

## **Federal Tax Liens-A Certificate of Discharge is Construed Narrowly.**

Section 6325(b) of the Internal Revenue Code has provisions authorizing the IRS to discharge its tax lien as to specific property under certain circumstances. For example, it can issue a certificate of discharge if it is paid the value of its interest in particular property. I.R.C. § 6325(b)(2)(A). The IRS can also issue a certificate of discharge if there is an agreement that all proceeds from sale of a property will be held and that all liens and encumbrances will attach to the proceeds with the same priority they previously had. I.R.C. § 6325(b)(3).

A recent opinion from the First Circuit looks at the impact of the certificate of discharge on the rights of competing creditors. *Hannon v. City of Newtown*, 2014 U.S. App. LEXIS 3854 (1st Cir. Feb. 28, 2014). The IRS had a filed a notice of federal tax lien in an effort to collect approximately \$5.5 million in back taxes. Mr. Hannon owned a beach front house in Newton, Massachusetts that was subject to a purchase money mortgage. After the IRS filed its lien, Rita Manning, a creditor, obtained judgment against Hannon for approximately \$100,000. 2014 U.S. App. LEXIS 3854, slip op. at \*5-\*6.

Subsequently, the City of Newton decided that it would acquire Hannon's beach front home through eminent domain so that an unstable retaining wall could be repaired. Consequently, Newton applied to the IRS for a certificate of discharge under Section 6325(b)(2)(A), submitting an appraisal that valued the property at \$2.3 million. *Id.*, slip op. at \*6-\*7. The IRS issued the requested certificate, which stated that the government was "saving and reserving, however, the force and effect of said tax lien[s] against and upon all other property or rights to property to which said lien[s] [are] attached, wheresoever situated." *Id.*, slip op. at \*8-\*9.

Hannon was dissatisfied with the amount of compensation that Newton paid for his property; under Massachusetts law he was entitled to sue for additional compensation, and he did so. *Id.*, slip op. at \*10. Manning, the judgment creditor, intervened in the action to assert her interest, and the IRS issued a notice of levy, asserting its right to any amount recovered by way of judgment. After Hannon recovered a judgment and the proceeds were paid into the court's registry, the government intervened to assert that it was entitled to the proceeds of the judgment.

The case reached the Court of Appeals after the district court granted Manning summary judgment ruling that the certificate of discharge had eliminated the federal tax lien on the judgment proceeds, reasoning that the government could retain its lien on proceeds only under Section 6325(b)(3) and that Massachusetts law made Hannon's right to recover a substitute for the real property that was the subject of the certificate of discharge. *Id.*, slip op. at \*11-\*13.

The First Circuit reversed. First, the court noted that Section 6325(b)(2)(A) was intended to give a purchaser clear title to specific property and that the plain language of the statute did not in any way suggest that other property would also be discharged. *Id.*, slip op. at \*16-\*17. Next, it rejected Manning's argument that Section 6325(b)(2)(A) and Section 6325(b)(3) had to be read together and that the latter section limited the scope of the former. Here, the court noted that Section 6325(b)(3) was added long after Section 6325(b)(2)(A) and was intended to facilitate the sale of a property where competing lien holders disputed their relative priority. *Id.*, slip op. at \*20-\*21. Accordingly, in the First Circuit's view it was incorrect to treat Section 6325(b)(3) as the sole means for the IRS to retain priority over the proceeds from the sale of the property.

The case demonstrates that a certificate of discharge under Section 6325(b) will be narrowly construed so that it only discharges the lien on the specific property listed in it.

Jim Malone is a tax lawyer in Philadelphia. © 2014, MALONE LLC.