

In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:

FRANK J. HERNANDEZ
d/b/a Classic Auto Painting
and Bodyworks, Inc.
(Chapter 7 Case 93-40680)

Adversary Proceeding
Number 95-4047

and

SHERYL R. HERNANDEZ
(Chapter 7 Case 94-41596)

Adversary Proceeding
Number 95-4048

Debtors

WILEY A. WASDEN, III
TRUSTEE

Plaintiff

FILED
at 12 O'clock & 16 min. P.M.
Date 1-30-96

MARY C. BECTON, CLERK
United States Bankruptcy Court
Savannah, Georgia

v.

THE CITY OF SAVANNAH,
CHATHAM COUNTY,
MELLON BANK and
FIRST UNION NATIONAL BANK
OF GEORGIA, N.A.

Defendants

**MEMORANDUM AND ORDER ON TRUSTEE'S MOTION
FOR SUMMARY JUDGMENT**

Trustee, Wiley A. Wasden III (hereinafter "Trustee"), filed this

adversary proceeding on April 26, 1995, seeking a determination of the extent, validity, and priority of certain liens against property of the estate of Frank J. Hernandez (hereinafter "Debtor") pursuant to the applicable provisions of federal law and in particular in light of the provisions of 11 U.S.C. Section 724(b). This proceeding is a core matter under 11 U.S.C. Section 157(b)(2)(A). These findings of fact and conclusions of law are entered pursuant to Fed.R.Bankr.P. 7052.

As originally drafted, Trustee's complaint in Count I sought authority to distribute the proceeds from Debtor's residential property located on Herb River Drive in the following order: First, to pay administrative claims under 11 U.S.C. Section 507(a)(1) to the extent of the allowed real and personal property tax claims; second, to the first mortgageholder on the real estate; third, to the junior lienholder; and fourth to the subordinated real property tax liens. On June 2, 1995, Trustee included within his complaint Count II which requested permission to sell Debtor's residential property, pay the first mortgage holder at closing, and retain the proceeds until resolution of Count I. In effect, Count II besides authorizing the actual sale of the property proposed to elevate the claim of the first lien holder above the ad valorem tax claims which attached to the residential property. This Court granted judgment

as to Count II on August 1, 1995.¹ The Defendants² all timely filed answers generally denying that Plaintiff was entitled to the relief sought in Count I and on September 26, 1995, Trustee filed a Motion for Summary Judgment. Defendants deny the appropriateness of the relief sought by the Trustee although the material facts are not in dispute.³

FINDINGS OF FACT

Frank J. Hernandez (hereinafter "Debtor") filed for relief under Chapter 11 of the Bankruptcy Code on April 21, 1993. The case was converted to Chapter 7 on September 6, 1994, and Plaintiff was appointed as the Chapter 7 Trustee.

At the time the original Chapter 11 case was filed, Debtor owned an undivided one-half interest in certain residential real property known as 113 Herb

¹ In this adversary proceeding the real dispute is between Trustee and the taxing authorities. Mellon Bank, the first lien holder, was fully secured. This Court permitted Trustee to satisfy Mellon Bank's claim ahead of the tax claims to keep future interest payments from burdening the estate.

² The original defendants were the City of Savannah (hereinafter "City"), Chatham County (hereinafter "County"), Mellon Bank, and First Union Bank of Georgia. Mellon Bank's claim has been satisfied and, therefore, is no longer a party to this adversary proceeding.

³ Trustee's amended Motion of October 20, 1995, includes a statement of material facts which he contends are not in dispute as provided for pursuant to United States District Court Local Rule 56.1. That statement of material facts has not been controverted by any party in interest.

