

IN THE UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In The Matter of

COUNTRYSIDE INVESTMENT . Case No. 88-554-C
COMPANY, a Partnership, . Chapter 11

Debtor.

ORDER - MOTION FOR PRELIMINARY INJUNCTION

On July 19, 1988, a hearing was held on the motion for preliminary injunction. The following attorneys appeared on behalf of their respective clients: Michael P. Mallaney for Debtor; John Waters for the Iowa Department of Revenue and Finance (hereinafter "IDR"); Richard F. Stageman for General Electric Capital Corporation; Theodore R. Boecker for EFO Commercial Realty, Inc.; and Terry L. Gibson for the United States Trustee. At the conclusion of said hearing, the Court took the matter under advisement upon a briefing deadline of July 27, 1988. Briefs were timely filed and the Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2). The Court, upon review of the pleadings, arguments of counsel, evidence presented and briefs, now enters its findings and conclusions pursuant to F.R. Bankr.

P. 7052.

FINDINGS OF FACT

1. Debtor filed a Chapter 11 petition on March 14, 1988.

2. Debtor is a partnership owned by Victor Vashi and his wife, Surekha Vashi. Debtor owns a Ramada Inn motel in Des Moines, Iowa. Previously, Debtor also owned a Best Western motel in Des Moines.

3. The sales tax permits for the Best Western and Ramada motels were originally held by Countryside Management Corporation. Victor Vashi was president of Countryside Management Corporation and was a stockholder in the corporation. Countryside Management Corporation handled the day-to-day operation of the motels owned by Debtor.

4. A second management company, Des Moines Hotels Management, Inc., subsequently took over the operation of the motels. Victor Vashi was president of Des Moines Hotels Management, Inc. and was a stockholder in the corporation.

5. Both management companies, Des Moines Hotel Management, Inc. and Countryside Management Corporation, incurred substantial delinquencies in filing returns and making payments of sales tax and hotel/motel tax. Between December 1985 and January 1988, sixteen violations occurred with Ramada Inn concerning filing returns or paying tax to IDR. From May 1985 through January 1988, twenty-three violations occurred with Best Western. Both Countryside

Management Corporation and Des Moines Hotels Management, Inc. were required to file sales tax on a semi-monthly basis.

6. Prior to filing for relief under Chapter 11 of the Bankruptcy Code, Debtor did not hold a sales tax permit. The sales tax permits were held by the management companies. Shortly after filing its bankruptcy, Debtor applied for a sales tax permit. IDR informed Debtor there was a problem concerning the sales tax permit because Debtor was substantially similar to other companies which had incurred an unacceptable number of delinquencies in filing and paying taxes. As a result, IDR informed Debtor that a permit could be issued only if a \$100,500.00 bond was posted.

7. Debtor entered into negotiations with IDR concerning the bond requirement. An agreement was reached which would have satisfied IDR's need for security in the event of future delinquencies and which avoided the necessity of Debtor posting a bond in the amount of \$100,500.00. Said agreement was eventually reduced to writing in the form of a stipulated order for the Court's approval. The stipulated order has not been signed by the parties or by the Court.

8. The proposed agreement provided that IDR would receive a \$30,000.00 bond to be paid in installments. Installment payments were to be in the amount of \$2,500.00 per month and were to begin on June 15, 1988. In addition,

Debtor agreed to give IDR a lien on a post-petition accounts receivable to secure the installment payments. Debtor also agreed to pay all sales and hotel/motel taxes on a semimonthly basis. Both parties contemplated that the stipulated order would be approved prior to June 15, 1988.

9. In an effort to obtain the required Court approval of the stipulated order, Debtor filed a motion to incur secured debt on May 12, 1988. HFC Commercial Realty, Inc. filed an objection to this motion on June 6, 1988. A hearing on HFC Commercial Realty's objection and Debtor's motion was held on July 19, 1988. The matter was continued pending a resolution of this motion for preliminary injunction.

