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## FEDERAL TAX LIENS: DIVESTITURE

In recent years, cases involving the federal tax lien have appeared frequently in our courts. In these cases problems are accentuated when the federal tax lien is subordinate or junior to other encumbrances. A recent United States Supreme Court case, *U.S. v. Brosnan*,<sup>1</sup> challenged and changed some of the traditional thinking concerning the divestiture of a junior federal tax lien.

A general tax lien in favor of the United States is imposed by federal statute where any person neglects or refuses to pay the assessed taxes after demand. The demand can only be made after the taxpayer has waived the right to litigate in the tax court, or, has litigated in the tax court. The lien relates back to the time of assessment and "shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time."<sup>2</sup> The amount of the lien embraces the tax, interest, additions to the tax, penalties, and costs. It shall attach to all property and rights to property whether real or personal, belonging to the delinquent taxpayer, including after-acquired property and property which by state law is exempt from creditors. The property interests of the taxpayer are determined by state law.<sup>3</sup> Property which by state law is held by the entireties cannot be subjected to a lien for the tax indebtedness of either spouse unless both parties are liable for the tax by reason of filing a joint return.<sup>4</sup> The general tax lien is not valid as against any "mortgagee, pledgee, purchaser, or judgment creditors until notice of the lien has been filed as prescribed by statute."<sup>5</sup> Although the general rule is that priority in rank is governed by the common-law rule that the first in order of time stands first in order of rank,<sup>6</sup> recent court decisions have illustrated the difficult problems created when priority is to be determined between claimants.

Traditional thought was that a federal tax lien could be divested in only two ways: (1) by administrative discharge or "release"<sup>7</sup> or (2) by instituting suit and joining the United States as a party defendant.<sup>8</sup>

1. 363 U.S. 237, 80 S.Ct. 1108, 4 L.Ed. 1192 (1960).

2. I.R.C. 6322 (1954); 26 U.S.C. 6322 (1958).

3. *U.S. v. Brosnan*, 363 U.S. 237, supra; *Aquilino v. U.S.* 363 U.S. 509, 80 S.Ct. 1277, 4 L. Ed.2d 1365 (1960); *City of New York v. U.S.*, 283 F.2d 829 (2d Cir. 1960); *Elliott v. Sioux Oil Co.*, 191 F. Supp. 847 (D. Wyo. 1960).

4. *Sterrett v. Sterrett*, 401 Pa. 583, 166 A.2d 1 (1960); *Moore v. Goltzbach*, 188 F. Supp. 267 (E.D. Va. 1960); *Yafanaro v. Ninos*, \_\_\_\_\_ Fla. \_\_\_\_\_, 123 So.2d 286 (1960); *Empire State Federal Savings and Loan Assn. v. Wokowitz*, 197 N.Y.S.2d 87 (1957).

5. I.R.C. 6323 (1954); 26 U.S.C. 6323 (1958); *Wyo. Stat.* § 29-108 to 114 (1957).

6. *U.S. v. City of New Britain*, 347 U.S. 81, 74 S.Ct. 98 L. Ed. 520 (1954); *Southwest Engine Co. v. U.S.*, 275 F.2d 106 (10th Cir. 1960); *U.S. v. Boston & Berlin Transportation Co.*, 188 F. Supp. 304 (D.N.H. 1960); *U.S. v. Mojac Const. Corp.*, 190 F. Supp. 622 (E.D.N.Y. 1960); *U.S. v. Roessling*, 280 F.2d 933 (5th Cir. 1960); *U.S. v. Bond*, 279 F.2d 837 (4th Cir. 1960); *Ganvey v. Basin Rig & Trucking, Inc.*, 185 F. Supp. 374 (D.N.D. 1960); *Empire Standard Life Inc. Co. v. Anderson*, 182 F. Supp. 246 (E.D. Texas 1960); *Marchant v. Artists Embassy, Inc.*, 25 Ill. App.2d 440, 166 N.E.2d 311 (1960); *Mertopolitan Life Inc. Co. v. U.S.*, 194 N.Y.S.2d 168 (1960); *Bank of America Nat'l Trust and Savings Assn. v. Embry*, 10 Cal. Rptr. 602 (1961).

7. I.R.C. 6325 (1954); 26 U.S.C. 6325 (1958).

8. 28 U.S.C. 2410 (1958).