River Drive, Savannah, Georgia ("Herb River Drive property").⁴ Debtor also owned certain parcels of commercial real property known as 3005 and 3006 Gibbons Street, Savannah, Georgia ("Gibbons Street property"),⁵ 110 Echols Street, Savannah, Georgia ("Echols Street property"), and 1600 Dean Forest Road, Savannah, Georgia ("Dean Forest Road property").⁶ At the time of the conversion to Chapter 7, Debtor still owned the aforementioned properties and Chatham County had statutorily perfected tax liens on all four parcels. When Debtor converted to a Chapter 7, Debtor also owed taxes to the City of Savannah on the three commercial properties. The Herb River Drive residential property lies outside of the City of Savannah and therefore only accrued County taxes. No significant equity existed in the commercial properties although there was substantial equity in the Herb River Drive estate.

On September 28, 1994, Trustee executed two documents entitled "Abandonment of Property" which were prepared by counsel for Coastal Bank. The documents were filed with the Clerk on September 29, 1994. The first document

⁴ At the time of filing, Mellon Bank had a perfected mortgage interest in the Herb River Drive property.

⁵ At the time of the filing, Ameribank had a perfected mortgage interest in the Gibbons Street property.

⁶ At the time of filing, Coastal Bank had a perfected mortgage interest in the Echols Street property and the Dean Forest Road property.

pertained to the Echols Street property, and the other document pertained to the Dean Forest Road property. No notice was given to the creditors in this case of the filing of the documents. Subsequently, Coastal Bank filed a Motion for Relief from Stay as to the Echols Street property and the Dean Forest Road property. By consent order dated October 19, 1994, which was filed of record on October 21, 1994, the Court granted Coastal Bank's Motion for Relief from Stay.

On November 2, 1994, Coastal Bank sold at foreclosure sale the Echols Street property and the Dean Forest Road property. Coastal Bank was the purchaser of the property at the foreclosure sale. On or about March 31, 1995, Chatham County and the City of Savannah were paid the delinquent taxes owed on the Dean Forest Road property and the Echols Street property.

On December 22, 1994, Trustee executed a document entitled "Abandonment of Property" which had been prepared by counsel for Ameribank. The document pertained to the third parcel of commercial real estate or Gibbons Street property. On February 21, 1995, counsel for Ameribank filed the document of record with the Clerk of Court. No notice was given to the creditors in this case of the filing of the document. Also on February 21, 1995, Ameribank filed its Motion for Relief from Stay as to the Gibbons Street property. By order dated March 28, 1995, which

was filed of record on April 10, 1995, the Court granted Ameribank's Motion for Relief from Stay as to the Gibbons Street property. On May 2, 1995, Ameribank sold the Gibbons Street property at foreclosure sale. Ameribank was the purchaser of the Gibbons Street property at that foreclosure sale. On or about May 12, 1995, Ameribank paid Chatham County and the City of Savannah the delinquent taxes which were owed on the Gibbons Street property.

Thus, as of May 12, 1995, all three commercial properties had been sold at foreclosure to the first mortgage holder and subsequently, both the County and City taxes were satisfied in order to extinguish the liens attaching to the properties.

On or about August 5, 1995, Trustee sold the Herb River Drive property to Dr. Mark Morales for approximately \$503,000. As previously mentioned, the sale was approved when this Court entered judgment on Count II of this adversary. After satisfying Mellon Bank's claim and paying other costs incidental to the sale, Trustee retains approximately \$78,000 in proceeds to disburse pursuant to 11 U.S.C. Section 724(b).

Trustee first contends that the taxes paid by the banks after foreclosure are proceeds of the estate and should be refunded by the taxing authorities. Trustee

would then administer the remitted proceeds and claims of the taxing authorities according to Section 724(b). Trustee also requests that the Court grant permission to distribute the \$78,000 according to Trustee's proposed distribution pursuant to Section 724(b).⁷

CONCLUSIONS OF LAW

In accordance with Federal Rule of Civil Procedure (applicable to bankruptcy under Fed.R.Bankr.P. 7056), this Court will grant summary judgment only if "there is no genuine issue as to any material fact and . . . the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). In Trustee's Motion for Summary Judgment he alleges that there is no genuine issue as to any material fact and that the issue raised by this litigation can be resolved as a matter of law. That view is apparently shared by the other litigants and I concur. In this case the Trustee seeks resolution of two issues:

