

In the United States Bankruptcy Court
for the Northern District of Iowa

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| CEDAR RAPIDS MEATS INC. d/b/a Farmstead Foods <i>Debtor(s).</i> | Bankruptcy No. L-90-00445C Chapter 7 |
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| MICHAEL C. DUNBAR Trustee <i>Plaintiff(s)</i> vs. CITY OF CEDAR RAPIDS IOWA and LINN COUNTY IOWA <i>Defendant(s)</i> | Adversary No. 93-1047LC |
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ORDER RE: MOTION FOR SUMMARY JUDGMENT

This matter came on for hearing before the undersigned on July 15, 1993 on Motion for Summary Judgment filed by Plaintiff Trustee Michael Dunbar in the captioned adversary matter and on Application for Allowance and Payment of Administrative Expense filed by Linn County in the captioned bankruptcy case. After the hearing, the Court took the matter under advisement and gave the parties until August 15, 1993 to file briefs. Having considered the record, arguments of counsel and briefs filed herein, the Court now makes the following ruling.

ISSUES

1. Motion for Summary Judgment

Trustee's adversary complaint names the City of Cedar Rapids ("City") and Linn County as defendants. It requests that the Court determine the treatment and subordination of the defendants' liens pursuant to 11 U.S.C. § 724(b). The City has a lien for unpaid sewer and water charges. Linn County has a lien for unpaid property taxes. These liens attached to property which has been sold free and clear of liens. By order of the court, the liens have now attached to the proceeds of the sale. Trustee argues that the defendants' liens should be subordinated to administrative expenses and wage priority claims.

2. Application for Allowance and Payment of Administrative Expense

Applicant Linn County seeks allowance and payment of postpetition taxes as an administrative expense. It seeks an order giving priority to taxes accruing after filing of the bankruptcy petition of \$414,590.48 as an administrative expense pursuant to 11 U.S.C. § 503(b). Trustee Dunbar resists the application.

Mackall, Crounse & Moore ("MC&M") resists Linn County's application as follows: It states that it holds an allowed, unpaid, administrative expense claim which is superior to Linn County's claim. There are not sufficient funds to pay all administrative expense claims. Penalties and interest added to the tax claim are also subordinate to claims under 11 U.S.C. § 507. The tax assessments were based on inflated values of real estate. The Court should only allow taxes based on actual value in light of the use made of the real estate.

UFCW P-3 and P-3 Retirees ("Union") also objects as follows: It asserts that it holds a § 507(a)(3) wage priority claim of over \$4 million and an unsecured claim of over \$20 million. Sec. 507 claims have a super priority over tax claims.

The Union also challenges the accuracy of the assessed values of the real estate. The property sold for a few hundred thousand dollars while the assessed value for property tax purposes was over \$4 million.

STATEMENT OF FACTS

Cedar Rapids Meats, Inc. ("Debtor") filed its Chapter 11 petition on March 14, 1990. The case was converted to Chapter 7 on February 4, 1991. The parties have jointly stipulated to the following facts regarding the motion for summary judgment.

During the course of the Chapter 7 proceeding, certain real estate was sold for a total price of \$175,000 free and clear of liens. The order approving the sale provided that valid liens on the real estate would attach to the proceeds of the sale. Prior to filing its Chapter 11 petition, Debtor was indebted to the City for water and sewer charges in the amount of \$268,034.59. Such charges constitute a lien on the premises under Iowa Code sec. 384.84(1). Also prior to filing bankruptcy, Debtor was indebted to Linn County for property taxes of \$268,198.07, including principal and interest. Additional property taxes accumulating post-petition amount to \$414,590.48. These property taxes constitute a lien against the property pursuant to Iowa Code sec. 445.28.

Other relevant facts are not disputed. Of the City's total claim, \$156,574.77 represents charges for services provided in 1986 and 1987. The first property taxes due to Linn County which Debtor failed to pay were those assessed for the second half of the 1988 tax year which accrued from January 1, 1989 through June 30, 1989. Thus, none of Linn County's tax lien predates the City's water and sewer charges of \$156,574.77. The remainder of the City's lien, \$110,459.82, apparently arose between January 1 and March 14, 1990.

