

## **Priority of A Federal Tax Lien: A Defective Legal Description Unseats A Purchase Money Mortgage.**

Congress has granted the IRS some very strong collection tools, including the federal tax lien under Section 6321 of the Internal Revenue Code. This lien attaches to any interest in property that they taxpayer may have. The breadth of this lien is altered, however, by Section 6323 of the Code, which recognizes that certain other property interests may take priority over a federal tax lien, including a perfected security interest. I.R.C. § 6323(a). “Security interest” is a defined term embracing an interest in property that was obtained by contract to secure performance, provided that the relevant property is in existence, the interest has become perfected under local law, and the holder of the security interest “has parted with money or money’s worth.” See I.R.C. § 6323(h).

Normally, priority disputes between mortgage lenders and the IRS are fairly straight-forward, but last week a district judge in Idaho faced an unusual circumstance: the legal description in the relevant documents was incorrect. The upshot was that a few typos cost the bank its priority. *Beal Bank v. United States*, 2015 U.S. Dist. LEXIS 111150 (D. Ida. August 20, 2015).

The relevant property was transferred by the seller to Frederick and Cheryl Hively by warranty deed in September 2004. *Beal Bank v. United States*, 2015 U.S. Dist. LEXIS 111150, slip op. at \*1. On the same day, Mrs. Hively gave her husband a quit claim deed transferring her interest in the property to him, and Mr. Hively financed the purchase by executing a promissory note and deed of trust that created a purchase money security interest, which ultimately was held by Beal Bank. *Id.*, slip op. at \*2.

There was just one problem: the warranty deed, and the quit claim deed had errors in the legal description of the property, that were replicated in the deed of trust that created the bank’s security interest. *Id.* Several years later, the IRS filed a notice of federal tax lien against Mr. and Mrs. Hively. Ultimately, the bank filed a state court action seeking to reform the defective deeds, and the government removed that action to federal court and filed a motion to dismiss asserting that its lien had priority over the bank.

The district court concluded that the government’s position that it had priority over the bank was sound. The court’s decision rested primarily on its conclusion that the state lien was not “choate.” Historically, this was a requirement for a state lien to trump a federal tax lien; a choate lien existed “when the identity of the lienor, the property subject to the lien, and the amount of the lien are established.” See *United States v. City of New Britain*, 347 U.S. 81, 84 (1954). While subsequent amendments to the Code technically eliminated the “choate lien” standard, the concept frequently resurfaces in situations where the priority of a lien is unclear under Section 6323 of the Code because it is not clear whether the competing state lien is perfected.

In *Beale Bank*, the district court noted that the problems with the legal description of the property related to the appropriate description of the metes and bounds of the property. 2015 U.S. Dist. LEXIS 111150, slip op. at \*10-\*11. Given the incorrect description, the court concluded that the lien was not choate because something else had to be done: the property description had to be corrected. In the court’s view, the bank’s decision to pursue a correction of the legal description demonstrated that the lien was not choate and therefore not entitled to priority over the competing federal tax lien. *Id.*, slip op. at \*11-\*12.

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