1) May Trustee utilize Section 724(b) to subordinate tax claims which have been satisfied subsequent to a

⁷ Within its original complaint, Trustee prays for the following proposed distribution:

- (a) Any and all administrative claims under 11 U.S.C. § 507(a)(1) to the extent of the real property tax claim (no less than \$101,085.34) and the personal property claim.
- (b) First mortgage holder Mellon Mortgage in the approximate amount of \$358,819.89.
- (c) The second mortgage holder First Union Bank in an amount to be determined by the outcome of adversary proceeding number 94-4022 pending in this Court.
- (d) The real property tax lien and personal property tax lien.

nonjudicial foreclosure following the grant of relief from stay, when Trustee has not abandoned the estate's claim?

2) How is Section 724(b) applied to proceeds of a sale when property sold by Trustee is encumbered by first priority tax liens which arise from the property itself and junior tax liens which arise from other property in which Debtor has an interest?

11 U.S.C. Section 724(b) reads as follows:

(b) Property in which the estate has an interest and that is subject to a lien that is not avoidable under this title and that secures an allowed claim for a tax, or proceeds of such property, shall be distributed--

(1) first, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is senior to such tax lien;

(2) second, to any holder of a claim of a kind specified in section 507(a)(1), 507(a)(2), 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, to the extent of the amount of such allowed tax claim that is secured by such tax lien;

(3) third, to the holder of such tax lien, to any extent that such holder's allowed tax claim that is secured by such tax lien exceeds any amount distributed under paragraph (2) of this subsection;

(4) fourth, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is junior to such tax lien;

(5) fifth, to the holder of such tax lien, to the extent that such holder's allowed claim secured by such tax lien is not paid under paragraph (3) of this

subsection; and

(6) sixth, to the estate.

The language of Section 724 is complex although the application is mechanical and is perhaps best summarized in the treatise discussion *Norton Bankruptcy Law and Practice 2d* at §71:3, p 71-5 through 71-6, as follows:

Code §724(b) governs the order of distribution of both real and personal property subject to tax liens that are not avoidable under title 11. Under §724(b), the trustee is permitted to subordinate tax liens on property, and to the extent that the tax liens allow, to pay administrative expense, wage and other priority claims. In essence, it enables the priority claimants to "step into the shoes of the tax collector," and to receive distributions of assets from the debtor's estate even though the tax claims are properly secured. Only two groups are affected by §724(b): the priority claimants, as a result of earlier distribution, and the taxing authority, as a result of the subordinated claim. Neither senior or junior lienors, nor unsecured creditors, are affected by this section.

(footnotes omitted). The congressional intent of this Code section is to fund the administration of Chapter 7's to the extent that taxing authorities possess allowed secured claims. In other words, Section 724(b) permits priority administrative claimants to "step into the shoes of the taxing authority" and to subordinate what

otherwise is an unavoidable secured tax lien; however, the amount of the secured tax claim which is carved out and subordinated to administrative priority claims is limited (a) to the amount of the "lien that is not avoidable under this title," and (b) which is attached to "property in which the estate has an interest . . . or proceeds of such property." 11 U.S.C. §724(b). In short, secured tax liens against property of the estate are subordinated to the extent that they are unavoidable.

I. Recovery and Subordination of Taxes Paid on Commercial Real Estate

As mentioned above, Debtor, at the time of conversion, owned three parcels of commercial real estate on which taxes were owed to both the City and County.⁸ Trustee consented to relief from stay on all three parcels. Thereafter each first mortgageholder foreclosed upon the property and paid the taxes due subsequent to the foreclosure. Trustee contends that, notwithstanding the fact that all of the commercial properties have been foreclosed on by the holders of first mortgages who received permission from this Court granting each motion for relief from stay, the estate still retains an interest in the property or its proceeds. As a result, Trustee attempts to invoke the provisions of Section 724(b) and recover the payments to the taxing authorities, whether made prior to the foreclosure, at the foreclosure, or after the foreclosure sale, and administer them under Section 724(b).

⁸ The three parcels were located on Gibbons Street, Echols Street, and Dean Forrest Road.

