizure of property, deduction from employee salary, and liens are only available through court proceedings. Directors, administrators and persons with management/legal representation of company at time of dissolution are jointly and severally liable for payment of any corporate or withholding tax due, as well as VAT and other indirect taxes.

Insolvency Law: There is no single instrument. The basic statutes include (a) Royal Decree of April 19-May1, 1835, (b) Mandatory Law 635/1937, (c) Legislative Decree 3562/1956, (d) Royal Decree of 22.12.56, (e) Law 1386/a983, (f) Presidential Decree 34/1985, (g) Law 1892/1990, (h) Law 2000/1991, (i) Law 2741/1999.

Tax Claims in Liquidation: Tax claims enjoy a general preference regardless of whether in insolvency, non-insolvency, or foreclosure. Administrative enforcement is not stayed on the debtor's insolvency. Joint and several liability with debtor of directors, board members and managers for payment of taxes, wages and social security, as well as criminal penalties for failure to fulfill these obligations. Prosecution and indictment are not suspended because of insolvency, but generally such persons are acquitted at trial, with various constructs based on their inability to make payments due to the bankruptcy. There is no formal "priority" between tax and secured claims, but rather the product of liquidation is divided into 1/3 for tax claims and 2/3 for secured (and other preferred claims), and each category of claim is paid preferentially from the respective parts of the proceeds. Wage claims for up to two years preceding bankruptcy have general preference over both tax and secured claims.

Tax Claims in Rehabilitation: Administrative enforcement of tax claims generally is stayed in reorganization. So-called reorganization agreement requires consent of 60% of all claims, including 40% of secured claims and 50% of shareholders. The agreement is binding on all, including dissenting and non-participating creditors and the State.

Other comments: On a practical experience basis, debtors heavily indebted for taxes and social security dues are generally unlikely to enter reorganization. Reorganization agreements must make express provision for payment of all social security dues, which are in any event preferred claims. Thus, creditors generally do not consent to consensual restructurings – if taxes and social security dues are expected to exhaust the going concern liquidation value, there is little incentive for secured creditors to organize it.

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HONG KONG, Special Administrative Region

Taxes: Property tax, salaries tax on income (individuals), profits tax from trade, profession, or business; duties assessed on dutiable goods (wine and liquor, tobacco, fuel) and other duties and levies (stamp duty, betting duty, business registration, hotel accommodation tax, air passenger departure tax, estate duty – abolished for deaths after February 11, 2006).

Enforcement: Surcharge for late payment; collection through judicial proceedings; direct collection of payments owed by third parties to taxpayer; personal liability of corporate directors, officers, controlling parties if offense relating to returns is committed; departure prevention order for individuals, no clearance for ship or aircraft departure, lien on aircraft; distraint and public auction of dutiable goods and related materials and equipment; no statute of limitations for proceedings for recovery of tax or duty; discretion to accept payment of tax in installments where taxpayer can prove genuine financial hardship.

Insolvency Law: Hong Kong Companies Ordinance provides for compulsory and voluntary liquidation and Schemes of Arrangement (Court sanctioned arrangement with creditors.)

Tax Claims in Liquidation: Tax claims and other statutory debts owed to the Government that are due and payable 12 months before the appointment of a liquidator or winding up order are entitled to priority in a liquidation, after payment of a limited amount of wages, salaries, severance payment, and other employee related contributions. No discharge of tax claims. Secured creditors generally are entitled to realize their security independently of the liquidation.

Tax Claims in Rehabilitation: Taxing authorities are separately classified from unsecured creditors for purposes of voting on a Scheme of Arrangement. Where the scheme for preferential creditors has been passed and sanctioned by the Court, it binds the taxing authorities.

Other comments: Prior to 1970, all debts due to the Crown (as it was then) had priority, even over wages. In 1970, “Crown debts” were divided into two categories: (a) statutory debts, e.g., for taxes, etc, which had priority ahead of employment-related claims, and (b) ordinary debts, e.g., for goods or services, which had priority after wages. In 1984, the order of priority was amended in favor of the present order, i.e., all “statutory debts” rank after specified employment related claims.

April 1998 Law Reform Commission Consultation Paper on The Winding Up Provisions of the Companies Ordinance proposed that the priority afforded to the Government, no matter how the debts arose, be abolished; the Government would retain a claim as an ordinary creditor. Prior to the publication of the Consultation Paper, the Commissioner of Inland Revenue stated that he supported the principle of *pari passu* distribution of assets of insolvent companies to creditors, unless there were compelling reasons to do otherwise. Certain debts owed to the Government such as taxes and duties were compelling enough to attract a preference. They represent a civic obligation due to the country and the public interest in seeing that such dues are fully paid justifies granting preferential entitlement to tax debts in insolvency cases.

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INDIA

Taxes: Income tax, wealth tax (individuals and companies), excise duty on commodities manufactured in India; sales tax, customs duties, stamp duties, service tax, expenditure tax, value added tax..

Enforcement: Interest and penalties; seizure of books of accounts, documents, and money; seizure of property held by third parties; assessment, attachment and sale of assets; joint and several liability of directors unless proves no gross neglect, misfeasance, or breach of duty. Penalties can be reduced or waived in cases of genuine hardship. There is no provision in the Income Tax Act with regard to the taxing authorities' ability to force a taxpayer into a bankruptcy proceeding.

Insolvency Law: The Indian Companies Act of 1956 and formerly, the Sick Industrial Companies Act of 1985 (SICA) .

Tax Claims in Liquidation: The Indian Companies Act provides that all revenues, taxes and rates due to the central, state or local government authorities that are due and payable 12 months before the winding up order are entitled to priority along with employee wages and salary due for a period not exceeding four months, accrued holiday pay, amounts due under the Employee's Sate Insurance Act certain rights that are transferable to workmen under the Workmen's Compensation Act, sums due to an employee from funds maintained by the debtor for the welfare of employees such as pension funds, and the expense of any investigation into the affairs of the company. These claims are paid pro rata after payment of secured claims and dues owed to "workmen" (persons employed in industry to do manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire as provided under the Industrial Disputes Act, 1947). The workmen's dues are payable on a pari-passu basis with the secured creditors.

