

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))

Debtors)

FILED
at 12 O'clock & 45 min PM
Date 5-29-96

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

WILEY A. WASDEN, III)
TRUSTEE)

Plaintiff)

v.)

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

Defendants)

ORDER ON MOTION FOR RECONSIDERATION

In the above Motion, Trustee asserts that this Court's previous Order of January 30, 1996, is in error principally because the Court failed to consider the

effect of 11 U.S.C. Sections 724(b) and 362(a). Trustee requests the Court to reconsider two issues:

(1) the divestiture of Trustee's Section 724(b) right to subordinate tax liens by a lender through the foreclosure of property; and

(2) this Court's exclusion of the 1994 and 1995 County tax figures from its Section 724(b) tax lien "carve out."

For the foregoing reasons, Trustee's motion will be granted, but solely for the purpose of expanding on the rationale, not the outcome of the prior order.

- I. Trustee seeks a reconsideration of this Court's decision to allow the unilateral divestiture of Trustee's 11 U.S.C. Section 724(b) rights by a lender through foreclosure of property.

Trustee initially requests this Court to reconsider its reliance on the interpretation of "proceeds" in the previous Order which effectively terminated Trustee's Section 724(b) rights upon foreclosure. Although Trustee does not refute the Court's interpretation of the U.C.C. definition, Trustee instead requests that the Court focus on the definition of "property of the estate" which as he contends includes Trustee's right to fund the administration of the estate and subordinate ad valorem tax

liens whether before or after foreclosure.

Specifically, Trustee appears to take issue with the language of the original order which stated that "because Trustee's title is derivative of Debtor's title, I cannot construe a post-foreclosure payment . . . to be proceeds of property in which the estate has an interest." Matter of Hernandez, Adv. Pro. No. 95-4047, Chap. 7 Case No. 93-40680, slip op. at 17 (Bankr.S.D.Ga., Feb. 9, 1996)(Davis, J.). Trustee contends that this Section 724(b) right does not derive from Debtor and, instead, is a grant from Congress and that the payment of these taxes amounts to a post-petition transfer that should be avoided under Section 549. While that may be arguable, I construe Section 724(b) only as a distribution priority provision which governs the order of distribution of estate property, but which has no impact on what constitutes estate property. Trustee cites In re Forrest Marbury, 137 B.R. 554, 556 (Bankr.D.Col. 1992), for the proposition that Congress has granted each Chapter 7 trustee a Section 724(b) right to fund the administration of an estate.¹ However, Trustee's reliance on the Forrest Marbury opinion is misplaced.

In re Forrest Marbury, 137 B.R. at 556, approvingly cites In re K.C.

¹ In his brief, Trustee states "[i]t is the benefit to the estate that results from subordination that is 'property'." See Trustee's Brief in Support of Motion for Reconsideration, p. 6.

Machine & Tool Company, 816 F.2d 238 (6th Cir.1986), for the proposition that "[b]ecause trustee's Section 724(b) right promised a benefit to the estate and therefore made it in the interest of the estate to retain the property," compelled abandonment may be inappropriate even if no equity existed in the property. In re Forrest Marbury, 137 B.R. at 556. This court agrees. However, Trustee views this "benefit to the estate" not as a defense to a motion for abandonment, but as establishing a new property right. I disagree.

If an estate contains a piece of property whose liens are greater than the fair market value, both Forrest Marbury and In re K.C. Machine & Tool Company recognize that compelled abandonment may be inappropriate because if the trustee sells the property, Section 724(b) still affords a benefit to the estate in permitting payment of some of the administrative claims incurred. In In re K.C. Machine & Tool Company, the trustee had arranged a sale and the Sixth Circuit Court of Appeals held that a trustee's Section 724(b) right to subordinate a tax lien promises a benefit to the estate that defeats a motion for abandonment, even if no equity exists. Here, Trustee, relying on Forrest Marbury and In re K.C. Machine, argues that he has an independent right to collect the amount of unpaid taxes, without remitting to the taxing authority, and subordinate the tax liens regardless of whether or not he sells the property. However, the Sixth Circuit Court of Appeals only stated that:

. . . the trustee's argument that § 724(b) creates *some benefit* to debtor's estate, *precluding abandonment*, has more merit. In re K.C. Machine & Tool Company, 816 F.2d at 245 (emphasis added); . . . § 724(b) subordination of tax liens to administrative expenses creates value or benefit to the debtor's estate *for purposes of § 554(b) abandonment proceedings*. Id at 244 (emphasis added).

