In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

JAMES ARNOLD TENEYCK and SUSAN RENEE TENEYCK — Bankruptcy No. X91-00487S

Debtors. — Chapter 7

ORDER RE: OBJECTION TO TRUSTEE'S FINAL REPORT

Gene and Hazel Beam object to the trustee's "Final Report and Account." Hearing was held on March 16, 1993, in Sioux City. Donald Molstad appeared as trustee; A. Frank Baron appeared as attorney for Beams; Calvin Moss appeared as attorney for Defiance State Bank, an unsecured creditor.

I.

James and Susan TenEyck (DEBTORS), husband and wife, filed their joint chapter 7 petition on March 18, 1991. Debtors scheduled an ownership interest in lot three (3), block three (3) in Dow City, Crawford County, Iowa. The property was the site of a convenience store which had been operated by debtors prior to filing. The store was referred to at trial and will be referred to in this decision as either a "handimart" or "minimart". Debtors scheduled as priority creditors the Internal Revenue Service, the Iowa Department of Revenue, and the Job Service of Iowa. The debt to the IRS was scheduled in the amount of $5,700.00 and was described as "FICA - nondischargeable." The debt to IDOR was scheduled in the amount of $1,800.00 as "sales tax." The debt to Job Service was scheduled at $140.46 without description.

Gene Beam, Susan TenEyck's father, held a mortgage against the minimart real estate. The mortgage was recorded in Crawford County on August 8, 1990. (Order, January 6, 1992, Docket no. 34) Donald Molstad, the case trustee, believing the mortgage to be a preferential transfer, instituted an adversary proceeding against Beam to avoid the transfer of the mortgage. Trustee and Beam settled the dispute with Beam agreeing to pay the estate $5,000.00 in return for the trustee's transfer of the property to him free and clear of all liens. Trustee's "Motion to Sell Free and Clear of Liens" was filed September 27, 1991 as contested matter 5151. (Docket no. 24) The sale was also to involve the assignment to Beam of the trustee's rights to state assistance in rehabilitating the property from environmental problems. Notice of the motion was filed and served on September 27. Neither the motion nor the notice mentioned federal tax liens filed against the property by the IRS on March 25, 1991 and April 1, 1991. Nor did they mention the "Notice of Lien" filed against the property on March 27, 1991 by Job Service of Iowa. The notice of the sale was served on the IRS at its office in Des Moines, Iowa; it was not served on the United States Attorney for the Northern District of Iowa. It was not served on the Job Service of Iowa. The trustee did not believe these liens to be valid because they were filed after the filing of the petition.

The Iowa Department of Natural Resources filed a "Response" to the Notice and Motion, requesting that before the sale be approved, assurances be required showing that Beam was entitled to state help on the site cleanup and that he was otherwise financially capable of completing the cleanup. (Docket no. 26) A settlement entered into among Beam, the Department of Natural Resources and the trustee (Docket no. 31) led to the approval of the sale. The court's "Order Approving Settlement and Sale" was entered January 6, 1992. It provided for the sale of the property to Beam for $5,000.00. The sale was to be free and clear of liens, including Beam's mortgage. Beam's mortgage lien was by agreement not to attach to the proceeds of sale. There was no mention of other liens attaching to proceeds as Molstad had not, in his motion, alleged the existence of other liens.

On February 10, 1992, the IRS contacted Susan TenEyck by telephone at her home. The IRS agent told her that if certain taxes were not paid by the end of that week, the IRS would foreclose on the couple's home, garnish any wages and take away the couple's vehicles. Upset, Susan TenEyck called her father and asked him to find her husband at work and have him call home. She briefly explained the problem to her father, who later came to her house to talk to her about it. She told him that they owed the debt to the IRS from the operation of the minimart, and she reiterated the threats of the IRS. Beam then called the IRS and talked to an agent located in Council Bluffs, Iowa. He discussed the IRS claim, the lien against the minimart, and learned that the IRS was not aware of the bankruptcy.