Tax Claims in Rehabilitation: Tax claims are separately classified and taxing authorities cannot be forced to accept payment over time in a rehabilitation proceeding.

Other comments: The SICA has been repealed and the rehabilitation of sick industrial companies is entrusted to the Company Law Tribunal constituted under the Companies Act. Many provisions of SICA have been incorporated in the Companies Act in diluted form.

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Date: February 17, 2006

JAPAN

Taxes: Direct Taxes: income, corporate, inheritance, and gift taxes; inhabitants tax (prefectural and municipal); enterprise, automobile, property, special landholding City planning, light vehicle, business office, real property acquisition, and automobile acquisition taxes. Indirect Taxes: withholding, consumption, liquor, tobacco, gasoline, local road, petroleum, stamp, petroleum gas, aircraft, automobile tonnage, registration and license, electric power resources development taxes; local consumption, tobacco, golf course, diesel oil delivery, and bathing taxes.

Enforcement: Assessment of interest and damage from unpaid tax, administrative seizure, garnishment by notice to third parties to pay amounts owed to taxpayer, ability to file bankruptcy proceedings against taxpayer, mandatory order for security interest over taxpayer property if taxpayer does not cooperate, no third party liability for manager, office holders, auditors or shareholders except where general partner or liquidator. Statute of limitations is 5 years from tax due date, unless national taxation office stopped execution proceedings for 3 years. Tax authorities can agree to extend due date or cease action for delinquent taxes, due to financial hardship.

Insolvency Law: Bankruptcy Code, amended effective January 1, 2005.

Tax Claims in Liquidation: General rules or priority for taxes is stated in the National Tax Collection law and Local Tax Law. Ranking of categories of priority in the event of insolvency is defined in the Bankruptcy Code. Claims for taxes and public dues for one year prior to the filing of bankruptcy are first priority claims along with the costs of administration of the judicial proceedings. Other tax and public dues claims are second priority claims, but are ahead of wage and other private claims that are second priority claims. General unsecured claims are subordinated to second priority claims.

Tax Claims in Rehabilitation: Tax claims are priority debts and must be paid when due unless a judicial decision intervenes. If there is a court decision that the reorganization of a company should begin, the company is protected from tax collection actions for up to one year. A grace period of up to three years for payment of the taxes can be included in a reorganization plan, but interest must be paid, and the taxing authorities must consent to any provisions in a reorganization plan that reduce the amount of the tax claim.

Other comments: Changes were made to the rules of priority for tax claims in the Bankruptcy Code revision effective January 1, 2005. Previously, all tax claims were first priority claims and all employee wages and benefit claims were second priority claims. The priority was changed because insufficient protection was given to employees in insolvency. The change in the laws was to provide more for employee wages and benefit claims as such payments will help the lives of the employees whose work contributed to the creation of the property of the insolvent company.

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LATVIA

Taxes: Corporate and individual income, social security contributions, real estate, lottery and gambling tax, passenger vehicles and motorcycles tax; VAT, customs duties, excise tax, natural resources tax, stamp duties.

Enforcement: Interest and penalties, seizure of property, involuntary bankruptcy, non-judicial tax liens, third party liability, installment plan for financial hardship, 3 year statute of limitations from decision.

Insolvency Law: Law on Insolvency of Undertakings and Companies (1996) (the “Latvian Insolvency Law”).

Tax Claims in Liquidation: After payment of administrative expenses of insolvency, the following claims are paid before payments to general unsecured creditors: (1) individual income tax payments, compulsory state social insurance contributions, and a list of certain employees claims; (2) certain payments for farm and agricultural undertakings, (3) compulsory state social insurance contributions for one year period of time prior to initiation of insolvency proceedings, (4) state claims regarding repayment of state-guaranteed loans, (5) other tax debts including the rest of the compulsory state social insurance contributions, except deferred tax payments, and (6) deferred tax payments. A company is discharged for an undertaking if bankruptcy proceedings have been completed and insolvency terminated.

Tax Claims in Rehabilitation: Taxing authorities can be compelled to accept payment over time if the settlement containing such a requirement is accepted by the creditors. The settlement requires vote by more than $\frac{3}{4}$ in amount if provides for less than half, or $\frac{2}{3}$ in amount if settles more than half of claims. Tax claims are classified together with all other claims in terms of voting on a settlement. A rehabilitation plan can be approved if it is accepted by two out of the following three groups of creditors: (a) secured creditors in the amount of the secured claims; (b) priority creditors and secured creditors in the amount of their unsecured claims; and (c) other creditors and secured creditors in the amount of their unsecured claims. In either settlement or rehabilitation, the repayment of tax claims depends on the provisions included in the respective plan.

Other comments: One of the most important amendments to the Latvian Insolvency Law came into force on November 20, 2003, and had a minor effect on the priority of tax claims. The compulsory state social insurance contributions giving rights to unemployment benefit were excluded from the list of the first priority group claims. The reason for this was that a special fund was established from which an insolvent company’s debts to its employees and tax debts with regard to these employees’ claims (including compulsory state social insurance contributions) shall be covered. Tax administration usually does not recover any tax debts at all because payment goes to secured creditor with mortgage or commercial pledge. There are no specific amendments under consideration relating to priority rules, but a new Law on Insolvency is being drafted that will emphasize reorganization and settlement in order to avoid bankruptcy.

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LITHUANIA

Taxes: Resident income, corporate profit tax, real estate tax for enterprises and organizations, pollution tax, inheritance tax, land tax; VAT, excise, social insurance taxes (pension, illness and maternity, unemployment, accident) among others.

Enforcement: Interest and penalties, seizure of property, order to credit institution to suspend financial transfers, involuntary bankruptcy (more than one third of bankruptcy proceedings are initiated by tax authorities, including State Social Insurance Fund Board), non-judicial tax liens, 5 year statute of limitations. Tax authorities may negotiate a settlement with a delinquent taxpayer which must include a payment schedule and provide for payment of interest.

