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William F. Mosner

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FEDERAL TAX LIENS AND FORECLOSURES

WILLIAM F. MOSNER*

In the ordinary course of events, an attorney who receives an adverse decision from the Court of Appeals based solely on statutory law — or the lack of it — knows well that the opinion will state, "If the recognized rule of law is to be changed, this is a matter for the Legislature, and not for this Court." Be the disappointed lawyer a crusading soul — or one with many friends in Annapolis — he may succeed in having a bill enacted to achieve the statutory change he feels desirable. However, the reverse of the picture is most unexpected — that the Courts, after the Legislature has considered a proposed amendment and rejected it, will construe existing law to achieve the result denied by the Legislature. And, once again, the Supreme Court of the United States has done the unexpected.

In its opinion of June 13, 1960, in *United States v. Brosnan*,¹ the Supreme Court has ruled that the foreclosure of a senior mortgage under State procedure will completely wipe out junior Federal tax liens, without prior notice to the Government, without joining the Government in the case, and without a one-year right of redemption attaching to the sale.

Perhaps a brief history of the matter would be enlightening. As was pointed out in an earlier article published in the *Maryland Law Review*,² there existed a considerable problem with respect to establishing clear title at a foreclosure sale when a Federal tax lien had been filed against the owner prior to sale. Even though the defaulted mortgage was senior to the tax lien, the practically unanimous holding of the cases reported at the time the prior article was written established the principle that a tax lien could only be discharged as provided by Federal statute.³ This meant by one of three ways: (1) applying

* Of the Baltimore County Bar; LL.B., 1952, University of Maryland School of Law.

¹ 363 U.S. 237 (1960).

² Mosner, *The Nature and Scope of Federal Tax Liens with a Special Consideration of Their Effect on Mortgage Foreclosures*, 17 Md. L. Rev. 1 (1957).

³ See *Michigan v. United States*, 317 U.S. 338 (1943); *United States v. Kensington Shipyard & Drydock Corp.*, 169 F. 2d 9 (3rd Cir. 1948); *Metropolitan Life Ins. Co. v. United States*, 107 F. 2d 311 (6th Cir. 1939); *Miners Sav. Bank of Pittston, Pa. v. United States*, 110 F. Supp. 563 (Pa.

to the Secretary of the Treasury for a discharge under Section 6325, Internal Revenue Code of 1954; (2) bringing suit to clear title in the Federal Court under the cumbersome provisions of Section 7424, Internal Revenue Code of 1954; (3) joining the United States as a party in the State foreclosure case under Title 28, U.S.C.A., Section 2410, which allows the Government one year from date of sale in which to redeem.

None of the three methods afforded a really practical remedy for the mortgagee, as the first two entail a great loss of time and the third results in a discounted price being bid at the foreclosure sale, since no buyer will pay top dollar with the year redemption right attaching to the property. The moneylender was, therefore, faced with a serious problem in protecting his investment even though the property was completely free of liens and the borrowers indebted in no way to the Government at the time the loan was made. The lender through no fault of his own was liable to incur financial loss through the facets of the tax laws which allowed the Government privileges never afforded to ordinary creditors.

The situation was sorely recognized by those affected, but every effort by the Bar Associations or Savings and Loan Leagues to effect remedial legislation in Washington was met with opposition from the Internal Revenue Service, and the tax laws were not amended to afford relief.

Enter the Supreme Court: The Third Circuit Court of Appeals, in a case involving a tract of land in Pennsylvania, had held that the Government's tax lien — junior to the mortgage — was effectively extinguished by foreclosure proceedings wherein the United States was not a party.⁴ The Ninth Circuit Court of Appeals, however, ruling on a California issue, decided that a foreclosure sale wherein the Government had no notice and was not a party, was ineffective to wipe out the junior lien as it could be divested "only with the consent of the United States and in the manner prescribed by Congress."⁵ The conflict between Circuits brought the case to the Supreme Court, and it granted certiorari.⁶

1953); *Integrity Trust Co. v. United States*, 3 F. Supp. 577 (N.J. 1933); *Oden v. United States*, 33 F. 2d 553 (W.D. La. 1929); and cases collected in 174 A.L.R. 1373, 1403 (1948) and 105 A.L.R. 1244 (1936).