10. From the time of filing bankruptcy until present, Debtor has failed to comply with the terms of the proposed stipulated order. Debtor has failed to pay the hotel/motel tax on a semi-monthly basis. The only payments made by Debtor towards the hotel/motel tax were a quarterly return filed for the period ending March 31, 1988, and a lump-sum \$9,000.00 payment made on or about June 29, 1988. The hotel/motel tax which would be due on a semi-monthly basis exceeds the \$9,000.00 payment. The parties dispute the exact amount which remains unpaid on hotel/motel taxes.

11. Debtor has also failed to comply with the provision in the stipulated order concerning the payment of the bond in installments. The first bond payment was to be

made on June 15, 1988, and the second payment on July 15, 1988. No bond payments have been made.

12. Debtor has also incurred problems concerning the payment of the Iowa withholding tax since the filing of its petition. Debtor failed to timely file withholding returns or deposits for the tax periods March, April, and May of 1988. On June 29, 1988, Debtor tendered returns and checks for payment of the March, April, May, and June, 1988, withholding tax obligations. The checks for the tax periods May and June, 1988, did not clear Debtor's bank account. IDR presented these checks to the bank on two occasions and they were returned marked "insufficient funds." After being ordered to do so, Debtor has made these checks good by providing IDR with a cashier's check. Because of Debtor's failure to timely file and pay withholding tax, additional penalty and interest is due in the amount of \$995.52 as of June of 1988.

13. Debtor did not set up a separate tax account at the time of filing of its bankruptcy as required by Local Bankruptcy Rule 6003. Despite written notification from the United States Trustee's office, Debtor claims to have been ignorant of the requirements of Rule 6003. Debtor justifies its failure to pay withholding tax on a timely basis by relying on its ignorance of Rule 6003. Victor Vashi testified that Debtor began to comply with Rule 6003 during the first week in June of 1988 when the tax account was set

up. Despite the fact that Debtor concedes it was aware of Rule 6003 during the first week in June of 1988, Debtor wrote checks on the tax account on June 29, 1988, and there were insufficient funds in the account.

14. Debtor has recently undergone significant changes in management. Gary Vashi, a former employee and former manager of the motels, has returned to India. Gunter Orband, the most recent manager, is no longer employed by Debtor. Within the past month, a new individual, Roger Vashi, has arrived to manage the motel.

15. The amount of bond originally required by IDR was \$100,500.00. The computation of this bond was in error, and the correct amount of the bond is \$67,100.64.

16. On June 24, 1988, IDR sent a formal notice to Debtor requiring Debtor to post a bond because of Debtor's failure to properly make the withholding tax payments, failure to have the stipulation approved by June 15, 1988, and failure to comply with the stipulation. Subsequently, Debtor's representatives met with IDR and agreed to pay the outstanding withholding tax obligations. On June 29, 1988, IDR received checks from Debtor for which Debtor had insufficient funds in its account. On July 6, 1988, IDR delivered a letter to Debtor informing it that its application for a sales tax permit was denied.

17. On July 7, 1988, Debtor filed an application for preliminary injunction enjoining IDR from denying its appli-

cation for the sales tax permit. In the application for preliminary injunction, Debtor requested a temporary or preliminary injunction until the hearing scheduled for July 19, 1988, on the motion to incur secured debt.

18. On July 7, 1988, a preliminary hearing on Debtor's application was held. The Court granted an injunction against IDR enjoining it from denying Debtor's application for sales tax permit prior to the July 19, 1988, hearing. Debtor was ordered to pay delinquent withholding taxes and to comply with Bankruptcy Rule 6003.

19. On July 15, 1988, IDR filed a resistance to Debtor's motion to incur secured debt and stated it was rescinding the agreement contained in the proposed stipulated order.

DISCUSSION

Two issues are presented in this case. The first is whether the Court has jurisdiction to enter a preliminary injunction. The second is whether Debtor is entitled to the issuance of a preliminary injunction against IDR.

Bankruptcy Code section 105(a) provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." An injunction pursuant to section 105(a) can only be issued if necessary to enforce a substantive provision of the Bankruptcy Code. United States v. Sutton, 786 F.2d 1305, 1307-08 (1st Cir. 1986).