Insolvency Law: Law on Bankruptcy of Enterprises (for legal persons) and Law of Restructuring, both adopted May 20, 2001, effective as of July 1, 2001 with further amendments.

Tax Claims in Liquidation: All taxes and other payments to the budget, social taxes (compulsory state social and health insurance payments), and loans received from the state or guaranteed by the state, are entitled to second priority after payment of secured claims and employees' claims related to employment relations.

Tax Claims in Rehabilitation: In restructuring proceedings the company must settle with current payments unless the creditors have consented. Disputes regarding settlement of current payments are heard by the court which decides on forms and payment terms. However, the court is not competent to decide on execution of and payment terms for taxes and other statutory payments, so the tax claims are privileged in this case.

Classification of priority rules under the Law of Restructuring differs slightly from the grouping under the Bankruptcy Law. The first priority includes payroll taxes (withheld from salaries), although this is not the case under the Bankruptcy Law. This was as a result of amendments at the beginning of 2003. Other taxes are in the second priority – and general claims are in the third priority grouping.

Other comments: 2003 amendment to Law on Restructuring grouped payroll taxes withheld with first priority group of employee claims.

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UNITED MEXICAN STATES

Taxes: Income for individuals and entities, asset tax, real estate property transfer tax, social security taxes; VAT, special tax on production and services.

Enforcement: Surcharges (updates to reflect inflation) and penalties, preventative and definitive seizure of property, non-judicial tax liens, third party liability, installment plan for financial hardship, generally 5 year statute of limitations.

Insolvency Law: Commercial Insolvency Law (LCM) (2000).

Tax Claims in Liquidation: According to the Fiscal Code of the Federation (CFF), Commercial Insolvency Law (LCM), and Federal Labor Law, all kinds of taxes (“contributions”) are included within the concept of tax credit and are treated alike. Tax credits together with certain labor credits are ranked fourth out of six credit categories in bankruptcy. Specifically, tax credits must be paid after (i) credits against the bankruptcy estate for the benefit of workers derived from wages or salaries, (ii) exclusively privileged creditors, and (iii) secured creditors. For a secured creditor to have preference over a tax debt, its security must have been duly registered in the public registry prior to the date on which a notice of the existence of the tax debt becomes effective. Taxing authorities do not need to validate claims in the context of insolvency proceedings. Upon commencement of insolvency proceedings, the court must give notice to the taxing authorities in order for them to decide whether to demand payment through an independent administrative proceeding. From the time the insolvency judgement is rendered, the amount of tax debts will continue to be updated as well as penalties and other charges related thereto.

Tax Claims in Rehabilitation: Taxing authorities may but are not required to permit payment on terms, whether deferred or in installments, without the term exceeding 48 months, provided that there is a guaranty of payment. This is not allowed for taxes withheld, transferred or collected. Until such time as the insolvency judgment is rendered by the court, surcharges and fines continue to accrue, but if the debtor’s reorganization plan is approved, fines and other charges accrued during the conciliation stage are cancelled. Plans of reorganization must include the payment of tax debts. The amount owed is determined by the tax agency, not by the insolvency court. Tax authorities consent to the reorganization plan is not required. In commercial insolvency, the taxing authorities may partially waive tax claims accrued pre-bankruptcy, provided that the debtor enters into an agreement with creditors in accordance with the following: (1) if tax debts are less than 60% of the aggregate debts in the proceeding, the waiver shall not exceed the minimum benefit granted to those creditors who, not being related parties, represent at least 50% of the recognized non-tax creditors; (2) if the tax debts exceed 60% of the aggregate debts recognized in the proceedings, the waiver shall not exceed the surcharges related to the outstanding tax credits.

Other comments: One can conclude that more than policies or reasons, there simply is an overriding interest in the collection of taxes, without much thought having been given to the impact that leaving wealth in private hands would have.

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MOZAMBIQUE

Taxes: Direct Taxes: individual and corporate income tax, stamp tax, tax on successions and donations, tax on onerous transfer of real estate property, tax over net receipts of gambling exploration activities, vehicle tax, tax of national reconstruction, and taxes issued by and due to the municipalities. Indirect Taxes: value added tax, tax over specific consumptions, and customs duties.

Enforcement: Assessment of penalties and interest for overdue taxes; property seizure; garnishment by notice to third parties; commencement of bankruptcy proceedings; non-judicial lien; personal liability of corporate officers, directors, and controlling parties; possessory lien for customs duties; statute of limitations. The state can agree to payment of tax debts in installments.

Insolvency Law: There is no separate insolvency code in Mozambique. The Civil Code and Civil Procedure Code govern liquidation of a company.

Tax Claims in Liquidation: Rules for priority in the event of insolvency are found in the Civil Code, Civil Procedure Code and tax laws. All taxes have priority over immovable assets for 15 years. Indirect taxes have priority over movable assets for 15 years and direct taxes have priority over movable assets for 2 years. Tax credits are ranked only after court fees and ahead of all other claims. Employee wages and contributions to the social security system are also entitled to priority over other creditors, but are ranked behind tax claims.

Tax Claims in Rehabilitation: There are no rehabilitation or reorganization proceedings under Mozambican law.

Other comments: A commission for drafting an insolvency code is about to be formed in Mozambique.

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THE NETHERLANDS

Taxes: Taxes include wage taxes, dividend taxes, VAT, customs duties, social security taxes.

Enforcement: Interest and penalties for overdue taxes, possibility to seize property, power to request bankruptcy of taxpayer, liability of corporate directors for mismanagement and if no timely warning has been given of late payment.

Insolvency Law: The Dutch Bankruptcy Act of 1896, as amended provides for three types of insolvency proceedings: bankruptcy of companies and other legal entities and natural persons, suspension of payments available to most companies and legal entities and to natural persons carrying out a business, and debt reorganization of natural persons.