Pursuant to order of this Court, MC&M holds an administrative claim for services rendered as attorney for Debtor. Some of the fees and expenses awarded have not yet been paid. This claim constitutes compensation and reimbursement awarded under 11 U.S.C. § 330(a) and has administrative expense priority under § 503(b)(2). A report filed by MC&M on June 22, 1992 indicates that the total claim exceeds \$150,000.

The Union has a wage priority claim under § 507(a)(3) of \$4,150,000. It also has an allowed unsecured claim of not less than \$20 million.

CONCLUSIONS OF LAW

11 U.S.C. § 724, "one of the more obtuse sections of the Bankruptcy Code," governs the treatment of certain liens on property in which the bankruptcy estate has an interest. In re Life Imaging Corp., 131 B.R. 174, 176 (Bankr. D. Colo. 1991). Assuming the liens are not avoidable, the property which is subject to a tax lien is distributed according to the priorities set out in § 724(b). Id. The effect of § 724(b) is to subordinate payment of statutory tax liens to payment of administrative expenses, up to the amount of the tax liens, leaving consensual lienholders and holders of unsecured claims undisturbed. In re Van Metre, 155 B.R. 118, 122 (Bankr. E.D. Va. 1993). Thus, whenever property of the estate is burdened by a local, state or federal tax lien, the amount of that lien can be used to pay administrative expenses. In re Packard Properties, Ltd., 112 B.R. 154, 156 (Bankr. N.D. Tex. 1990).

The first priority under § 724(b)(1) is granted to allowed, unavoidable, secured liens senior to the tax liens. Nonbankruptcy law applies to determine whether a lien competing with a tax lien is "senior." In re Terwilliger's Catering Plus, Inc., 911 F.2d 1168, 1176 (6th Cir. 1990), cert. denied, 111 S. Ct. 2815 (1991). Where the liens involved are not federal liens, the priority laws of the state apply. Id. Under Iowa law, priority is determined by the "first in time, first in right" rule. Briley v. Madrid Imp. Co., 255 Iowa 388, 122 N.W.2d 824, 825 (1963).

The City is claiming that its lien is senior to the tax lien on the property. The tax lien is the County's lien for taxes which accrued prepetition. See In re Pad Enters., Inc., 139 B.R. 516, 519 (Bankr. D. Or. 1992) (§ 724(b) only applies to prepetition secured tax claims). This lien represents taxes which accrued during the 1988 tax year. The City's claim arose in 1986 and 1987. This Court determined in a former order that the City's lien dates from the time the water and sewer charges were incurred, rather than from the date they were certified under Iowa Code sec. 384.84. See Order of Judge

Melloy, In re Cedar Rapids Meats, Inc., No. L-90-00445-C, (August 14, 1990). The City's lien is senior to the County's tax lien under the "first in time, first in right" rule.

The parties raise the issue of whether the City's lien should be treated as a tax lien under § 724(d). That section states:

A statutory lien the priority of which is determined in the same manner as the priority of a tax lien under section 6323 of the Internal Revenue Code of 1954 (26 U.S.C. 6323) shall be treated under subsection (b) of this section the same as if such lien were a tax lien.

11 U.S.C. § 724(d).

There is a dearth of authority on this issue. The Court could find no case which has applied § 724(d) to the statutory lien of a municipality. Courts considering whether utility charges constitute property taxes under § 507(a)(7)(B) have distinguished between "charges" and "taxes". In re Adams, 40 B.R. 545, 550 (E.D. Pa. 1984) (even though lien based on sewer rents may be collected as a tax, does not transform the charge into a tax under § 507(a)(7)(B)); In re Consolidated Southeastern Group, Inc., 75 B.R. 102 (Bankr. N.D. Ga. 1987) (accord). This distinction is not very helpful, however, because § 724(d) authorizes treatment of statutory liens as tax liens regardless of the type of debt the liens secure.