This analysis falls far short of establishing a Trustee's independent right under Section 724(b) to collect tax payments and subordinate all tax liens attaching to property of the estate in the absence of actually selling the property. According to Trustee's rationale, this independent right permits him to require all lenders who are about to begin foreclosure proceedings to turnover an amount equal to all ad valorem tax liens to the estate for the potential benefit of administrative claimants such as Trustee. The end result is that proceeds which would otherwise be paid to the taxing authorities would instead be used to pay at least a portion of Trustee's administrative claims whether or not Trustee actually participated in the disposition of the asset.

This expansive interpretation of the Code ignores a central tenet of bankruptcy law: liens pass through bankruptcy unaffected by a discharge. See Long v. Bullard, 117 U.S. 617, 620-621, 6 S.Ct. 917, 918, 29 L.Ed. 1004 (1886). Trustee appears to assume that Section 724(b) establishes an independent power to discharge

liens of the taxing authority without actually selling the property. I hold that Section 724(b) is more limited. Section 724(b) merely subordinates payment of a tax claim after the tax lien has been removed from the real estate. Thus, Section 724(b) necessarily contemplates utilization of another Code section that authorizes the stripping of liens. Here, Trustee requests of this Court to grant him authority to strip liens without evoking 363(f) or some other power in the Code.² Again, liens pass through bankruptcy unaffected. Without an express provision authorizing the extinguishment of a lien, I hold that Trustee may not strip and subordinate tax liens by solely relying on Section 724(b).³ Furthermore, Trustee misinterprets the holding of Forrest Marbury and the purpose of Congress in enacting Section 724(b). Congress

² Presumably, the trustee could extinguish the liens pursuant to 11 U.S.C. 363(f); however, that section requires the trustee to sell the property if he establishes one of five requirements. Section 363(f) provides as follows: The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if-- (1) applicable non-bankruptcy law permits sale of such property free and clear of such interest; (2) such entity consents; (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property; (4) such interest is in bona fide dispute; or (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest. See 11 U.S.C. § 363(f).

³ Courts have recognized the right of a trustee to extinguish a tax lien through an expansive interpretation of 724(b) and 363(f) if the trustee sells the property. See In re Grand Slam U.S.A., Inc., 178 B.R. 460 (E.D.Mich.1995)(Court approved sale of property of the estate free and clear of County's tax lien pursuant to 11 U.S.C. § 363(f)(5)); Matter of Tabone, Inc., 175 B.R. 855 (Bankr.D.N.J. 1994)(Court approved sale of property of the estate free and clear of County's tax lien pursuant to 11 U.S.C. § 363(f)(2) and (3)); In re Healthco International, Inc., 174 B.R. 174 (Bankr.D.Mass. 1994)(Court approved sale of property of the estate free and clear of County's tax lien pursuant to 11 U.S.C. § 363(f)(5)); In re A.G.Van Metre, Jr., Inc., 155 B.R. 118 (Bankr.E.D.Va. 1993)(Court approved sale of property of the estate free and clear of County's tax lien pursuant to 11 U.S.C. § 363(f)(3)). Each case involved a trustee's sale and I have not found a case which supports the trustee's position in the absence of a sale, other than Forrest Marbury, where the lien was extinguished by payment and not through Section 724(b) alone.

did not intend for a trustee to use Section 724(b) to attach monies rightfully belonging to the taxing authorities to pay administrative claims absent discharge of the lien. Instead, Congress established Section 724(b) as a vehicle to benefit the estate and to provide at least partial funding to administrative claims pursuant to Section 363(f) and 724(b) when the trustee has actually sold an asset free and clear of liens or in some other manner succeeded in removing the lien from the real estate.

In conclusion, I hold that Trustee does not possess an independent right to collect the amount of unpaid taxes and subordinate tax liens to the administrative claimants unless the lien is removed from the real estate through some other provision of the Code.⁴

II. "The Court erred in not including the 1994 and 1995 County Property Taxes in calculating the tax lien amount to be subordinated pursuant to section 724(b)."

Trustee requests that the Court include the tax years 1994 and 1995

⁴ Within its brief, Trustee also asserts in the alternative that pursuant to Section 550 he may recover from the taxing authorities payments made pre-foreclosure that extinguished the O.C.G.A. § 48-2-56 tax liens which attached to the Herb River Drive property. As to Section 724(b), this argument is without merit and only supports this Court's previous discussion. Section 550 permits recovery of transfers avoided under sections 544, 545, 547, 548, 549, 553(b), or 724(a). See 11 U.S.C. § 550(a). By including all of the provisions by which a trustee may avoid a transfer and making no mention of Section 724(b), Congress evidenced no intent that Section 724(b) be used as an "independent" avoidance provision. Therefore, the Trustee's alternative contention is denied.

within its order. Although throughout these proceedings Trustee had maintained that that 1994 and 1995 tax claims are entitled to Chapter 11 and 7 administrative expense status respectively, Trustee now requests this Court to reconsider and treat his prior position as incorrect. For the foregoing reasons, I hold that Trustee correctly classified the 1994 and 1995 tax claims as Chapter 11 and 7 administrative claims respectively.