Tax Claims in Liquidation: All tax claims are entitled to priority over employee wage claims in liquidation, and rank behind secured claims (except for claims secured by machinery and equipment) and administrative costs.

Tax Claims in Rehabilitation: Enforcement of tax claims is not stayed in rehabilitation – or liquidation proceedings.

Other Comments:

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NEW ZEALAND

Taxes: Withholding taxes (pay as you earn, resident withholding for interest or dividend, non-resident withholding); goods and services tax payable by seller of goods or services; customs duties and excise taxes on sale of goods; accident compensation levies; individual and corporate income and/or gross receipts taxes; indirect levies on land and motor vehicles which do not constitute specific taxes.

Enforcement: Assessment of interest and penalties; garnishment by notice to third parties to pay directly to tax authorities; general debt recovery; charge on property in limited circumstances; third party responsibility; specific charge on goods for unpaid duties; no statute of limitations on enforcement though there are no reinstatement provisions if time has lapsed.

Insolvency Law: Companies and Receiverships Acts of 1993; statutory management; individual bankruptcies.

Tax Claims in Liquidation: 7th Schedule of the Companies Act 1993, provides the following priorities in a formal insolvency: administrative expenses, employee entitlements (unpaid salary and wages limited to 4 months preceding insolvency and \$15,000 per employee), miscellaneous claims for deposits, layaway, and compromise; goods and services tax, pay as you earn, resident withholding and non-resident withholding tax. No restriction on the period over which the claims are accrued, although interest and penalties for overdue taxes rank as unsecured claims. Unpaid withholding tax deductions (including late payment or shortfall penalty) constitute a charge on the company's real and personal property and taxing authorities may register the charge, and the claim ranks immediately after prior registered charges. Customs duties also are a charge on goods until the duty is fully paid.

Tax Claims in Rehabilitation: The New Zealand equivalent of this would be a compromise between a company and its creditors. If tax authorities have a preferred claim, it must be separately classified. They are bound by the compromise if approved. Secured creditors rights are not impacted by the compromise.

Other comments: Insolvency legislation is facing a major overhaul with the introduction of the Insolvency Law Reform Bill (ILRB) which will align the law with Australian corporate law to reflect proposed closer economic ties, remove inconsistencies from enactment of new legislation, and harmonize the regimes for personal and corporate insolvency. The ILRB will have little impact on the position of tax priorities. The NZ Law Commission Study Paper 2, Priority Debts in the Distribution of Insolvent Estates recommended abolition of preferred status of withholding taxes for employees, goods and services tax, customs duties, and associated levies, but retention of resident withholding taxes for interest and dividends and non-resident withholding taxes. Subsequent lawmakers have failed to be swayed by the Commission's reasoning. Some sectors of the commercial community are critical of this position: there is reluctant acceptance that the taxing authorities are an involuntary creditor, but there is growing concern that the comfort of preferential ranking provides insufficient incentive for the taxing authorities to act more swiftly in dealing with the potentially insolvent taxpayer. Some points in the Study Paper have been dealt with in other ways through subsequent legislative changes. Specifically, although purchase money security interests are entitled to priority over the assets they finance, claims – those previously covered by the floating charge are no longer a charge over a company's accounts receivable and inventory.

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THE PHILIPPINES

Taxes: Direct taxes include individual and corporate income tax, gross receipts tax, capital gains tax, real property tax, and local business and transfer tax. Indirect taxes include withholding tax on certain types of income (such as employee salaries and wages, lease payments, payments of contractors, payments to non-residents); final withholding tax on passive income (such as dividends, interest, winnings); value added tax; customs duties; and excise taxes.

Enforcement: Interest and penalties for overdue taxes; distraint, levy, garnishment and sale of property at public auction; garnishment by notice to third parties to pay amounts directly to taxing authorities; non-judicial lien on property; possessory lien for customs duties on imported goods. No ability to force a taxpayer into bankruptcy. Corporate directors, officers, and controlling parties are not liable for taxes in the absence of exceptional circumstances such as fraud or bad faith. 3 year statute of limitations on enforcement. Taxing authorities can compromise payment of tax when taxpayer has a clear inability to pay. Evaluation Board must approve compromise if the basic tax involved exceeds a certain amount or if the settlement is less than the prescribed minimum compromise rate.

Insolvency Law: Suspension of payments and insolvency proceedings are primarily governed by Act No. 1956 (the "Insolvency Law"); corporate rehabilitation is a remedy provided under Presidential Decree No. 902-A and Interim Rules of Procedure on Corporate Rehabilitation issued by the Supreme Court in 2001 (the "Rehabilitation Rules").

Tax Claims in Liquidation: Taxes that constitute liens take precedence over other claims with regard to the property they attach, as do secured claims. Taxes duties and fees due on specific movable or immovable property (e.g., basic real property tax) take precedence over other all other claims with respect to the property without the need for registration. All other taxes and assessments due to the national government, any province, and any city or municipality, are entitled to priority and are payable from property that is not encumbered by secured claims or liens, after payment of expenses of illness and funeral, employee claims for one year before the proceeding, compensation for labor accidents, claims for family support, and court approved legal expenses incurred in administering the insolvent's estate, but before payment of general creditors.

Tax Claims in Rehabilitation: It is unsettled under Philippine law and jurisprudence whether tax liens are affected by a stay order or a court mandated rehabilitation plan. Although the Rehabilitation Rules define claim to include all claims or demands of whatever nature or character against a debtor or its property whether for money or otherwise and do not distinguish between tax and non-tax claims, according to the "lifeblood doctrine" tax collection cannot be curtailed by injunction or any like action or the government unit will be crippled in dispensing the needed services to the people. To date, this issue has not been ruled upon by the Supreme Court.

Other comments: There is pending legislation on Corporate Recovery in Congress, encompassing provisions on corporate insolvency, rehabilitation, and suspension of payment, but it has been pending for some time, and is not priority legislation in the Philippines.