⁴ *United States v. Brosnan*, 264 F. 2d 762 (3rd Cir. 1959).

⁵ *United States v. Bank of America National Trust & Savings Association*, 265 F. 2d 862 (9th Cir. 1959).

⁶ 361 U.S. 811 (1959).

The opinion of the majority (Justice Harlan) cut through the multitude of previously adjudicated Federal cases, declaring that uniformity throughout the States was a necessary objective to oil the machinery for the effective collection of Federal taxes. The Court recognized that different states had different procedures for foreclosure — some requiring a public sale, some not; some requiring notice to junior lienors, others not. But, rejecting the time-honored precept of uniformity, the Court declared, "We believe that, so far as this Court is concerned, the need for uniformity in this instance is outweighed by the severe dislocation to local property relationships which would result from our disregarding state procedures . . . ;"⁷ and the opinion continued, "We . . . believe it desirable to adopt as federal law state law governing divestiture of federal tax liens"⁸

Having thus stated its objective, the Supreme Court set about achieving it by declaring Sections 6325, 7424 and 2410⁹ to be permissive only, and not mandatory directions as to the exclusive methods for disposing of tax liens, as had been held by the former decisions.¹⁰ (One cannot but comment that these statutes — if not mandatory — will quickly become as archaic and unused as those on our books which authorized public whippings, for no sane attorney with a title problem will add to his woes by making the Government a party where the simpler, quicker and more readily available state procedure will suffice.) Justice Harlan declared that the legislative history of the cited sections gave no evidence that Congress believed that a suit to which the United States was a party was the only way in which a Federal lien could be extinguished, and he reasoned that those statutes were only enacted as optional methods which could be used in addition to existing state procedures. But it is respectfully submitted that this reasoning is difficult to follow. Consider, for instance, certain excerpts from the legislative debates preceding enactment of these statutes as set out in footnotes to the majority opinion:

"At the present time, in cases in which the lien prior in time to that of the United States equals or exceeds in amount the value of the property, *there is*

⁷ *Supra*, n. 1, 242.

⁸ *Id.*, 241.

⁹ *Id.*, 246-250.

¹⁰ *Supra*, n. 3.

no method whereby the lien for taxes may be discharged without payment.”¹¹

“In such circumstances, the mortgagee finds himself at an impasse. *It is impossible for him to bring about a judicial sale of the property* owing to the cloud upon the title created by the Government’s lien. *He cannot remove the lien* as there is no method by which he may bring the United States in as one of the parties to the foreclosure proceeding. * * * The law provides and equity dictates that the Government’s lien in such circumstances should have a junior status, yet under the present practice the inability of the plaintiff to bring the United States in as a party to the preceding to foreclosure or have execution and sale on a court judgment where a Government lien is found to have been placed on the property subsequently to the time of the plaintiff’s encumbrance ties the hands of a prior lien holder by making it impossible for him to grant a clear title to the property and thus for no just reason deprives him of the benefits of his security or court judgment as the case may be.”¹²

“[B]ut this [state foreclosure] would do him [mortgagee] no good unless he could get the United States made a party to the proceeding in some way so that the lien would be relieved on the part of the Government.

“The foreclosure [in state court without the Government being a party] the gentleman speaks of *could not possibly discharge* the Government’s lien.”¹³

It would seem apparent from these debates that Congress was of the opinion that the tax lien was unaffected by state procedures, and that the enactment of Section 2410 was specifically intended to alleviate the problem by allowing the United States to be made a party to a state foreclosure and thus have the lien extinguished. But, apart from what can be gleaned from the legislative history as to the lawmakers’ intent, there would appear to be no purpose whatsoever to Section 2410 if prior to its enactment federal liens were considered discharged by the foreclosure of a senior encumbrance. The very enactment

¹¹ *Supra*, n. 1, 247, fn. 11; Senate Committee, S. Rep. No. 398, 68th Congress, 1st Sess. 46. Emphasis supplied.

¹² *Supra*, n. 1, 248, fn. 11. House Committee, H. Rep. No. 95, 71st Congress, 2nd Sess. 1-2. Emphasis supplied.