Trustee relies on In re Forrest Marbury House Assocs. Ltd. Partnership, 137 B.R. 554 (Bankr.D.D.C. 1992), a decision which yielded the results sought by Trustee. In that case, the payment to the taxing authorities occurred after relief from stay was granted but before foreclosure, although language in the opinion indicates that the court might well have reached the same result had the payment to the taxing authorities occurred after foreclosure. Id. at 557. Not surprisingly, the taxing authorities have objected and contend that after the foreclosure sale the estate retained no further interest in the property or its proceeds. They argue that Forrest Marbury should, at the very least, be limited to its facts so that when a valid non-judicial foreclosure under Georgia law has been consummated and tax liens remain attached, any subsequent payment to the taxing authority should not be subject to a claim by the estate.

The taxing authorities argue first that Trustee abandoned his interest in the commercial properties which were the subject of these foreclosures. While it was not included in the statement of material facts that are not in dispute, the record does reveal, and Trustee does not contest, that he executed written abandonments of all of the subject properties and the effect of abandonment would yield the result sought by the taxing authorities if abandonment had in fact occurred. However, Trustee argues that the abandonments which he attempted to execute were without

notice and were not the subject of a hearing as required by 11 U.S.C. Section 554 and Fed.R.Bankr.P. 6007(a). The taxing authorities contend that Trustee should be estopped to raise this defense since admittedly Trustee attempted to execute the abandonments. The doctrine of judicial estoppel prevents a party from successfully assuming one position in a legal proceeding and then later assuming a contrary position because his interests have changed. See In re Direct Air, Inc., 1995 WL 714283, 7 (Bankr.N.D.Ill.). However, I conclude that estoppel is not appropriate in an instance where the Court has not formally approved the abandonment pursuant to Section 554 and Fed.R.Bankr.P. 6007(a). See Id. at 7. ("the litigant must have convinced the court to accept its position in the earlier litigation"); See also In re UNR Industries, Inc., 143 B.R. 506 (Bankr.N.D.Ill. 1992).

The taxing authorities further contend that in regard to the Dean Forrest Road property foreclosed upon by Coastal Bank, this Court's Order entered October 21, 1994, recited "on September 28, 1994, Chapter 7 Trustee, Wiley A. Wasden, III, abandoned the estate's interest in said collateral." The taxing authorities argue that this recital in an unappealed final order should be *res judicata*. I reject that contention, however, because while the recital is contained in the Order as argued, the operative portion of the Order was not to approve abandonment of the property from the estate, but rather reads as follows: "The Trustee's abandonment of said property

was based upon the fact that the Coastal Bank maintained secured interests in said properties, and that there was no equity in said properties. The Court hereby finds that there is no equity in this real estate, and the Coastal Bank's motion for relief from automatic stay is hereby granted."

Courts have recognized that there is a difference between the granting of a motion for relief from stay and the abandonment of property from the estate in that in the former instance, the estate retains an interest in the proper accounting for all proceeds of sale if the amount realized exceeds the mortgage indebtedness of the first mortgageholder, whereas in the later, the state's interest is forever, irrevocably, and totally extinguished. See In re Ridgemont Apartment Assoc., 105 B.R. 738, 741 (Bankr.N.D.Ga. 1989)("[t]ermination of the automatic stay is neither analogous to, nor the equivalent of, an abandonment of property of the estate"); Matter of Killebrew, 888 F.2d 1516, 1519 (5th Cir.1989)("concept of abandonment appears to have become confused with actions taken to allow Guaranty to realize on its security interest through the lifting of the automatic stay under section 362"). As I construe the October 21 Order, the Court order was limited to granting relief from stay and not that the property be abandoned, even though there was a recital that Trustee had already abandoned the property.