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POLAND

Taxes: Corporate and personal income, gifts and inheritance, real estate, agriculture and forest, means of transportation, VAT, excise, gaming, customs duties. Most significant source of revenue and easiest tax to collect is VAT.

Enforcement: Interest and penalties, seizure of property, deduction from employee salary, involuntary bankruptcy, non-judicial tax liens, third party liability, installment plan for financial hardship, 5 year statute of limitations from due date.

Insolvency Law: Law on Bankruptcy and Reorganization, dated February 28, 2003 (the “Bankruptcy Law”).

Tax Claims in Liquidation: The Bankruptcy Law provides second priority for all taxes and public charges due for a year immediately preceding the declaration of bankruptcy, including interest and costs of enforcement. The balance of tax claims are paid as third priority along with other unsecured claims. First priority is granted to costs of administering the bankruptcy proceeding, payments under contracts assumed by the administrator, premiums for pensions, disability and sickness benefits, and dues for work. These rules do not apply to secured claims which are satisfied from the proceeds of sale of the encumbered property.

Tax claims secured by proprietary rights in rem enjoy priority only if they rank higher than secured claims of other creditors, except that tax and social security claims secured by a mortgage always rank higher than mortgages other than mortgages securing bank’s claims under credit agreements.

Tax claims are not discharged under the bankruptcy law, except that on motion of an individual bankrupt, tax claims may be annulled once during a 10 year period on terms specified in the Bankruptcy law.

Tax Claims in Rehabilitation: Tax claims are subject to rehabilitation (arrangement) proceedings and may be subject to any arrangement agreed in such proceedings among the creditors, including deferral for the fulfillment of obligations, an arrangement for the repayment of debts in installments, the reduction of the amount of debts, the conversion of claims to shares or stocks, the change, exchange or annulment of a right securing specific claims. Tax authorities do not enjoy any privileges regarding voting on a plan of reorganization or rehabilitation.

Other comments: As a result of the 2003 Bankruptcy Law, tax claims remain privileged but the scope of the privilege has been narrowed from the 1934 law. Tax claims have been included in arrangement proceedings and subject to all rules regarding modification of claims in such proceedings. In liquidation proceedings, tax claims are no longer privileged in terms of distributions of proceeds from the sale of secured assets. This means that general rules of priority of secured creditors are applicable to tax claims.

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PORTUGAL

Taxes: Personal and corporate income, net wealth tax (includes transfer tax and local tax on real estate), VAT, excise taxes on consumption of certain goods, stamp duty and road transportation tax, municipal vehicle tax, parafiscal system to finance social security payable by recipient of income and employer.

Enforcement: Interest and penalties, seizure of property, injunctive relief against disposition of property, involuntary bankruptcy, non-judicial tax liens, third party liability, installment plan for financial hardship, periodic legislation provides forgiveness of interest for delinquent taxpayers.

Insolvency Law: Insolvency and Companies Recover Portuguese Code, effective September 2004 (the “2004 Insolvency Code”), provides the framework for a unified single insolvency proceeding based on debtor patrimony liquidation but also grants creditors the possibility to approve a specific plan in order to promote the company’s liquidation in a different way or to promote the recovery of the company.

Tax Claims in Liquidation: The Portuguese Civil Code, as limited by the 2004 Insolvency Code provides states and municipalities the following priority for taxes due for 12 months prior to the beginning of the insolvency proceeding: *special creditor’s preferential claims* for claims against assets to which specific taxes relate, *immovable creditors’ preferential claims* for real estate tax claims against real estate, and *general creditors preferential claims* with regard to movable assets not encumbered by special statutory preferences. Legal mortgages for real estate taxes registered more than two months before the insolvency proceeding also are recognized. The balance of tax claims are treated as common credits. Tax claims are not dischargeable.

Tax Claims in Rehabilitation: Tax debts have exactly the same treatment as other debts, except in what concern special creditor’s preferential claims as state above.

Other comments: Under prior law, governmental entities were given preference prior to settlement ahead of other creditors. This preferential treatment meant that only in rare cases would creditors other than the State, the municipalities or social security and entities holding security receive payment. The 2004 Insolvency Code presents a compromise solution, according to which some governmental credits are deemed privileged depending on the duration of the privilege. It significantly limits the priority/preference rules found in the Portuguese Civil Code. The 2004 Insolvency Code also foresees that the declaration of insolvency extinguishes several creditor’s preferential claims and legal mortgages that usually benefit the tax authorities.

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RUSSIAN FEDERATION

Taxes: Federal - VAT, excise taxes, individual income tax, unified social tax, profits (income) tax on organizations, mineral extraction tax, inheritance and gift tax, state duties; Regional - corporate property tax, transport tax, and gaming tax; Local taxes – land tax and individual property tax.

Enforcement: Attachment of bank accounts and other property, fulfillment of tax obligations can be secured by pledge of property, suretyship, late payment interest, suspension of operations on bank accounts and arrest of property; fines for evading taxes; criminal liability for non-payment of a significant sum of taxes due, can include imprisonment for up to six years.

Insolvency Law: October 26, 2002 Federal Law on Insolvency (Bankruptcy) replaced the previous law of 1998. The 2002 Bankruptcy Law is the third legislative initiative undertaken seeking to establish an effective bankruptcy regime. There is separate legislative applicable to the banking industry and the Russian electricity, oil, and gas supply monopolies.

Tax Claims in Liquidation: The Bankruptcy Law provides first priority to fees and expenses relating to post-bankruptcy activities and costs of bankruptcy proceedings. Thereafter claims of creditors are satisfied in the following order: individual claims for harm to life or health, severance payments and wages and compensation under contracts, claims of creditors secured by a pledge of property, indebtedness for obligatory payments to the fiscal budget and to off-budget funds (including taxation); other claims.

Tax Claims in Rehabilitation: Commencement of a rehabilitation proceeding entails a moratorium on collection of monetary obligations and obligatory payments (including taxes) for amounts due before the proceeding was commenced. Interest continues to accumulate although financial sanctions are not charged. Creditors claims are satisfied in the order of priority stated above.