The legislative history of § 724(d) merely mentions ERISA liens as falling within this section. The ERISA lien provision at 29 U.S.C. § 1368 expressly provides that priority of the ERISA lien "shall be determined in the same manner as under section 6323 of Title 26." Collier on Bankruptcy points out that there is nothing in the wording of § 724(d) "to exclude from section 724(b) treatment statutory liens lacking a specific reference to 26 U.S.C. § 6323." 4 Collier on Bankruptcy, § 724.05, at 724-19 (15th Ed. 1993).

The Court must determine whether the priority of the City's lien "is determined in the same manner as the priority of a tax lien under section 6323." Iowa Code sec. 384.84 allows that such liens have equal precedence with ordinary taxes and may be collected in the same manner as taxes. The words "ordinary taxes" appear to refer to local property taxes, not federal taxes subject to § 6323. Property taxes and utility charges are given priority over federal taxes in § 6323 itself. 26 U.S.C. § 6323(b)(6)(A), (C). In essence, priority of the City's lien is determined by state law in a manner dissimilar to federal law priorities under § 6323. The Court concludes that the City's lien should not be treated as a tax lien under § 724(d). It has first priority in the § 724(b) distribution scheme.

Next in priority are claims specified in § 507(a)(1) through (6) according to § 724(b)(2). Initially, § 507(a)(1) gives priority to administrative expenses under § 503(b). Proceeding through this labyrinth of Code sections, administrative expenses are determined to be costs of preserving the estate, taxes incurred by the estate, debtor's attorney fees under § 330(a), certain creditor expenses, fees for professional services, etc. 11 U.S.C. § 503(b).

Property taxes accruing postpetition are administrative expenses under § 503(b)(1)(B)(i). Pad Enters., 139 B.R. at 520. Interest and penalties on these taxes are also considered administrative expenses. In re Allied Mechanical Servs., Inc., 885 F.2d 837, 839 (11th Cir. 1989). The parties have stipulated that the County has a claim for postpetition property taxes of \$414,590.48. MC&M has an administrative expense claim of more than \$150,000 under § 503(b)(2). Doubtless there are other administrative expense claims which remain to be paid.

Distribution under § 724(b)(2) is allowed only to the extent of the amount of the tax claim. If funds are insufficient to pay all § 503(b) administrative expense claims in full, the claimants must share pro rata among the available assets. In re IML Freight, Inc., 52 B.R. 124, 137 (Bankr. D. Utah 1985).

Next in line for distribution under § 724(b)(2) are claims under § 507(a)(2), which do not appear to be an issue in this case. Then, § 507(a)(3) acts to give priority to wage claims such as the Union's claim for \$4,150,000. Finally, the tax lien holder (the County) is allowed a distribution to the extent its lien exceeds the amount distributed to administrative expense claims. § 724(b)(3). Any junior lienholder (the City to the extent its lien was not senior to the County's, or \$110,459.82) is then allowed a distribution under § 724(b)(4).

Another issue raised by the parties is whether the Court should reduce the amount of the County's tax lien to reflect the actual value of the property as opposed to the assessed value. The property in question was valued at approximately \$4

million during 1988 through 1991 tax years. The Trustee herein successfully challenged the valuation for the 1992 tax year, resulting in application of an assessed value of approximately \$400,000. It appears that the property actually sold for \$180,000. The Union and MC&M assert that the County's tax lien based on the inflated assessed values should be reduced to reflect actual value.

The Court has authority under § 505(a) to determine the amount of any tax in some circumstances. Arguably this would require some further proceedings for introduction of evidence for determination of values based on state law. See In re Fairchild Aircraft Corp., 124 B.R. 488, 492 (Bankr. W.D. Tex. 1991) (valuation of property under § 505(a) must be consistent with state law principles). The Court may abstain from making a § 505(a) valuation if the impact of abstention on the general administration of the estate, and on the Debtor, is minimal or nonexistent. In re American Motor Club, Inc., 139 B.R. 578, 581 (Bankr. E.D.N.Y. 1992).