Likewise, with respect to the motion for relief from stay granted Ameribank, Ameribank and Debtor's counsel entered into a consent order which recited that Trustee had abandoned the property and in fact Trustee had executed such an abandonment. By Order dated March 7, 1995, this Court issued a notice under Fed.R.Bankr.P. 4001(d) to all creditors and other parties in interest notifying them that a consent order for the granting of relief from stay had been entered into and that the parties had a period of fifteen (15) days in which to file an objection in the absence of which stay relief would be granted. No objection was timely received and the Court on April 10, 1995, entered an Order approving the consent order which although it recited Trustee's abandonment, did not in fact adjudicate that the property had been abandoned from the estate but simply granted relief from the automatic stay to permit foreclosure.

Accordingly, although Trustee executed documents entitled "Abandonment of Property" in each case, and notwithstanding the fact that it may have been the Trustee's intent to abandon his interest, the effect of his action without giving the requisite notice under Section 554 merely amounts to Trustee's lack of opposition to or consent to the granting of the motion for relief from stay and under the previously cited authorities the estate still retains an interest in the proceeds of such property for the purposes of Section 724(b).

However, with respect to both foreclosures, the record is clear that the creditors did not pay the outstanding ad valorem taxes on the commercial property prior to or at the time of the sale. Instead, each of the properties was exposed for public sale at auction on the courthouse steps of Chatham County as required by Georgia law and was sold to the holders of the mortgage, each of whom entered credit bids equal to the principal and accrued interest on the mortgage obligation. The bid amount therefore included only the amount of the mortgagee's interest and no portion of the bid amount was paid over to the taxing authorities to extinguish those authorities' tax liens. Rather, the sales at public outcry were made subject to the outstanding taxes of record which passed through the foreclosure, attached to the real estate, and became an obligation of the purchaser. Thereafter, apparently at a time when the properties were resold, the purchasers remitted the amount necessary to pay off the taxes and obtained lien releases.

Trustee contends that even after foreclosure the tax payments to the City and County constitute proceeds of property in which the estate has still an interest within the meaning of Section 724(b) and relies on Forrest Marbury, or at least the *dictum* contained in that decision. However, Forrest Marbury is distinguishable because the court's opinion relies on language from the debt deed which required that from the proceeds of any sale taxes shall be paid.

Even if the District has not been paid in advance of the foreclosure sale, the terms of the deed of trust required that the tax lien be paid out of the proceeds of the foreclosure sale. Accordingly, had the tax lien not been paid in advance, the proceeds of the foreclosure sale would have included an amount equal to the pre-petition tax lien of the District.

In re Forrest Marbury House Assocs. Ltd. Partnership, 137 B.R. at 557. Here, there is no evidence of such a provision and because the taxes were not extinguished until the subsequent sale it is clear that the taxes were not paid from the proceeds of the foreclosure sale.

The central issue is whether the post-foreclosure payment of a tax lien can be considered proceeds of an earlier sale. While the Bankruptcy Code contains no definition of proceeds, it is a well recognized concept in commercial law. O.C.G.A. 11-9-306(1), the Georgia version of the Uniform Commercial Code, provides in relevant part that "whatever is received upon the sale, exchange, collection, or other disposition of collateral are proceeds." By this definition, proceeds include the consideration which flows from the disposition of property of the estate. When the state nonjudicial foreclosure occurs, the estate's interest in the realty is terminated and attaches to the proceeds, that is what was bid in by the successful bidder at the auction. If that amounts only to a credit bid in satisfaction of the mortgage with the

buyer receiving the property subject to the tax liens, the proceeds of sale are limited to the amount of that credit bid. Any subsequent payment made or received in exchange for a transfer of that property or to satisfy pre-existing liens is beyond the definition of U.C.C. Section 306 because the lien is satisfied *after* the initial sale when the Debtor/estate's interest was extinguished. Because at that moment the real property is no longer estate property, the tax payment cannot be deemed proceeds of "property in which the estate has an interest" within the meaning of Section 724(b).