Other comments:

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SOUTH AFRICA

Taxes: Individual and corporate income, capital gains, taxes on property (rates), pay as you earn, resident withholding tax on dividends or interest, non-resident withholding tax on dividends or interest, VAT, customs and excise taxes

Enforcement: Interest and penalties, seizure of property, garnishment by notice to third parties to pay amounts owed to taxpayer directly to taxing authorities, involuntary bankruptcy, non-judicial tax liens.

Insolvency Law: South African Insolvency Act 24 of 1936 (the “Insolvency Act”), applicable to the winding up and reorganization of companies by the Companies Act 61 of 1973.

Tax Claims in Liquidation: Section 99 of the Insolvency Act provides priority for the following taxes and charges after payment of secured creditors, costs of liquidation and certain employee claims: amounts due under the Workers Compensation Act, withholding taxes (income tax owed by others and from earnings and non-resident tax withheld on interest earned), customs, excise, or sales duties (plus interest and penalties), sales tax plus interest and penalties, unemployment insurance contributions. Other Section 99 priorities are amounts due to the General Council on Pneumoconiosis and the National Supplies Procurement Fund and the appreciation contribution due to the Community Development Board. Section 101 of the Insolvency Act provides that after the Section 99 amounts are paid, the following amounts are entitled to priority: income and profits taxes (plus interest), certain partnership income taxes. None of the foregoing have priority over secured claims, except that municipalities are entitled to be paid for rates for property taxes in arrears for up to two years preceding the date of liquidation out of the proceeds of immovable property.

Tax Claims in Rehabilitation: Recovery of claims from corporate debtor will be dealt with in a court sanctioned plan which the tax authorities would be compelled to accept, even if it defers payment or deals with the claims in some other way. Taxing authorities are entitled to vote on plan as other creditors.

Other comments: The 1984 South African Law Commission Report on *Amendments to South Africa’s Insolvency Laws* [ISBN 0621 090840] recommended preference for administrative costs, employee claims limited to R3000 per employee, and claim for arrears maintenance in terms of a court order and that all other preferences be abolished. In December 1989, the Cabinet endorsed the view taken by the Cabinet Committee for Economic Affairs that the abolition of preferences could not be supported because it would have unacceptable cost implications for the State. See also, South African Law Commission Working Paper 61, *Review of the Law of Insolvency: Statutory provisions that benefit creditors* (1995); BH Swart, *Die rol van ’n concursus creditorum in die Suid-Afrikaanse insolvensiereg* (1980) (doctoral thesis).

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SPAIN

Taxes: Direct taxes include personal, corporate and non-resident income tax; wealth, gift and inheritance, capital gains tax on land, real estate tax, vehicles tax, tax on economic activities and construction and works tax. Indirect taxes include withholding on personal income tax, value added tax, insurance premium tax, transfer tax, corporate operations tax, stamp duty tax, and customs and excise duties.

Enforcement: Interest and penalties, levy and seizure of property, garnishment of salaries, credits and securities, right to commence insolvency proceedings, third party liability for corporate directors, successors, duty agents; tax and possessory liens. Possible to defer payment based on financial hardship as part of general agreement with creditors, except that the agreement must not constitute a state subsidy to the debtor in accordance with the case law of the European Court of Justice.

Insolvency Law: Insolvency Act 22/2003 of July 9, 2003, effective September 1, 2004, which unified and modernized the prior law.

Tax Claims in Liquidation: Tax debts guaranteed by specific assets by means of mortgage or pledge, VAT on imports and excise and customs duties with retention rights, and taxes such as annual real estate taxes registered in public register, have priority over all creditors as secured creditors. The new Insolvency Act provides that amounts withheld by debtor that are owed by third parties (employees, suppliers) have priority over all other creditors except employee claims and registered secured creditors. 50% of all other pending tax claims rank next in priority; the remaining 50% of tax credits is treated as general ordinary credit.

Tax Claims in Rehabilitation: Taxing authorities have the right to decide whether the tax claims will be included in the general insolvency agreement or not. If included in the general insolvency agreement, the taxing authorities are bound by the contents of the agreement as accepted by the creditors and approved by the court.

Other comments: Prior to the enactment of the new Insolvency Act, tax credits were ranked as privileged for their whole amount. Also, withheld amounts were enforced on a separate basis – they were not considered part of the liquidation, but instead amounts held on behalf of the taxing authorities. One of the goals of the new law is to try to help the continuity of activity, reinforcing the principal of the par condition creditorum, and minimizing the impact on other market agents such as suppliers and other creditors.

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SWEDEN

Taxes: Income from employment, capital, and business; tax on capital, real estate, inheritance, gift; VAT and excise on duties.

Enforcement: Interest and penalties, seizure of property, involuntary bankruptcy, third party liability, installment plan for financial hardship under certain circumstance.

Insolvency Law: Bankruptcy Act (1987) for winding up of insolvent business and Reorganisation of Business Act (1996) for reorganising business activities with the protection of the court. The Rights of Priority Act (2004) governs the priority of claims among creditors.

Tax Claims in Liquidation: There are no priority or preference rules for claims of taxing authorities. Tax claims are treated like other unsecured claims and are payable after secured claims, costs of bankruptcy, claims secured by a floating charge (limited to 55 percent of the value of the assets covered by the floating charge), and employee salary claims.

Tax Claims in Rehabilitation: The court can, after an application, open a business reorganization and the taxing authorities can be required in these proceedings to accept payment over time. Pre-reorganization tax claims are classified together with other claims without priority in terms of voting.

Other comments: Sweden abolished priority rules for tax claims in insolvency on January 1, 2004, as part of a package of law changes regarding priority legislation. One of the aims of the changes is to facilitate business reorganization without bankruptcy. See Government Bill, proposition 2002/03:49 and proposal of the Right of Priority Committee, SOU 1999:1, which contain calculations regarding the changes (English Summary discusses the right of priority for tax claims at 34-36). Also, paper on dividends on tax claims by Anna Berlin (Law Student, University of Stockholm), concluding that state's losses as a result of the abolishment of the priority of tax claims, often are neutralized by the increased dividends on prioritized wage claims. The state takes over the wage claim from the employee if the State-administered wage guarantee is used.