After his call to the IRS, Beam told his daughter that he would deposit money in her account to pay the IRS. He told her to write the IRS a check for $6,680.83; he also told her to note on the check "payed (sic) in full taxes", which she did. The check was sent that day. The following day, February 11, 1992, Beam deposited $6,680.00 in his daughter's account at Crawford County Trust & Savings Bank. The deposit was made by check drawn on an account of Beam's wife, Hazel, at the same bank. Beam says he handled the payment through his daughter's account because he believed that if he paid the IRS directly, the IRS would not know who he was or how to apply the money.

Beam was not personally obligated for the debtors' taxes to the IRS. Beam, in providing the money to pay the IRS, was motivated by a desire to help his daughter who was being threatened with the loss of her home, vehicles and either or both of the debtor's wages. Beam testified he was also motivated by a desire to obtain the minimart property free and clear of liens. That desire, he says, was being threatened by the IRS's expressed intent to foreclose its alleged lien on the property. At the times he promised to provide the money and when he deposited it, Beam realized that he had reached an agreement with the trustee by which he would receive the minimart property free of liens from the estate. Nonetheless, he did not call his attorney about the IRS threat until after he deposited the money in his daughter's account. At the time he made the money available to Susan, he had no expectation that the trustee would repay him from the estate.

Susan testified that she did not consider the money received from her father as a loan or a gift. She has no agreement on repayment and does not intend to repay. She did not ask her father for the money; she did not ask her father to pay the IRS. It was his idea.

On February 18, 1992, A. Frank Baron, Beam's attorney, wrote to the trustee asking what he intended to do about removing the tax liens and some judgment liens from the property. Baron closed his letter by saying he had the purchase money available for the trustee upon the trustee's delivery of marketable title. The deed to the property was executed by the trustee on April 14, 1992; the deed and money were exchanged shortly thereafter.

The trustee filed his "Final Report and Account . . ." on January 5, 1993, giving notice to all creditors. In it, the trustee states that he has received $11,921.68 by the liquidation of assets, that he has disbursed $2,961.39 and that he has a balance on hand of $8,960.29. Of this, he proposes to pay $1,703.90 in administrative expenses, with the balance of $7,256.39 to be distributed among one priority and nine unsecured claims. The trustee proposes no distribution to Beams. He recommends disallowance of (objects to) the priority claim filed by Beams in the amount of $6,680.83.

Gene and Hazel Beam object to the "Final Report and Account" resisting the disallowance of their priority claim. Beams contend that by virtue of their providing funds for the payment of the IRS claims against the debtors, they should be equitably subrogated to the claim of the IRS and that that claim should be recognized as a priority claim and paid in full after the payment of administrative expenses.

The trustee and Defiance State Bank disagree. They argue that Gene Beam made the funds available to his daughter as a volunteer with no intent to protect his own interests and, therefore, he cannot qualify as a subrogee. Moreover, the trustee contends that Beams have failed to show to what amount of the IRS claim they might be subrogated inasmuch as not all of the IRS claim would have been a priority claim, some portion being post-petition interest and penalties and some portion being pre-petition penalties not entitled to priority status.

II.

Subrogation may be legal or conventional. Conventional subrogation arises by agreement either between the debtor and

the payor or between the payor and the old creditor. Home Owners' Loan Corp. v. Rupe, 225 Iowa 1044, 283 N.W. 108, 109 (1938). Legal subrogation arises in favor of one who to protect his or her own rights pays the debt of another. Id. There is no evidence that Beams paid the taxes under an agreement with the IRS that they be subrogated to the IRS claim against TenEycks. The evidence is contrary to any finding that Beams paid TenEycks' debt to the IRS pursuant to any agreement with TenEycks. Beams are, therefore, not entitled to conventional subrogation. The remaining question is whether Beams are entitled to legal subrogation.

