

# In the United States Bankruptcy Court

## for the Northern District of Iowa

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HENKE MANUFACTURING CORP.

Bankruptcy No. L92-00873W

*Debtor(s).*Chapter 11

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### ORDER RE: IRS' OBJECTION TO CASH COLLATERAL AGREEMENT

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The matter before the court is the Internal Revenue Service's (IRS) objection to a cash collateral agreement entered into by the debtor and two of its secured creditors. Hearing on the objection was held on November 17, 1992, in Cedar Rapids, Iowa.

The agreement was among the Henke Manufacturing Corp. (DEBTOR or HENKE), National Bank of Waterloo (BANK) and Steel Warehousing, Inc. (STEEL). It was filed July 22, 1992, and notice of the agreement was given to creditors pursuant to Fed.R.Bankr.P. 4001(d)(1). The only objection was filed by the United States on behalf of the Internal Revenue Service.

The agreement permits the debtor to use cash collateral of Bank and Steel to the extent of \$210,000.00 per month through August 31, 1992.<sup>(1)</sup> As adequate protection for such use, debtor would provide the two creditors, with replacement liens in debtor's post-petition assets. Also, debtor would pay Bank \$5,601.70 per month, representing post-petition interest on the Bank's pre-petition secured claim. Debtor agreed also to keep the creditors' hard collateral insured, provide reports and to limit the compensation of Debtor's chief executive.

The agreement was the result of the settlement of the debtor's resisted effort to use cash collateral which was begun by motion in May. The motion alleged the interests held by Bank and Steel in property owned by the debtor. It also acknowledged the potential secured claim of the IRS. In its motion, debtor contended that the IRS "would be adequately protected by granting [it] a replacement lien in Debtor's after-acquired accounts receivable, cash and inventory of the same priority and validity as [it] enjoyed prior to Debtor's filing but only to the extent of any equity position which [it] may have held in Debtor's assets prior to the filing of the petition." Motion for Authority to Use Cash Collateral, Contested No. 2133, Docket No. 8, page 2, filed May 6, 1992.

The IRS filed no objection to the Debtor's initial motion seeking authority to use the cash collateral of the secured the application for continued use, but this objection was resolved at a hearing on October 14. The court entered an order permitting further temporary use through October 23. The parties have agreed that temporary use may continue until the court rules on the IRS objection. If the agreement is approved, it would permit the use of cash collateral through November 30, 1992, a date which has now passed. However, debtor and Bank have agreed to the extension of their agreement through January 1, 1993.

creditors. It objects, however, to the agreement reached among Debtor, Bank and Steel. IRS claims that it has a perfected tax lien against the commercial paper, accounts receivable and inventory acquired by the Debtor after June 4, 1992, and that the lien is superior to any lien which Bank and Steel may have in such property. IRS objects to the agreement because it fails to provide IRS with adequate protection of its interest in the collateral.

No evidence was presented at the hearing, the parties believing that the matter involved undisputed facts and a dispute over the law. The essence of the dispute, as the court now views it, is that the IRS does not think that Bank and Steel should get adequate protection for the use of their collateral because the debtor has not offered the same protection to the IRS. The court finds two things odd about the IRS position. First, the lack of adequate protection of the IRS interest in debtor's property would be a basis for objecting to debtor's use of cash collateral in which the IRS had an interest. It is

an unlikely reason for objecting to the protection to be given to other creditors for the use of their collateral, especially when the IRS does not object to the existence of that interest but only to its priority in relation to the IRS as to some, but not all, of the collateral.

Second, the debtor, in its original motion, proposed the use of cash collateral through the end of July, 1992, and it alleged that any interest of the IRS would be adequately protected by a replacement lien of the same priority and validity as it enjoyed pre-petition. The IRS did not object to this treatment. Bank, however, objected to the treatment originally proposed for it and that objection led to the settlement which is before this court. While the settlement and the IRS objection to it have been pending, Bank and Debtor have agreed, in writing and orally, to extensions so that the Debtor would have cash collateral available to it under roughly the same terms and conditions through January 1, 1993.