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THAILAND

Taxes: Personal and corporate income tax, value added tax, specific business tax, stamp duty, customs duties and excise taxes. Withholding tax is applied only to direct taxes (personal income and corporate income).

Enforcement: Assessment of interest and penalties, measures for seizing property, garnishment by notice to third parties to pay amounts owed to taxpayer directly to taxing authorities, involuntary bankruptcy, non-judicial lien on property, third party responsibility of corporate directors, officers, controlling persons, statute of limitations on enforcement, authorization to negotiate a settlement with taxpayer to take account of financial hardship.

Insolvency Law: Bankruptcy Act of 1940, as amended by B.E. 2542 in 1998, provides for liquidation proceedings and business reorganization process.

Tax Claims in Liquidation: Tax claims due within 6 months prior to bankruptcy proceeding are entitled to same priority as 4 months of employee wages, after secured claims, expenses of administration and receiver, liquidation and court fees. Tax claims are dischargeable if claim is not filed within specified time after bankruptcy.

Tax Claims in Rehabilitation: Taxing authorities can be paid over the time specified in a rehabilitation plan approved by the court. Tax claims are classified at the same rank as other claims in terms of voting on a rehabilitation plan. Interest and penalties are treated the same as principal amounts.

Other comments: Rehabilitation provisions were added to the Bankruptcy Act in 1998.

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REPUBLIC OF TURKEY

Taxes: Personal income tax (some collected by withholding – e.g., wages), corporate, motor vehicle, real estate, VAT, customs, special consumption, bank and insurance transactions.

Enforcement: Interest and penalties, seizure of property, deduction from employee salary, involuntary bankruptcy as measure of last resort, non-judicial tax liens, third party liability (parties who are required to withhold and pay the debtor's tax liabilities to the authorities but fail to do so), installment plan for financial hardship, 5 year statute of limitations. Also, from time to time the Turkish Parliament passes "Tax Peace Laws", which provide for general dismissals and exemptions from certain taxes.

Insolvency Law: Turkish Code of Execution and Bankruptcy 2004 (TCEB), which includes Law No. 5092 (2/21/04), Restructuring of Capital Companies and Cooperatives by Conciliation.

Tax Claims in Liquidation: TCEB and the Law on Procedure of the Collection of Public Claims, No. 6183 provide that taxes and claims arising in rem (land or building taxes for immovable property, motor vehicle taxes for vehicles) and customs tax for related property are satisfied from sales proceeds of related property, with priority over all other claims. All other tax claims are paid 4th rank, with all other unsecured debts, after payment of employment claims, guardian or tutelage claims, and other specified privileged debts. If tax authorities establish a lien to secure the tax claims then such security gives them the position of a secured creditor with regard to the property. Execution proceedings are stayed by commencement of bankruptcy proceedings, with the exception of proceedings for foreclosure of security interests and levy and garnishment which are administrative actions of tax authorities. Tax claims are not dischargeable but penalties and interest may be discharged by law.

Tax Claims in Rehabilitation: The 2004 amendments to TCEB allow an insolvent company or cooperative to apply to the commercial court of first instance for restructuring where a restructuring plan (concordat) has already been approved by an affirmative vote of the required number of affected creditors. There are no examples of how this will be implemented, but it is assumed that taxing authorities would be treated equally with other creditors for voting and satisfaction because there is no priority rule for tax claims in this type of reorganization. Restructuring does not specifically regulate interest and penalties which therefore should be restructured under same conditions applicable to principal tax claims. In the event of approval of a concordat, tax authorities are not obligated to obey the concordat rules based on Law No. 6183. In the event of a postponement under Law 6183, maximum deferral is two years; additional interest continues to accrue over deferral period.

Other comments: Priority for tax claims in insolvency proceedings was abolished in July 2003. Prior to that time, unsecured tax claims were ranked as 5th priority and other unsecured debts were 6th priority. This amendment ranking unsecured tax claims the same as other unsecured claims is aimed at protection of rights of the other ordinary creditors. The "postponement of insolvency" procedure also was introduced which results in post-ponement of all execution proceedings against the debtor including proceedings related to tax claims. The time periods for such postponement are set forth in the relevant legislation. The 2004 amendments to TCEB provide for restructuring of capital companies and cooperatives by conciliation. Within the scope of this procedure, creditors, including taxation authorities, may approve a restructuring plan.

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UNITED KINGDOM

Taxes: Withholding taxes, VAT, customs and excise duties, social security/pension/payroll, income/gross receipts (capital gains tax, inheritance tax and corporation tax), taxes on property (stamp duty); and others (air passenger duty, aggregates levy, climate change levy, council tax, development land tax, insurance premium tax, landfill tax, motor vehicle taxes and petroleum revenue tax).

Enforcement: Judicial proceedings; assessment of interest and penalties for overdue taxes; measures for seizing property; ability of taxing authorities to force taxpayer into personal bankruptcy or company liquidation proceedings (rarely used); and liability of corporate directors and officers only where the directors have been at fault. Normal limitation period for a tax claim is 5 years. Negotiated settlement is possible where delinquent taxpayer with insufficient resources to make an adequate offer.

Insolvency Law: The Insolvency Act 1986 ("IA"), as amended (winding up, corporate voluntary arrangement, administration, appointment of administrative receiver of company's property pursuant to a debenture secured by a floating charge or other form of security). Enterprise Act 2002 prohibits appointment of an administrative receiver, except in respect of certain types of financing transactions.