Since, in this case, the tax liens were not paid until after the consummation of the foreclosure sale at a time when Debtor's interest had been terminated as a matter of law and because Trustee's title is derivative of Debtor's title, I cannot construe a post-foreclosure payment to extinguish a tax lien which was not paid off at the time of foreclosure to be proceeds of property in which the estate has an interest. Accordingly, Trustee may not include in the amount of the carve out sum, to which tax liens will be subordinated and administrative claims elevated, the amount of tax payments made post-foreclosure.⁹ As a result, neither the City nor the County will be required to remit tax payments received on the three commercial properties.

⁹ Trustee had asked the Court for a determination of whether a payment to the taxing authorities pre-foreclosure or directly out of the sums realized at foreclosure would constitute proceeds of such property for the purposes of Section 724(b). While I have no case in controversy before me that requires a determination on this point, under the rationale set forth above it appears that extinguishing the tax liens either before or during foreclosure would constitute such proceeds.

II. Section 724(b) Subordination of Taxes on Residential Real Estate

Trustee also seeks a determination of how to distribute approximately \$78,000 in proceeds derived from the sale of the Herb River Drive property pursuant to Section 724(b). As mentioned earlier, Section 724(b) permits the subordination of claims by the taxing authorities to those of administrative claimants to the extent of the allowed tax lien. Trustee contends that he may subordinate not only the ad valorem taxes arising from the subject real estate itself, but also perfected tax liens which arise from the ownership of other (commercial) property and which attach to the residential property pursuant to O.C.G.A. Section 48-2-56.¹⁰ In other words, Trustee attempts to locate all existing tax liens on any of Debtor's property to subordinate the amount of all such liens while elevating an equivalent amount of administrative claims.

The relevant facts are as follows as they existed at the time of conversion.¹¹ Trustee owns the Herb River Drive property valued at \$503,000. After incidental costs necessary to the disposition of the property, the estate's gross proceeds will equal \$462,000. Chatham County possesses a first priority tax lien arising from

¹⁰ Under Georgia law, a tax lien against one piece of an individual's real property attaches to all property owned by that individual.

¹¹ Note, in regard to the following discussion, all amounts are only approximations offered by the parties during the hearing.

the property itself on the real estate for \$28,000. Mellon Bank has a first deed to secure debt in the amount of \$384,000. Chatham County also holds perfected tax liens of \$9,000¹² secured by the Herb River Drive Property although arising from the commercial real estate owned by Debtor.¹³ Both the City and County hold additional tax liens which attach to the Herb River Drive property, but were not perfected. Accordingly, I rule that all of the City of Savannah taxes on commercial property and the accrued Chatham County taxes on the commercial property which are not evidenced by record of perfection in the Office of the Clerk of Superior Court of Chatham County, Georgia, are avoidable by the Trustee pursuant to the Trustee's strong arm powers in 11 U.S.C. Section 544(a)(3) and the amount of those taxes cannot be computed in determining the "carve out" amount under Section 724(b)(2). However, the Section 724(b) amount includes all perfected liens whether arising from the subject property or not. The fact that the taxes accrued against other property than that which is being sold affects only the priority, not the enforceability of the lien.

Having established the amount to be subordinated, when applying

¹² This estimate is derived from Plaintiff's Reply to Response Briefs of the City of Savannah, First Union National Bank, and Chatham County. The Court summed the County's perfected tax claims listed in Plaintiff's Exhibit A for a total of \$8,925.98 or approximately \$9,000.

¹³ The claims attach to the property pursuant to O.C.G.A. § 48-2-56 and are perfected when recorded on the County's General Execution Docket ("GED").

Section 724(b), it is the well settled rule that the relative priority among valid liens is determined by nonbankruptcy law. See Pearlstein v. U.S. Small Business Admin., 719 F.2d 1169 (D.C. Cir.1983).¹⁴ Moreover, this rule also applies to competing tax liens. See In re Darnell, 834 F.2d 1263, 1268 (6th Cir.1987)("We can see no justifiable reason for treating competing tax liens differently").¹⁵ In accordance with the intent of Section 724(b) to keep the status of the senior and junior lienors intact, at the time of filing this Court requires (1) a listing of all lien holders under applicable non-bankruptcy lien law and then (2) an orderly subordination of all tax claims to administrative claims pursuant to Section 724(b).¹⁶ Therefore, in the present case, considering the status of

¹⁴ "A more detailed analysis of the legislative history of that provision and its predecessors, however, shows that in section 724(b)(1) Congress did not establish a federal system of priorities between tax and nontax liens. That history establishes that Congress intended, in bankruptcy proceedings, for the relative priority of tax and nontax liens to be determined *according to the law that governs the priority of these competing interests outside of bankruptcy.*"(emphasis supplied). Id. at 1171.