Debtor argues Bankruptcy Code section 505 is such a substantive provision. Section 505(a) allows the Court to determine the amount or legality of "any tax, any fine or penalty relating to a tax, or any addition to tax...." However, Debtor's argument is unpersuasive for the following reasons. First, section 505(a) on its face does not apply to a bond. The bond in question is neither a tax, a fine or penalty relating to a tax, nor an addition to tax. Rather, the bond is a post-petition financial responsibility obligation imposed on account of Debtor's pre-petition behavior. Second, Debtor has failed to cite, and the Court has not been able to locate, a single case applying section 505 to a bond. As a result, section 505 is inapplicable. Therefore, the Court does not have jurisdiction to issue a preliminary injunction because there is no substantive provision of the Bankruptcy Code to enforce.

Assuming *arguendo* the Court does have jurisdiction, the next issue is whether Debtor is entitled to the issuance of a preliminary injunction. The Court must consider the following four factors in determining whether to issue a preliminary injunction: 1) whether irreparable injury to movant would result in its absence; 2) whether the threatened injury to movant outweighs the harm that issuance of a preliminary injunction would cause to other parties; 3) the likelihood of movant's success on the merits; and 4) whether the public interest would be adversely affected.

In re Continental Air Lines. Inc., 61 B.R. 758, 782 (S.D. Tex. 1986), citing Holland America Insurance Co. v. Union Bank & Central Pecan Shelling Co.. Inc., 777 F.2d 992, 997 (5th Cir. 1985). The Court will address each factor individually.

A. Irreparable Injury to Debtor

If the preliminary injunction is not entered, Debtor faces two choices: 1) pay the \$67,100.64 bond in order to acquire a sales tax permit necessary to remain in business; or 2) withhold payment of the bond and be shut down for good. It is clear that Debtor will not be able to operate its motel without the sales tax permit. Debtor could be caused irreparable injury if it is unable to post a bond.

B. Harm to Other Parties

The other parties that would be affected by the issuance of a preliminary injunction are the State of Iowa and its taxpayers. The purpose of the bond required by IDR is to secure the state against future tax liabilities which a permit applicant may incur. Iowa Code §§ 422.52(3), 422A.1 (1987). Countryside Management Corporation and Des Moines Hotels Management, Inc. were owned and controlled by Victor Vashi. While operating the Ramada Inn and the Best Western, both management companies incurred substantial delinquencies in their payment of tax and the filing of tax returns. Specifically, sixteen violations occurred at the Ramada Inn and twenty-three violations occurred at the Best

Western. Victor Vashi and his wife are now Debtor's sole partners. Given Vashi's past track record, it is reasonable for IDR to assume that the issuance of a sales tax permit to Debtor, controlled and operated by Victor Vashi, will result in further tax delinquencies. IDR is willing to assume the risk of further delinquencies if a bond is filed to protect the taxpayers from misappropriation of trust fund taxes which Debtor collects from its customers. However, requiring IDR to provide a sales tax permit without a bond has the potential of significant harm to the State of Iowa and its taxpayers.

C. Public Interest

The public's interest is that the local rules of this Court and the laws of the State of Iowa be enforced. Victor Vashi's previous businesses have violated the provisions of the Iowa Code concerning the reporting of sales and hotel/motel tax and the payment of same. Debtor, Vashi's current business, has also had a pattern of violation of the Iowa tax laws with regard to withholding tax. Debtor's only excuse for these violations is that it was unaware of the requirements of Local Bankruptcy Rule 6003.

Local Rule 6003 requires that excise and withholding taxes collected or withheld by a debtor-in-possession be remitted to a separate tax account within two working days. If Debtor had complied with Local Rule 6003, there would have been sufficient funds in its tax account to cover the

withholding checks written on June 29, 1987. Victor Vashi claims he became aware of Local Rule 6003 during the first week of June and then began to comply with said rule. However, on June 29, 1988, there were insufficient funds in the tax account to cover the withholding tax checks. In light of Debtor's disregard for Local Rule 6003, it is reasonable for IDR to collect a bond to secure itself against future violations of said rule.