Tax Claims in Liquidation: Enterprise Act 2002 amended Section 386 and Schedule 6 of the IA to eliminate priority treatment for PAYE (income tax withheld), VAT and customs and excise duties, which now rank as unsecured claims. Only remaining priority claims are: (1) employer's contributions to occupational pension schemes; (2) limited amount of employee remuneration claims for accrued holiday pay; and (3) coal and steel levies. Employee remuneration may be paid by the Redundancy Payments Service which upon payment takes over the employees' claims by way of subrogation and has preferential status in the same way as the employee would have had. Where floating charge is granted and enforced after 15 September 2003, a portion of recoveries from assets subject to the charge will be ring-fenced and set aside for the benefit of unsecured creditors: 50% up to £10,000 and 20% in excess of £10,000 up to £600,000. Not applicable if company's net assets are less than £10,000 and the cost of making a distribution to unsecured creditors would be disproportionate to the benefits.

Tax Claims in Rehabilitation: In an administration, the amount of any corporation tax on chargeable gains accruing on the realisation of any asset of the company is regarded as an "expense of the administration" which has the effect that it will be payable in priority to distributions to preferential creditors and floating charge holders (but not in priority to fixed charge holders), rather than being treated as an unsecured claim. In administrative receivership, however, this tax liability does not attach as a preferential claim. All other tax claims are treated as unsecured claims in the administration.

Other comments: Enterprise Act 2002 reforms promote a rescue culture and abolition of the crown preference serves this goal. Abolishing Crown preference is to benefit unsecured creditors. Losses to the government from the will be offset by increased taxes received from the continued trading of surviving companies. See, *Productivity and Enterprise, Insolvency – A Second Chance* (government white paper) at <http://www.insolvency.gov.uk/cwp/cm5234.pdf>; *Insolvency Provisions – Regulatory Impact Assessment* (government assessment) at <http://www.dti.gov.uk/ccp/enterpriseact/pdfs/ria-insolvency.pdf>; <http://www.opsi.gov.uk/acts/en2002/2002en40.htm> (government's explanatory notes); and <http://www.insolvency.gov.uk/information/faq/faqact.htm> (Insolvency Service's website –

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Date: June 1, 2005

UNITED STATES

Taxes: Personal and corporate income, social security, sales, motor vehicle tax, real estate tax, customs duties, certain excise taxes, employee withholding for income social security, unemployment insurance. Federal taxes are income, social security, customs duties, and certain excise taxes. Other taxes are state level except for real estate and motor vehicle which are municipal.

Enforcement: Interest and penalties, seizure of property, deduction from employee salary, non-judicial tax liens created by filing notice, third party liability for withheld amounts (responsible persons and financiers of net wages), installment plan for financial hardship permitted, __ year statute of limitations.

Insolvency Law: Title 11 United States Code (the “Bankruptcy Code”) provides for liquidation (Chapter 7) and business reorganization (Chapter 11).

Tax Claims in Liquidation: Section 507(a)(8) of the Bankruptcy Code provides eighth level priority for the following taxes: income or gross receipts tax (3 years), property tax (1 year), taxes required to be withheld (no limit on time), employment tax on wages, salaries, commissions (3 years), excise tax (3 years), customs duties (1 year), penalties fore foregoing to the extent they compensate for pecuniary loss. Eighth level priority claims are payable after administrative expenses, certain employee wage and benefit claims, certain claims of grain producers and fishermen, consumer deposits, and alimony and child support claims. Any additional tax claims are paid as unsecured claims. Where notice is properly filed before bankruptcy petition, a statutory lien attaches to all real or personal property, in accordance with first in time, first in right filing priority and gives taxing authorities secured status. However, the statutory tax lien is subordinate to other priority claims in a liquidation. Enforcement of tax claims is stayed by commencement of Chapter 7 liquidation. Bankruptcy Court has authority to determine amount of tax claims pursuant to Section 505 of the Bankruptcy Code.

Tax Claims in Rehabilitation: Enforcement of tax claims is automatically stayed upon commencement of Chapter 11 case. Priority tax claims must be paid in full but under a confirmed plan of reorganization, the debtor can stretch out payments over six years provided that debtor pays interest. Tax claims secured by liens are treated as secured claims which must be paid in full at market rate if they are not paid in full on effective date of reorganization plan.

Other comments: Tax priorities were limited in duration in the 1978 Bankruptcy Code, along with priority claims in general. They have not been further amended since that time. Reference materials: Senate Report 95-989 (1978); House Report 95-595 (1977); Report of the Commission on the Bankruptcy laws of the U.S., H.R. Doc. No. 93-137 (1973); United States Trustee Program, Preliminary Report on Chapter 7 Asset Cases 1994-2000 (June 2001) contains statistics on receipts and disbursements to classes of creditors.

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VENEZUELA

Taxes: Individual and corporate income tax, withholding taxes, value added tax, stamp tax on transactions, municipal gross income tax on businesses.

Enforcement: Interest and penalties; tax authorities, when they are authorized by law to do so, have authority to forgive interest and penalties, but not unpaid taxes, which can only be forgiven by special law. 4 year statute of limitations on enforcement. Tax authorities are entitled to an executory process before Venezuelan courts whereby they can proceed to seize assets in a very expedited way. In addition, the genuineness and authenticity of all information and facts contained in the tax assessment issued by tax authorities is presumed, and tax debtors have the burden of proving that they are false.

Insolvency Law: Insolvency Procedure and Moratorium Procedure (for corporation that has liquidity problems) under Venezuelan Commercial Code of 1919.

Tax Claims in Liquidation: Organic Tax Code grants a general privilege for taxes, interest and penalties over all assets except assets subject to mortgage or pledge, and claims for wages and social security. Civil Code specifies priority for national and municipal taxes and contributions over all movable assets. Special contributions and registration fees relating to real estate have priority with regard to the real estate. The filing of an insolvency procedure does not stay collection of secured or priority claims, including tax claims, and such tax claims continue to accrue interest.

Tax Claims in Rehabilitation: Same treatment for tax claims in moratorium procedure as in insolvency procedure.

Other comments: Prior to 2001, the Tax Code priority was restricted to taxes for the current year and two preceding years, with no priority for interest or penalties. In 2001 the Tax Code was changed to eliminate these restrictions.

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