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Federal Tax Liens in Mortgage Foreclosures

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To provide or to deny equitable relief to a shareholder should not be dependent upon the existence or non-existence of a supposed legal relationship between the parties sufficient to support the fiduciary concept. It is through an approach similar to that presented in the *Hodge* case or to that in the stock transaction cases and known therein as the "special facts rule" that will allow the courts the most latitude in arriving at an equitable result in the cases concerning transactions, stock or otherwise, between corporate directors and individual shareholders. It is through these similar approaches that one could conclude that while in general no legally recognized fiduciary relationship exists between the director and individual shareholders, special facts may place the director in such a position of confidence that their existence will give rise to the fiduciary rule. Such an approach would lead to the same desired result in raising the fiduciary rule when required in personal dealings between these parties without resort to extensive syllogisms in establishing or denying the existence of a fiduciary relationship between these parties.

GEORGE J. ARGERIS

FEDERAL TAX LIENS IN MORTGAGE FORECLOSURES

An attorney who is to subject property owned by a judgment debtor or mortgagor to a judicial sale must determine whether the property is incumbered by another lien of any kind and if such a lien exists, its relative priority to the lien sought to be satisfied. In recent years the federal tax lien has appeared in such cases more and more frequently.

I.R.C. Sec. 6321 (1954) creates a lien in favor of the government on all the real and personal property and rights to property which belongs to a taxpayer who neglects or refuses to pay an *assessed* tax upon *demand*.

An assessment, based either upon the return filed by the taxpayer, or an audit by the Internal Revenue Service, can only be made after the taxpayer has waived the right to litigate in the tax court,¹ or, in the case of income, estate, or gift taxes, has litigated in the tax court.²

Within sixty (60) days after assessment the District Director of Internal Revenue is required to give notice to the taxpayer of the assessment and demand payment.³

If, after the demand is made, the tax is not paid, a general federal tax lien is created and related back to the time of assessment.⁴ In determining whether the federal lien has attached to the property sought to be sold, the rule is that the lien attaches to everything subject to ownership,⁵

1. I.R.C. § 6213 (d).

2. I.R.C. § 6212 and § 1213.

3. I.R.C. § 6303 (a).

4. I.R.C. § 6322.

5. *Citizens State Bank of Barstow, Tex. v. Vidal*, 114 F.2d 380 (10th Cir. 1940).

including property which by state law is exempt from creditors, (homestead)⁶ and including after acquired property.⁷

State law determines the property interest of the taxpayer; property which by state law is held by the entireties cannot be subjected to a lien for the tax indebtedness of either spouse,⁸ unless both parties are liable for the tax by reason of filing a joint return.⁹

It seems clear that if the judgment debtor or mortgagor, whose property is to be judicially sold, is also a delinquent taxpayer, a federal tax lien has been attached to all his property, unless it is property held by the entireties. However, until the lien is perfected by filing¹⁰ it is not valid as against any "mortgagee, pledgee, purchaser, or judgment creditor" probably even if the mortgagee had notice of the assessment against the mortgagor when the mortgage was executed.¹¹ Of course, the private lien must be perfected before it can be prior in right to the federal tax lien.¹² Thus it is equally clear that for purposes of quieting a title, foreclosing a mortgage, or collecting a money judgment by judicial sale the attorney need only determine if a tax lien has been recorded (a) in compliance with the state law providing for filing of such liens, or (b) in the District Court if the State has not authorized the filing.¹³

In Wyoming notices of federal tax liens must be filed in the office of the county clerk in order to be perfected.¹⁴

A lien which is recorded will in most instances be an encumbrance which will have to be extinguished in order to get a price for the property which will protect the interest of the private lienor. A valid federal tax lien¹⁵ can be divested in two ways; (a) by administrative discharge or "release,"¹⁶ or (b) by instituting suit and joining the United States as a party defendant.¹⁷

Even under the 1939 Code an administrative discharge could be had, but it involved some payment of the delinquent tax. The Department of Justice, desiring to minimize litigation, recommended an amendment to the 1954 Code which would clearly authorize the Internal Revenue Service to release property from the lien in cases where the federal lien was of no value because of priority of a private lien. This amendment is the present

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6. I.R.C. § 6334 (c), *United States v. Heffron*, 158 F.2d 657 (9th Cir. 1947).
 7. *Glass City Bank v. United States*, 326 U.S. 265, 66 S.Ct. 108, 90 L.Ed. 56 (1945).
 8. *Shaw v. United States*, 94 F.Supp. 245 (W.D. Mich., S.D. 1939).
 9. *Whittaker v. Kavenagh*, 100 F.Supp. 918 (E.D. Mich., S.D. 1951).
 10. *Wyo. Comp. Stat. § 55-603* (1945).
 11. *United States v. Beaver Run Coal Co.*, 99 F.2d 610 (C.C.A. 3d, 1938). 9 *Mertens, Law of Federal Income Taxation*, § 54.46.
 12. *Hart v. United States*, 207 F.2d 813 (8th Cir. 1953); *United States v. Security Trust Savings Bank*, 340 U.S. 47, 71 S.Ct. 111, 95 L.Ed. 53 (1950).
 13. I.R.C. § 6323 (a) 1 & 2.
 14. *Wyo. Comp. Stat. § 55-603* (1945), 6 *Wyo. L.J.* 195.
 15. I.R.C. § 6322.
 16. I.R.C. § 6325.
 17. 28 U.S.C.A. § 2410.