¹⁵ The language of § 724(c) also supports this interpretation.

"If more than one holder of a claim is entitled to distribution under a particular paragraph of subsection (b) of this section, distribution to such holders under such paragraph *shall be in the same order as distribution to such holders would have been other than under this section.*"(emphasis supplied).

11 U.S.C. § 724(c).

¹⁶ The purpose of the statute is to subordinate senior tax liens and not to elevate junior tax liens which clearly would not leave junior and senior lienors in the same position of priority. See In re Darnell, 834 at 1268 ("In such a situation, treating both tax liens as "priorities" under § 724(b)(2) and (3) would result in elevating the concededly "junior" tax lien above the lien occupying the superior position under § 724(b)(4). [Footnote omitted]. This result cannot be squared with the stated Congressional intent that the status of senior and junior lienors remain intact under the current Code"). Accordingly, this Court holds that when initially administering the estate pursuant to § 724(b) "such" tax lien refers only to the tax lien(s) which is/are senior to all other liens under applicable non-bankruptcy lien law and that all other junior liens, whether tax liens or not, shall be viewed as § 724(b)(4) liens until subsequently administered. As the distribution proceeds, each § 724(b)(4) tax lien shall be administered and subordinated pursuant to § 724(b)(2) and (3).

the claims at filing, pursuant to Section 724(b) the appropriate method of distribution after listing all liens under applicable non-bankruptcy law is as follows:

Estimated Amount to be Distributed = \$462,000

Order of Distribution Pursuant to 724(b);

1. 724(b)(1) lien;

- a. Liens on property senior to such tax lien
- b. Here, none exist because under state law the highest priority lien is Chatham County's claim for \$28,000

Balance = \$462,000
Amt. Distr. = \$0
Remainder = \$462,000

2. 724(b)(2) tax lien;

- a. Administrative claims to the extent of County's secured lien arising from residential property (\$28,000)
- b. Administrative claims = \$100,000 (estimated)
- c. Chatham County ad valorem taxes for years 1993 and prior = \$28,000

Balance = \$462,000
Amt. Distr. = \$28,000
Remainder = \$434,000

3. 724(b)(3) tax lien;

- a. County's claim to the extent that its allowed claim (\$28,000) exceeds administrative claim (\$100,000) = 0

Balance = \$434,000
Amt. Distr. = \$0
Remainder = \$434,000

4. 724(b)(4) lien;

- a. Junior Lienor (1)
- b. First Mortgage Holder Mellon Bank = \$384,000

Balance = \$434,000
Amt. Distr. = \$384,000
Remainder = \$50,000

5. 724(b)(4) lien;

- a. Junior Lienor (2)
- b. Second Mortgage Holder; Here, none exist.

Balance = \$50,000
Amt. Distr. = \$0
Remainder = \$50,000

6. 724(b)(4) tax lien;

- a. Secured tax liens in amount of \$9,000 arising from commercial properties pursuant to O.C.G.A. § 48-2-56, but subordinated in accordance with 724(b)(2) to remaining administrative claims to the extent of the allowed tax claim¹⁷
- b. Remaining balance of administrative claims = \$72,000
- c. Perfected tax liens arising from commercial properties = \$9,000

Balance = \$50,000

¹⁷ In effect, this is a § 724(b) analysis within a § 724(b) analysis. Again, this Court will first prioritize all liens in accordance with applicable nonbankruptcy law and then subordinate each tax lien in order as the distribution proceeds. See In re Darnell, 834 F.2d at 1269 ("Admittedly, resort to nonbankruptcy law to determine the status of competing tax liens may, in certain instances, require a complex and sophisticated distribution analysis. (footnotes omitted) However, the result is inescapable where the intent of Congress is manifested by both the express language of § 724(b) of the Code as well as the stated purpose to continue prior practice without substantial modification").