¹³ *Supra*, n. 1, 248-249, fn. 11. Rep. Graham (Pennsylvania). Emphasis supplied.

of the statute presupposes that it has some purpose, and if Congress had not thought a new statute necessary to dispose of junior tax liens, why would it have cluttered up the books with "permissive" legislation? If there were no problem, there need be no remedial statute. However, the highest court of the land has an exclusive monopoly on mind reading when it comes to legislative intent, and we can only hope that a new Congress agrees that its predecessors meant — not what they said — but what the Supreme Court decided they meant to say. If the new Congress does not so agree, we can anticipate another statute specifically declaring the status of tax liens in state foreclosures and executions.

The final matter dealt with by the majority was the objection by the United States that a judicial sale in a state foreclosure case — if it disposed of the Government's interest in the property — was actually a suit against the United States, which could not be maintained without its consent.¹⁴ Recognizing the merit in the Government's argument, the Court nonetheless refused to extend the principle of sovereign immunity from suit to such limits, as such a principle would:

" . . . trespass upon the considerations which have led to our refusal to fashion a federal rule of uniformity respecting the extinguishment of federal junior liens under state procedures. * * * Until Congress otherwise determines, we think that state law is effective to divest Government junior liens in cases such as these."¹⁵

Four justices dissented from the majority view,¹⁶ and the vigorous minority opinion by Justice Clark took the stand that the denial of uniformity in tax collection procedures not only departed from the traditional approach of the Supreme Court to similar problems, but that such denial actually impairs the revenue of the United States. It is difficult to argue with this latter statement, for, as Justice Clark points out, the United States — as a junior creditor — will not even receive notice of a foreclosure or execution sale in order to lay claim to a surplus for unpaid taxes.

While the minority holds out for a uniform rule applicable in every state, it indicates that it would settle for a

¹⁴ *The Siren*, 7. Wall. 152 (U.S. 1868); *Minnesota v. United States*, 305 U.S. 382 (1939); *United States v. Alabama*, 313 U.S. 274 (1941).

¹⁵ *Supra*, n. 1, 251-252.

¹⁶ Chief Justice Warren, Mr. Justices Black, Frankfurter and Clark.

requirement that the Government — if not made a party — at least receive notice of the sale in time to protect its interest in the property. Since the majority recognized that Congress might well step in to clarify the situation, it is a reasonable prediction that, as a compromise to the rule of uniformity which will doubtless be pressed for by the Government at the next legislative session, the lawmakers might well heed Justice Clark's plea for a requirement of notice to the Government, but otherwise allow the disposition of Federal tax liens to be governed by state law.

While certain of the language used above may seem to indicate that the writer is hypercritical of the majority decision in these cases, such is not the case. It has long been the opinion of the writer that the Federal Government went entirely too far in protecting its liens. There is no just or equitable reason why an individual or an institution which lends its money on an unencumbered piece of real estate, must face the endless red-tape of discharge procedures, or else get a depreciated price for the property at public sale when the Government's right of redemption is made known to purchasers. Admittedly, the collection of revenue must be protected, but how far are we from socialism when the interests of a central government rise so far above — and actually discriminate against — the interests of the individuals who make up the society? We are in complete agreement with the result achieved by the majority opinion, but it must be confessed that our thoughts on the rules of *stare decisis* and statutory interpretation may never again be the same.

Of particular interest to the Maryland practitioner is the fact that he is no longer obliged to make a search of the Federal Tax Lien Index right up to the very day of the foreclosure sale. The purchaser will take the title as held by the owner at the time of the mortgage, regardless of intervening Federal liens. Our procedure is such that all junior liens are wiped out by foreclosure of a prior encumbrance,¹⁷ and tax liens now fall under the same rule. In addition, even if the foreclosing party has actual knowledge of the existence of a junior tax lien, he is not obliged to make the United States a party to the suit, or even to give notice of the foreclosure. Until Congress acts further, the testy problem of tax liens in foreclosures and executions has been alleviated.

¹⁷ 5 MD. CODE (1957) Art. 66, § 7(c); *Madore v. Thompson*, 155 Md. 676, 142 A. 529 (1928); *Chilton v. Brooks*, 71 Md. 445, 18 A. 868 (1889).