I.R.C. Sec. 6325 (b) (2). Under this section, the Secretary of the Treasury or his delegate is permitted to release any part of the property subject to the federal tax lien if (1) the Secretary, or his delegate, is paid an amount not less than the value of the government's interest in the property, or (2) if the Secretary, or his delegate determines that the interest of the government has no value; meaning that there is a lien senior to the government's interest which will leave nothing to satisfy the junior federal tax lien.

Probably because attorneys don't know of the mechanics for release of the property, or because joining the United States as a party defendant is a procedure more closely approximating general practice, the release of property from a federal tax lien administratively is not sought in as many instances as the officials of the government desire.

In addition to the fact that the Government must spend time and money unnecessarily defending many of the actions in which the United States is named as a party defendant the plaintiff's attorney should give first consideration to the administrative discharge provided for in I.R.C. Sec. 6325 (b) (2) because when the federal tax lien is so released: (a) Foreclosure may follow state procedure or the terms of the power of sale in the mortgage instrument¹⁸ rather than strictly comply with the federal judicial sales requirements.¹⁹ (b) There will be no future litigation by appeal or otherwise because as to the property involved, the federal lien no longer exists. (c) If the lien satisfied by foreclosure sale is prior in right to the lien of the United States, the United States has one year from the date of the sale in which to redeem, rather than the shorter periods allowed by state statute. Administrative discharge eliminates the one year right of redemption in the United States, which in the case of a foreclosure joining the United States as a party defendant may reduce the amount of the bids and the number of bidders.²⁰

Unless the Attorney General approves, a discharge is not available after the foreclosure suit is commenced. Therefore, before filing the action, the form for applying for the discharge should be obtained from the office of the District Director of Internal Revenue. If, from the application, it is determined that the federal lien is valueless, the District Director will send the applicant a conditional commitment to discharge, and the certificate of the discharge will issue after the foreclosure proceedings are concluded.

If it is determined that the government has an equity in the property, the discharge cannot be obtained, and the lien can only be removed by

18. Wyo. Comp. Stat. § 59-115, Wyo. Comp. Stat. § 59-201 (1945).

19. *Supra* note 18.

20. There is some question as to the force of the government's right of redemption since the statute provides the right but not the manner of redemption, does not designate the person who can decide to redeem, and does not authorize a source from which payment can be made. *Supra* note 18.

instituting foreclosure naming the United States as a party defendant. If the United States is not made a party to an action affecting property in which the United States has an interest, judicial sale resulting from that action will have the same effect on the federal lien as state law provides for other liens of similar standing.²¹ In other words the federal lien is not effected.

Authority for a suit against the United States in cases where the United States has an interest in the property involved comes from title 28, U.S.C.A. Sec. 2410. The action may be brought in the state district court, or in federal district court. If brought in the state court, the action may be removed to the federal district court upon an appropriate motion by the United States.²²

If the United States has a lien senior to the one satisfied by the sale, the lien of the United States will not be disturbed by the sale unless the United States consents that the property may be sold free of its lien and the United States gets the share of the proceeds to which it is entitled.²³

JOHN V. CROW

DISTINCTION BETWEEN CAPITAL EXPENDITURES AND EXPENSES FOR THE CONSERVATION OF PROPERTY HELD FOR THE PRODUCTION OF INCOME

In 1941 a taxpayer was involved with extensive investments in real estate, bonds and stocks. In pursuit of these interests he hired others to assist him in offices rented for that purpose. For the tax years in question, he claimed that salaries and expenses incident to looking after his properties were deductible under Section 23 (a) of the 1939 Internal Revenue Code, which provided for deduction of all ordinary and necessary expenses incurred during the taxable year in carrying on any trade or business. The court held that the taxpayer merely kept records and collected interest and dividends from his securities and could not be considered as carrying on a trade or business, and disallowed the deduction.¹

Such reasoning by the courts seemed unduly harsh, since a person receiving income was charged with his gross receipts and not allowed to set

21. *United States v. City of New Britain*, 347 U.S. 81, 74 S.Ct. 367, 98 L.Ed., 520 (1954).

22. 28 U.S.C.A. § 1444.

23. The government's rights to share in the proceedings of a judicial sale are as any other lienor, "first in time, first in right." *Supra* notes 13, 14, and 23. As between the federal tax lien and the lien of any mortgagee, pledgee, purchaser, or judgment creditor, the priority is to be determined as of the date of first recording. 9 Mertens, *Law of Federal Income Taxation*, § 54.42. As between the federal tax lien and all other liens, the relative priority of the federal lien is determined as of the date of assessment, and the private liens as of the date of perfection. State law determines what constitutes a perfected lien. 9 Mertens, *Law of Federal Income Taxation* § 54.40.

1. *Higgins v. Commissioner*, 312 U.S. 212, 61 S.Ct. 728, 85 L.Ed. 1145 (1941).