Beams had no obligation to pay the IRS the taxes owed by TenEycks. Beams would be entitled to be subrogated to the IRS's claim against TenEycks only if Beams acted under some compulsion to pay in order to protect their rights, for example, if they were junior lienholders paying the senior lien for their own protection. G. S. Wormer & Sons v. Waterloo Agricultural Works, 62 Iowa 699, 702, 14 N.W. 331, 332 (1882). "But where a person is in no manner bound, and on his own motion, in the absence of a contract or expectation that he will be substituted in the place of the creditor, pays the debt, he will be regarded as an intermeddler and not entitled to subrogation." Id.; Wragg v. Wragg, 208 Iowa 939, 226 N.W. 99, 102 (1929).

Gene Beam in essence testified that in addition to helping his daughter, he paid the IRS to protect his interest in the minimart real estate. If he did so, this was a mistaken effort. From a bankruptcy perspective, the IRS lien filing violated the automatic stay of 11 U.S.C. 362. Although no relief had been sought by or granted to the IRS, it nonetheless filed a tax lien against the minimart property. It would seem that the trustee had at least two options and perhaps more. He could have joined the IRS as a party to the motion to sell the property free and clear of liens, had the lien of the IRS attach to the proceeds of sale and then institute a preference action to avoid the lien against the proceeds. In that event, the property would have passed, as intended, free and clear of liens to Beams. Or, the trustee might have attempted avoidance of the IRS lien prior to the sale of the property to Beams.

Because the trustee failed to join the IRS as a party to the motion to sell free and clear, the trustee could have instituted a proceeding against the IRS for violation of the stay. One possible remedy would have been to force the IRS to release its lien. The trustee might have sought a determination that the filing of the "Filing of the Notice of Federal Tax Lien" was ineffectual to create a lien because of the stay.

The trustee would have needed to take some action to fulfill his obligation to transfer the property to Gene Beam free and clear of liens. Beam's only obligation to the trustee was to pay the $5,000.00, which his attorney was still holding. Beam had no obligation to satisfy the IRS lien in order to obtain the property free and clear of liens. Beam was aware at the time he paid the money into his daughter's account that he was in the process of buying the property free and clear of all liens.

From a non-bankruptcy standpoint, Beam did not need to protect himself. His mortgage was recorded August 8, 1990. The IRS notices of tax lien were filed March 25, 1991 and April 1, 1991. Beam's mortgage was superior to the IRS lien. See 26 U.S.C. 6323(a); CECO Corp. v. United States, 554 F.Supp. 569, 571 (D. Minn. 1982).

Thus, if Beam paid the money under the belief that he needed to do so to protect his property interest in the minimart, he did so mistakenly. Yet, if Beam paid the IRS under an honest belief that he needed to do so to protect his property interest, he still would be subrogated to the claim he paid. 83 C.J.S. Subrogation 9, page 607. The desire to protect his interest in the minimart is sufficient to avail him of the rights of a subrogee if that desire was a motivation in the payment of the IRS debt. It need not be the primary motivation. Beam's main motivation may have been to help his daughter, but if he had any motivation to protect his own interest, that ought to be sufficient to permit him to be subrogated to the IRS claim. Said another way, if but for a desire to protect his interest in the minimart, Beam would not have provided the money to pay the IRS, he should be entitled to subrogation.

I find, however, that the desire to protect his property interest was not a motivating factor in his decision to give his daughter the money necessary to pay the IRS. At the time he paid, his sole motivation was to help his daughter--to prevent an IRS seizure of her property. His payment was admirable and understandable, it was not made with any thought or expectation that he be repaid out of the estate as the subrogee of the IRS.

I, therefore, conclude that Gene and Hazel Beam are not entitled to be legally subrogated to the claim of the IRS. Their objection to the trustee's "Final Report and Account" should be overruled. Accordingly,

ORDER

IT IS ORDERED that the objection to the trustee's "Final Report and Account" filed by Gene and Hazel Beam is overruled.

IT IS FURTHER ORDERED that the "Final Report and Account" will be approved by separate order to be submitted by the United States Trustee.

SO ORDERED ON THIS 18th DAY OF AUGUST, 1993.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on _____ I mailed a copy of this order and a judgment by U. S. mail to: Donald Molstad, Harold Van Voorhis, A. Frank Baron, Karen McCarthy and U. S. Trustee.