The administrative discharge or "release" of any property subject to the federal tax lien can be granted by the Secretary of the Treasury or his delegate if he "finds that the liability for the amount assessed, together with all interest in respect thereof, has been fully satisfied," or has become legally unenforceable. . . ;"<sup>9</sup> or, if the Secretary or his delegate accepts a bond from the delinquent taxpayer "that is conditioned upon the payment of the amount assessed, together with all interests in respect thereof."<sup>10</sup> A certificate may also be issued to discharge any part of the property subject to the federal tax lien if the Secretary or his delegate, is paid an amount not less than the value of the government's interest in the property, or 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.<sup>11</sup> "A certificate of release or of partial discharge . . . shall be held conclusive that the lien upon the property covered by the certificate is extinguished."<sup>12</sup> The administrative discharge cannot be obtained if it is determined that the government has an equity in the property; nor will it be issued unless the taxpayer is divesting himself of title.

It has been the traditional thought that the only other way to remove the lien would be to institute a foreclosure proceeding naming the United States as a party defendant.<sup>13</sup> If the United States is not made a party to an action effecting property in which the United States has an interest, a judicial sale will have no effect upon the federal lien. A sale to satisfy a lien inferior to a lien of the United States will not disturb the government's lien unless the government consents that the property may be sold free of its lien and the proceeds divided as the parties may be entitled. Where a judicial sale of real estate is made to satisfy a lien prior to that of the United States, the United States shall have one year from the date of sale within which to redeem.<sup>14</sup>

There are many advantages to the administrative discharge over the judicial foreclosure and sale proceeding with the United States named as a party defendant. The foreclosure may follow state procedure or the terms of the power of sale in the mortgage instrument rather than strictly comply with the federal judicial sales requirement. If the administrative discharge is obtained there will be no future litigation by appeal or otherwise because as to the property involved, the federal lien no longer exists. 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 eliminated the one year right of redemption in

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9. I.R.C. 6325 (a)1 (1954); 26 U.S.C. 6325 (a) 1 (1958).  
 10. I.R.C. 6325 (a) 2 (1954); 26 U.S.C. 6325 (a) 2 (1958).  
 11. I.R.C. 6325 (b) 2 (1954); 26 U.S.C. 6325 (a) 2 (1958); 13 Wyo. L.J. 146, 148  
 12. I.R.C. 6325 (c) (1954); 26 U.S.C. 6325 (c) (1958).  
 13. 28 U.S.C. 2410 (c); 26 U.S.C. 7424 (1958).  
 14. 28 U.S.C. 2410 (c) (1958); U.S. v. City of New Britain, 347 U.S. 81, 74 S.Ct. 367, 98 L. Ed. 520 (1954); Sherwood v. U.S. 5 F.2d 991 (E.D.N.Y. 1955); Metropolitan Life Ins. Co. v. U.S., 107 F.2d 311 (6th Cir. 1939).

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.<sup>15</sup>

The recent United States Supreme Court case, *U.S. v. Brosnan*,<sup>16</sup> permits a third method for the divestiture of the federal tax liens. The *Brosnan* case is the result of a consolidation of two cases, one from Pennsylvania and one from California. The facts were that the United States held federal tax liens on Pennsylvania and California real properties which were junior to defaulted mortgages held on the same properties by other parties to the original suits. In the Pennsylvania case the mortgagees obtained an *in personum* judgment against the mortgagor-taxpayer, pursuant to which the property was sold under a writ of *fieri facias*. Then the United States instituted suit under 26 U.S.C. 7403, seeking an enforcement of its tax lien by foreclosure and sale. The District Court held that the Government's lien had been effectively extinguished by the Pennsylvania proceedings.