IRS does not seem really to object to the Bank and Steel obtaining adequate protection, so long as IRS receives adequate protection also. The IRS objection has locked IRS and Bank in a dispute over the relative priority of their respective liens in the debtor's accounts receivable and inventory acquired after June 4, 1992. Bank believes that IRS has no lien in debtor's post-petition accounts or inventory. IRS contends that under 26 U.S.C. § § 6321 and 6323, it has a tax lien superior to the Bank in debtor's accounts receivable and inventory acquired after June 4, 1992. The parties agree that if Bank is correct, IRS's lien is not entitled to adequate protection because it is likely valueless. If the IRS is correct and it has a first priority lien on debtor's accounts and inventory acquired after June 4, then that interest is entitled to adequate protection and the debtor may not use such collateral without providing it.

## I.

Believing the dispute to be primarily a legal one, the parties have not introduced evidence to enable the court to determine the value of accounts or the dollar amount of inventory which existed either prior to or subsequent to the filing of bankruptcy. Nor could the court determine the value of the IRS's lien on the date of filing. Debtor filed a statement with the court attempting to set out some figures and estimating that accounts receivable arising after June 4, 1992 were more than adequate to protect the claim of the IRS if the IRS lien is prior to the Bank's and thus entitled to protection. Because of the lack of evidence, it is impossible to determine whether this is so. IRS has indicated that it would accept as adequate protection monthly payments in an amount equal to eight per cent per annum on its claim.

First, however, the court will deal with the adequate protection offered to the bank. The court does not consider that the IRS's objection to the adequate protection/cash collateral agreement between Bank and Debtor is valid. IRS has not offered a substantive objection to it. It argues only that Bank and Steel should not get protection because IRS has not gotten any. Such an objection goes to whether Debtor should be able to use IRS's cash collateral, a point to be addressed shortly. IRS concedes that the Bank has a security interest in accounts receivable and inventory existing pre-petition. IRS also does not dispute that Bank would have a security interest in proceeds of such inventory sold post-petition. IRS does not argue that the adequate protection being given to Bank or Steel is improper. That the IRS is not pleased with the adequate protection being given it is not a valid reason for refusing to approve Debtor's agreement with Bank and Steel. Accordingly, Debtor's agreement to use cash collateral and provide adequate protection to Bank and Steel will be approved with the period of use extended to and including January 1, 1993.

## II.

Debtor's proposed use of IRS's cash collateral for the period from May 1, 1992 through August 11, 1992 is also approved. Debtor's initial proposal filed May 6, 1992, acknowledged that the IRS might claim a federal tax lien against its accounts, cash and inventory. It proposed to use the collateral through July 31, and stated that the adequate protection to be provided would be to afford IRS a replacement lien in debtor's post-petition accounts, cash and inventory of the same priority and validity as the IRS enjoyed pre-petition. To this, the IRS filed no objection. The first objection filed by IRS was to the agreement reached between Debtor and Bank and Steel. The objection was filed August 11, 1992. That objection was the first indication given the court that IRS objected to the use of its cash collateral. Accordingly, the court will approve the debtor's proposed use of IRS's cash collateral through August 11, 1992.

The court will now consider that IRS objects to Debtor's use of IRS's cash collateral--inventory and accounts--after August 11, 1992, and that Debtor's offer of adequate protection for such use is the provision of a replacement lien as before. Debtor also offers monthly interest payments. IRS is willing to accept the offer, if the court determines that the

IRS's lien is entitled to adequate protection.

The court finds and concludes that it is. Absent bankruptcy, the IRS would have a lien on all property of Debtor from the date of assessment of the tax. 26 U.S.C. § 6321. However, the lien is not valid against certain third parties, including the holder of a security interest, until notice of the lien has been filed. 26 U.S.C. § 6323(a). And, "[e]ven though notice of a lien . . . has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing but which . . . is in qualified property. . . . 26 U.S.C. § 6323(c)(1)(A). "Qualified property" includes accounts receivable and inventory (26 U.S.C. § 6323(c)(2)(C)) which is acquired by the taxpayer within 45 days of the filing of the notice of lien. 26 U.S.C. § 6323 (c) (2) (B). Because the notice of tax lien was filed in this case on April 20, 1992, the IRS claims a first priority lien on all accounts and inventory acquired by the debtor beginning on the 46th day after filing of the notice--beginning June 5, 1992. IRS contends that as to such collateral, it has a lien prior to the lien of the Bank as provided under the adequate protection agreement. Bank, on the other hand, argues that the filing of the chapter 11 petition cuts off the attachment of the IRS's tax lien in property acquired post-petition.