In pertinent part, 362(a) provides as follows:

[A] petition filed under . . . this title . . . operates as a stay, applicable to all entities, of . . . (4) any act to create, perfect, or enforce any lien against the property of the estate.

11 U.S.C. § 362(a)(4). This Code provision prevents the perfection of property tax liens which come into existence after the petition date. In lieu of the super-priority position normally enjoyed by these ad valorem tax claims outside of bankruptcy, section 507(a) of the Code provides that tax claims arising post-petition are usually afforded a status of administrative priority. Until this Motion, Trustee generally acknowledged the effect of Sections 362(a)(4) and 507(a) on post-petition tax claims arising against property of the estate; however, he now argues that the post-petition tax liens should receive their state law super-priority position and then be subordinated

pursuant to Section 724(b) in favor of administrative claims.

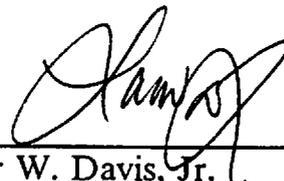
In support of his position, Trustee cites In re Thurman, 163 B.R. 95 (Bankr.W.D.Tex. 1994), which holds that post-petition property tax liens fit within an annual exception provision of Section 362(b)(3), are perfected for purposes of Section 724(b), and do not violate the automatic stay. Moreover, the Thurman Court also holds that acts in violation of the automatic stay are voidable and not void. I find that the position the Thurman Court is contrary to the weight of judicial authority. See In re Parr Meadows Racing Association, Inc., 880 F.2d 1540 (2nd Cir.1989)(holding that automatic stay prevents the perfection of post-petition county liens which, in any event, would be void if perfected); Equibank, N.A. v. Wheeling-Pittsburgh Steel Corp., 884 F.2d 80, 84 (3rd Cir.1990); Makoroff v. City of Lockport, N.Y., 916 F.2d 890 (3rd Cir.1990); In re C.S. Associates, 29 F.3d 903 (3rd Cir.1994)(holding that [s]ection 503 indicates that post-petition tax claims are generally afforded the status of ordinary administrative expenses, unless they are the type of taxes specified in Section 507(a)(7)); In re Glaspy Marine Industries, Inc., 971 F.2d 391, 395 (9th Cir.1992)(holding that state property tax statutes fail to establish a present interest sufficient to trigger 546(b)); In re Formisano, 148 B.R. 217, 225 (Bankr.D.N.J. 1992)(holding that as to post-petition taxes, the automatic stay prevents the creation of a lien post-petition); Matter of Guterl Special Steel Corporation, 111 B.R. 107, 113

(Bankr.W.D.Pa. 1990)(holding that post-petition tax liens violate the automatic stay and, therefore, are null and void). Accordingly, I hold that the automatic stay prevents the perfection of tax liens arising post-petition and, in the alternative, they are void if perfected. Trustee's initial proposal to treat the 1994 and 1995 tax claims as Chapter 11 and 7 administrative claims respectively is the appropriate disposition of these claims.

ORDER

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that the Motion for Reconsideration is granted, not as to the result, but to enunciate a more comprehensive rule for the application of 11 U.S.C. Section 724(b). While the "proceeds" rationale of the prior ruling is, in my view, still valid as an alternative holding, the more comprehensive approach is as follows: The Trustee may not exercise Section 724(b) distribution priorities as to tax lien claimants in the absence of extinguishment of the lien against the real estate. Such extinguishment can be accomplished only within the parameters of due process, as for example, by a motion or adversary proceeding for sale of property free and clear of liens, with the liens attaching to proceeds. In the absence of an order authorizing a sale free and clear, after notice and a hearing, or a lien avoidance under some "strong arm" power of the trustee, a payment, pre or post-foreclosure measured by or

intended to satisfy the lien on realty, must be paid to the taxing authority. After the lien is cancelled by payment, the Trustee's remedy, if any, is an action under 11 U.S.C. Sections 547 or 548, against the taxing authority.



Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This 28th day of May, 1996.