Under state law, sales tax and hotel/motel tax are collected from the public by the retailer and remitted to the state. See Iowa Code §§422.48, 422A.1 (1987). The public has an interest in assuring that the taxes which they pay are in fact remitted to the taxing authorities. Further, Debtor's operation during the Chapter 11 proceedings should not be financed with the funds of the taxpayers of the State of Iowa. Thus, it is reasonable for IDR to request appropriate assurances to prevent any future misappropriation of trust fund taxes.

D. Likelihood of Success on the Merits

The merits of this matter involve whether IDR can require a bond from Debtor because it is "substantially similar" to Countryside Management Corporation and Des Moines Hotels Management, Inc. Iowa Administrative Code section 701-11.10(1) (b) provides that a bond is required of any applicant which is "substantially similar" to an entity that would have been required to post a bond under the

guidelines for existing permit holders. Existing permit holders who file on a semi-monthly basis must post a bond if they have had eight or more delinquencies during the last twenty-four months. Iowa Admin. Code §701-11.10(1)(c)(1986). Countryside Management Corporation and Des Moines Hotels Management, Inc. clearly would fall within the guidelines for requiring an existing permit holder to post a bond. Thus, the only question is whether Debtor is "substantially similar" to Countryside Management Corporation and Des Moines Hotels Management, Inc.

Iowa Administrative Code section 701-11.10(1)(b) provides that "[t]he applicant is 'substantially similar' to the extent that said applicant is owned or controlled by persons who owned or controlled the previous permit holder." Debtor contends it is not "substantially similar" to Countryside Management Corporation and Des Moines Hotels Management, Inc. because it is a separate legal entity. IDR concedes Debtor is a separate legal entity. However, the test is whether Debtor is owned or controlled by the same person who owned or controlled Countryside Management Corporation and Des Moines Hotels Management, Inc., not whether Debtor is a separate legal entity.

A review of the evidence shows that Victor Vashi owned and controlled all three entities. Debtor is owned by its partners, Victor Vashi and his wife. Countryside Management Corporation and Des Moines Hotels Management, Inc. are owned

by their stockholders. Victor Vashi was a stockholder of both companies. There was no testimony as to whether there were any other stockholders. A corporation is controlled by its officers and a partnership is controlled by its partners. Victor Vashi was the president of both Countryside Management Corporation and Des Moines Hotels Management, Inc. Thus, Victor Vashi owned and controlled all three entities. As a result, Debtor is "substantially similar" to Countryside Management Corporation and Des Moines Hotels Management, Inc.

Debtor argues that filing bankruptcy somehow negates the fact it is "substantially similar" to those management companies. However, Debtor's behavior prior to the bankruptcy may be taken into account when imposing postpetition obligations. In re Rees, 61 B.R. 114 (Bankr. D. Utah 1986); In re A. C. Williams Co., 51 B.R. 496, 500 (Bankr. N.D. Ohio 1985). Further, Bankruptcy Code section 525 does not prohibit the type of future financial responsibility provision imposed by IDR. See Duffey v. Dollison, 734 F.2d 265, 273 (6th Cir. 1984); A. C. Williams, Co., 51 B.R. at 500; In re Holder, 40 B.R. 847, 849-50 (Bankr. E.D. Wisc. 1984). As a result, IDR's actions clearly fall within the requirements of the Iowa Code, the Iowa Administrative Code, and the Bankruptcy Code. Thus, no reasonable possibility exists that any action filed by

Debtor to compel IDR to issue a sales tax permit would succeed on the merits.

In balancing these four factors, the Court believes any possible harm to Debtor caused by not granting the injunction is outweighed by the harm such an injunction would cause to the other parties. Further, the public interest in enforcing state law and local bankruptcy rules tilts heavily toward not granting the injunction. Finally, since IDR's bond requirement is completely justified, Debtor's likelihood of success on the merits is highly unlikely. As a result, the Court refuses to grant a preliminary injunction on Debtor's behalf.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes it does not have jurisdiction to enter a preliminary injunction.

FURTHER, the Court concludes Debtor is not entitled to the issuance of a preliminary injunction against IDR.

IT IS ACCORDINGLY ORDERED that Debtor's motion for preliminary injunction is denied.

Dated this 12th day of September, 1988.

RUSSELL J. HILL
U.S. BANKRUPTCY COURT