Amt. Distr. = \$9,000
Remainder = \$41,000

7. 724(b)(4) tax lien;

- a. County's claim to the extent that its allowed tax claim arising from commercial property pursuant to O.C.G.A. § 48-2-56 exceeded administrative claim
- b. Amount County's tax claim arising from commercial real estate (\$9,000) exceeds balance of administrative claims (\$72,000) = \$0

Balance = \$41,000
Amt. Distr. = \$0
Remainder = \$41,000

8. 724(b)(5) tax lien;

- a. Tax lien subordinated from 724(b)(2) status; County's tax claim arising from residential property subordinated to administrative claims
- b. Amount of tax claim subordinated from 724(b)(2) = \$28,000

Balance = \$41,000
Amt. Distr. = \$28,000
Remainder = \$13,000

9. 724(b)(5) tax lien;

- a. Tax lien subordinated from 724(b)(4) status; County's tax claim arising from commercial property pursuant to O.C.G.A. §48-2-56 subordinated to administrative claims
- b. Amount of tax claim subordinated from 724(b)(4) = \$9,000

Balance = \$13,000
Amount Distributed = \$9,000

Remainder = \$4,000

10. 724(b)(6);

- a. The Estate, including administrative claims and unsecured creditors pursuant to 11 U.S.C. §726.

The above distribution represents a hypothetical distribution at the time of filing. First, all liens both tax and non-tax are listed in order of priority according to state law. Second, as the distribution proceeds beginning with the senior lien, in each instance where Trustee encounters a qualifying tax lien, Section 724(b) permits the subordination of that lien and the elevation of administrative claims equal to the amount of the tax lien. Accordingly, Trustee may not elevate junior tax liens to senior status and when subordinated each tax lien retains its relative degree of seniority within the group of subordinated tax liens.

In the present case, however, the analysis is not complete. Since Debtor converted to a Chapter 7 in September 1994, two significant changes have occurred affecting the order of distribution. First, Mellon Bank's claim has been satisfied through the consent of the participating creditors, Trustee, and this Court. More importantly, the Chatham County tax liens arising from the commercial property

were paid, post-foreclosure and no longer attach to the residential property.¹⁸ Thus, the final issue to be resolved is whether Trustee may still subordinate "fictitious" tax liens because they existed at the time of filing. I hold that when applying Section 724(b) only liens that exist at the time of distribution may be subordinated by Trustee. See In re K.C. Machine & Tool Company, 816 F.2d 238, 245 (6th Cir.1987)("the language of Section 724(b) providing that 'property in which the estate has an interest . . . shall be distributed' does not make Section 724(b) distribution of all property in the estate at the time of conversion to Chapter 7 liquidation mandatory. Rather, Section 724(b) merely mandates a particular method of distribution of what property is left in debtor's estate at the time of distribution"). It would be illogical to focus on the property remaining at distribution and the liens present at conversion. Therefore, I hold that liens extinguished before distribution may not be subordinated by Trustee.

In the present case, by removing the junior lienor and extinguishing the lower tax liens, the result is that the only remaining claimants are (1) Chatham County for ad valorem taxes which arose from the residential real estate itself, (2) the administrative claimants, and (3) the unsecured creditors of the estate. Trustee is authorized to distribute the remaining proceeds first under Section 724(b)(2) to the

¹⁸ As mentioned in part I of this discussion, Trustee may not recover the funds paid after foreclosure to satisfy tax liens on the commercial property because they are not proceeds of the estate.

administrative claimants to the extent of the Chatham County's allowed tax claim arising from the residential real estate; second, pursuant to Section 724(b)(5) to Chatham County's subordinated tax lien; finally, the remainder to the estate pursuant to Section 726.

IT IS SO ORDERED.



Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This 29th day of January, 1996.