The California property was sold by the trustee- mortgagee pursuant to a power of sale which was contained in the instrument. The United States received no actual notice of the sale. Thereafter, the mortgagee, who bought in at the sale, brought suit against the government under 28 U.S.C. 2410 to quiet title, claiming that the exercise of the powers of sale had effectively extinguished the federal tax lien. The Court of Appeals reversed the District Court, holding that the federal lien could be divested "only with the consent of the United States and in the manner prescribed by Congress."<sup>17</sup>

The majority (5 to 4) of the Court felt it desirable to adopt as federal law state law governing divestiture of federal tax liens, except to the extent that Congress may have entered the field. They felt that even though the lien was a part of the machinery for the collection of federal taxes, when Congress resorted to the use of liens, it came into an area of complex property long since settled and regulated by state law. Mr. Justice Harlan wrote, "We think it harmonious with the tenets of our federal system and more consistent with what Congress has already done in this area, not to inject ourselves into the network of competing private property interest, displacing well-established state procedures governing their enforcement, or superimposing on them a new federal rule." Thus the result is that in both instances, a sale under Pennsylvania law and a non-judicial sale pursuant to a power of sale in accordance with California law, a junior federal tax lien was effectively extinguished. The United States was not, and under state law was not required to be, a party to these proceedings.

Wyoming presently has statutory law which enables the Wyoming

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15. 13 Wyo. L.J. 146, 148.

16. 363 U.S. 237, 80 S.Ct. 1108, 4 L. Ed. 1192 (1960).

17. 265 F.2d 862, 869 (9th Cir. 1960).

attorney to take advantage of this *Brosnan* ruling. Previously, it had been assumed that the "foreclosure by advertisement and sale" would not divest a junior federal tax lien and that the only way to divest the lien would be to obtain a judicial decree or an administrative discharge. But now, because of the *Brosnan* case, it is clear that the "foreclosure by advertisement and sale" will divest the junior federal tax lien. The Wyoming law relating to the "foreclosure by advertisement and sale" provides that every mortgage of real estate containing a power of sale upon default being made of any condition of the mortgage, may be foreclosed by advertisement within ten years after the maturing of the mortgage.<sup>18</sup>

Whether the state laws or the federal laws of redemption apply to the case where the Government's junior federal tax lien has been divested, in the manner permitted by the *Brosnan* case, has not been directly ruled upon by the United States Supreme Court.

The United States Court has made it very clear that in a suit for the foreclosure of a mortgage or other lien upon property which the United States has a claim, the Government is guaranteed a one-year right to redeem if the plaintiff proceeds under § 2410, and that it is guaranteed no such right if he proceeds under § 7424. The United States Supreme Court recently heard a case<sup>19</sup> in which the appellees argued that even though the proceeding had been by § 2410, the one year right of redemption should only be granted when such right is granted under state law. They even argued that when some privileges of redemption are given by the State to junior lienors, although of lesser magnitude than that provided in § 2410, the federal right is no longer pertinent. The Supreme Court denounced this argument and ruled that § 2410 did guarantee a one-year right of redemption and these protective conditions "must be strictly observed and exceptions thereto are not to be implied."

In Wyoming, if the "foreclosure by advertisement and sale" proceedings were used to divest a junior federal tax lien, as now permitted since the *Brosnan* case, the period allowed for the redemption by the Government would need to be determined. The Wyoming law regulating redemption<sup>20</sup> provides, with certain exceptions, that after the expiration of six months and before the expiration of nine months from the date of the sale of the land "upon execution, decree of foreclosure, or under foreclosure by advertisement and sale," that it shall be lawful for any person holding a lien on the land so sold to redeem it. The federal statute providing for redemption<sup>21</sup> concerns a judicial sale and guarantees the one-year right of redemption for the government. If federal law were to govern the redemption period in such a case, which seems very unlikely, there

18. Wyo. Stat. § 34-68 (1957).

19. U.S. v. John Hancock Mutual Life Ins. Co., \_\_\_\_\_ U.S. \_\_\_\_\_, 81 S.Ct. 1, \_\_\_\_\_ L. Ed. \_\_\_\_\_ (1960).

20. Wyo. Stat. § 1-481 (1957), as amended by the Sesison Laws of 1961, ch. 181.

21. 28 U.S.C. 2410 (1958).

would then be a conflict between the laws regulating the redemption rights of the mortgagor and the government. Consequently, federal law would control and the government, which is a junior lienor, could redeem the property before the mortgagor had an opportunity to exercise his redemption right provided for by state law. However, if the United States Supreme Court were to hear a case concerning the redemption of property which had fallen under a state non-judicial foreclosure and sale, it would seem that because of the statutes and the implication given by the *Brosnan* case that the Court would hold that state law should also regulate the period of redemption.

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