The Court notes that none of the parties made any attempts to challenge the assessed values during the pendency of the estate until the 1992 tax year. It is well known that property values may fluctuate widely. Neither the 1992 revised assessed value nor the sale price is necessarily an accurate reflection of the actual value of the property in 1988 through 1991. Furthermore, as demonstrated in the attached table, reduction of taxes to reflect actual property values will have little impact on the amount of money available to lienholders under § 724(b). Considering the lack of evidence present on actual value, the Court will accept the amounts set out in the parties' stipulation of facts as constituting the County's prepetition and postpetition tax claims.

The Court is aware that the Union and MC&M were not involved in the joint stipulation of facts by the Trustee, the City and Linn County. Neither of these parties have presented a case for a § 505(a) re-evaluation. If they wish to seek a § 505(a) determination, the appropriate motion should be made and evidence presented.

The attached table illustrates the Court's conclusions. See e.g., Darnell, 834 F.2d at 1269 n.12; Van Metre, 155 B.R. at 122. Proceeds of sale of \$175,000 are available for distribution under § 724(b). The City has a senior lien of \$156,574.77 which should not be treated as a tax lien under § 724(d). Thus, \$17,425.23 is available for distribution under § 724(b)(2). The County has a postpetition tax claim of \$414,598.48 which has administrative expense priority under § 503(b)(1)(B)(i). MC&M's § 330(a) claim of approximately \$150,000 shares administrative expense status under § 503(b)(2). These two administrative expense claims and any other administrative expense claims share the \$17,425.23 proceeds pro rata. No funds remain to distribute on the Union's claim for wages under § 507(a)(3), Linn County's prepetition tax lien or the City's junior lien.

WHEREFORE, Trustee's Motion for Summary Judgment is GRANTED to the extent provided herein.

FURTHER, proceeds from the sale of property will be distributed as set forth herein and in the attached table.

FURTHER, the County's Application for Allowance and Payment of Administrative Expense is GRANTED to the extent provided herein.

FURTHER, the County's postpetition tax claim of \$414,590.48 constitutes an administrative expense under § 503(b)(1)(B)(i).

SO ORDERED this 4th day of October, 1993.

Paul J. Kilburg
U.S. Bankruptcy Judge

U.S. Bankruptcy Court

DISTRIBUTION OF PROCEEDS
Cedar Rapids Meats, Inc.

| <u>11 U.S.C.</u> | <u>Amount</u> | <u>Description</u> |
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| | | Estate property available for distribution § 724(b)(1)-156,574 City's senior lien. |
| \$175,000 | | |
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| | | This entire amount is available for distribution to claims falling within § 724(b)(2) because it is less than the amount of the County's prepetition tax lien. (1) |
| \$ 724(b)(2) | | |
| § 507(a)(1) | | |
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| § 503(b)(1)(B)(i) | 414,590 (2) | County's postpetition tax lien, including penalties and interest. |
| § 503(b)(2) | 150,000 | MC&M's attorney fee expense under § 330(a) |
| § 503(b) | unknown | Other administrative expenses (3) |
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| | | Because there are insufficient funds available from the proceeds of sale, the |

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| | | following remain unpaid: |
| § 507(a) 4,150,000 (3) | | Union's wage claim |
| § 724(b) 268,198 (3) | | County's prepetition tax lien |
| § 724(b) 110,459 (4) | | City's junior lien |
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1. The stipulated amount of the County's prepetition tax claim is \$268,198.07. If actual value is accepted as \$400,000, compared to the assessed value at that time of \$4 million, the tax claim would equal approximately \$26,819. The Court will not consider the \$180,000 sale price as the prepetition actual value at this time.
2. It appears that this amount would be reduced to approximately \$41,459 if property values are reduced from \$4 million to \$400,000.
3. All of the § 503(b) claims share pro rata among the available funds.