Absent bankruptcy, the IRS would achieve a priority position over the Bank under 26 U.S.C. § 6323(c). And absent bankruptcy, the IRS's federal tax lien would continue to attach to any property acquired by the debtor. Glass City Bank v. United States, 326 U.S. 265 (1945); Seaboard Surety Co. v. United States, 306 P.2d 855, 859 (9th Cir. 1962).

Although Bank argues that the filing of bankruptcy cuts off the IRS's lien in after-acquired property, it admittedly can cite no case or statutory authority directly supporting the proposition. The court believes there is none. The Bankruptcy Code, 11 U.S.C. § 552(a), provides that "property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." 11 U.S.C. § 552(a). This section does not apply to non-consensual, statutory liens. Also, the automatic stay prevents creditor acts to create or perfect a lien against property of the estate. 11 U.S.C. § 362(a)(4). In the case of a federal tax lien where notice has been properly filed pre-petition, the lien arises automatically post-petition and not by any action taken by the IRS.

As harsh as it may seem, a federal tax lien continues to attach to property of the debtor and the estate after the filing of bankruptcy. In re National Financial Alternatives, Inc., 96 B.R. 844, 849 (Bankr. N.D. Ill. 1989). Bank has not been able to point to anything in the Bankruptcy Code which would prevent this. It does argue that the debtor-in-possession is a "separate entity" for bankruptcy purposes and that thus its property is not subject to a lien for debtor's federal taxes. However, the court agrees with counsel for the IRS that this theory has been discredited by the United States Supreme Court. N.L.R.B. v. Bildisco & Bildisco, 104 S.Ct. 1188, 1197 (1984). See also, In re Mohar, 140 B.R. 2731 279 (Bankr. D. Mont. 1992).

Under 11 U.S.C. § 545(2), a debtor might seek to avoid the statutory lien of the IRS in the accounts and inventory acquired by a debtor after filing, but this Debtor has not sought to do. To the extent the debtor could avoid the IRS's statutory lien in such property, the debtor could preserve the lien for the estate. However, absent avoidance, the IRS's lien has attached to debtor's accounts and inventory acquired after June 4, 1992. The IRS's lien is superior to any interest of Bank or Steel granted as adequate protection. IRS recognizes that Bank has a superior lien to it in accounts and inventory acquired after the notice of lien but before the filing of bankruptcy and in qualified proceeds of Bank's pre-petition collateral. In re National Financial Alternatives, Inc., 96 B.R. 844, 850-854 (Bankr. N.D. Ill. 1989); 26 CFR § 301.6323(d).

IT IS ORDERED that the cash collateral agreement among Henke Manufacturing Corp., National Bank of Waterloo, and Steel Warehousing, Inc. is approved, effective through January 1, 1993.

IT IS FURTHER ORDERED that Debtor's Motion to Use Cash Collateral of the IRS is approved through August 11, 1992, with adequate protection provided to the IRS as proposed in the motion of May 6, 1992.

IT IS FURTHER ORDERED that debtor may use cash collateral of the IRS after August 11, 1992, and to January 1, 1993 with adequate protection provided to the IRS as proposed in the motion of May 6, 1992, as provided in paragraph 5 of the agreement with Bank, and by paying IRS monthly payments equal to eight per cent per annum of the IRS claim.

SO ORDERED ON THIS 4th DAY OF DECEMBER, 1992.

William L. Edmonds  
Chief Bankruptcy Judge

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1. Debtor filed its chapter 11 case on May 1, 1992. In an order dated May 7, the court allowed interim use of collateral pending hearing on the Motion for Authority to Use Cash Collateral. The dispute among debtor, Bank and Steel was resolved on the day of the scheduled hearing. The court continued the temporary use of cash collateral pending service of the agreement pursuant to the Rules. After IRS objected to the settlement agreement, Debtor applied for continued use under the same temporary conditions, pending hearing on the IRS objection. Hearing on the continued temporary use was scheduled for the same date as the hearing on the IRS objection. Bank objected to the application for continued use, but this objection was resolved at a hearing on October 14. The court entered an order permitting further temporary use through October 23. The parties have agreed that temporary use may continue until the court rules on the IRS objection. If the agreement is approved, it would permit the use of cash collateral through November 30, 1992, a date which has now passed. However, debtor and Bank have agreed to the extension of their agreement through January 1, 1993.