

better able to protect himself from the impact of possible intervening state and local tax liens.

In the case of *International Harvester Credit Corp. v. Goodrich*, previously referred to in connection with the discussion under "*E—State and Local Taxes*," the Supreme Court opinion emphasizes this point. There, in discussing the problems of sellers under conditional sales agreements who found that the state statute imposed a highway use tax lien upon trucks sold under conditional sales agreements for the taxes due from the purchaser, the court said:

This statutory lien does not destroy the efficacy of conditional sales financing. Practically, it suggests that the conditional vendors secure assurance from their carrier-customers that the latter's highway use taxes are not in arrears.⁸⁰

The Government is an unwilling tax creditor. It does not have these means of protecting itself. It cannot select its tax debtor after examination of his financial condition. It has no choice in the extension of credit for taxes. The debt is created *ex parte* by the taxpayer's failure or neglect to pay the taxes owed.

Creditors should be reminded not to sleep on their rights. They may very well and very properly conclude that a person who fails to satisfy his debts may very possibly be in the process of incurring a tax debt which will result in a lien. They will be protected if they place themselves in the position of a purchaser, pledgee, mortgagee, or judgment creditor in the conventional meaning of those words as indicated in the judicial decisions.

The discharge of property from lien procedure is very often rewarding and can be used to give relief to persons affected by these tax liens.

The application of procedures to effect the discharge of property from the effect of Federal tax liens depends upon the specific facts involved, and an elaborate discussion does not appear desirable. However, it may be said that in any lien case, Internal Revenue Service officers and attorneys in the office of the Regional Counsel may be in a position to aid in a resolution of lien problems and, I may add, will be happy to be of service.

⁸⁰ *International Harvester Credit Corp. v. Goodrich*, 350 U.S. 537, at 546 (1956).

TITLE PROBLEMS IN CONNECTION WITH FEDERAL TAX LIENS*

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As will be seen from the title, my task in this Institute is to discuss not federal taxes, their size or how they are acquired, but their effect on real estate titles. Although it may be somewhat elementary, it would seem appropriate to preface this talk with a brief discussion on how titles are established. In the United States the predominate method of evidencing titles is through recording Acts. In order to determine the validity of marketability of real estate titles, abstracts of the records are prepared and are examined by attorneys. It may be assumed that practically all Iowa lawyers in general practice are competent to examine abstracts of title, but are not tax specialists. Fortunately, insofar as federal tax liens are concerned, the title examiner about nine times out of ten is examining title either for a purchaser or for a mortgagee. This limits the needs for exact and special knowledge of federal tax liens to those which have, or may have, priority over the claims of these two classes of clients. If it seems elementary in this audience to discuss abstracts of title and examination and opinions thereon, I am reminded of the case of the attorney who was arguing an appeal in the Supreme Court. He spent a great deal of time in what appeared to be elementary propositions and was finally stopped by one of the Justices who said, "Mr. Jones, it would seem that you ought to assume that this court knows something about these elementary propositions." The arguing attorney said, "Your Honor, that is just the mistake I made in the lower court and I don't want to make it again here in this court."

In an earlier day, attorneys generally made examinations of title by direct search of the records or from abstracts which they, themselves, prepared. In a great majority of cases, this is no longer true and abstracts are made by "abstracters" who are specialists in their profession. An abstract is just what the term indicates. It is a summary of all the material parts of the public records. An abstract begins with what is called a caption. The caption gives an exact description of the real estate under examination and the opening date of the search. Ordinarily, the opening date is the original entry and Patent from the United States Government. There follow "entries", which are brief statements of the material parts of the records. The abstract then closes with the abstracter's certificate. This certificate is the abstracter's contract with his customer. It states the extent of his search and the closing date thereof.

When the abstract has been prepared and certified, it is delivered to the customer or to the customer's attorney and the attorney then prepares an opinion thereon for which he assumes liability. The attorney's opinion begins with a description of the real estate in the abstract under examination and shows the opening and closing date, usually setting out the number of the entries contained in the abstract. It is a very good practice for an attorney to make some indication on the opening and closing entries of

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the abstract of the date when he made his examination. In the practice in our office, we find that the records which we have kept over many years are of great help in shortening the work necessary to make subsequent examinations. By noting the date of the previous examination and the number of entries contained therein, we are able greatly to cut down the time consumed in examining for a subsequent opinion. In the opinion the attorney should first make a finding of "record title" and it is proper to state that the record title rests on a certain instrument, warranty deed, etc., giving the date of such instrument and the entry at which it can be found. There follow next the exceptions to marketability. If there are any clouds on the title, or matters which need correction, these are set out as exceptions. The attorney should also indicate in his opinion suggested methods of clearing whatever exceptions to marketability he has noted. It is well also to add a "caution" clause in which the attorney advises his client that there are certain matters such as forged deeds, marital status of parties to instruments contained in the abstract and so on, which will not be disclosed by the records, and as to which the client must take notice. It is always proper to call the client's attention to the fact that possession of real estate is notice of the rights of the person in possession. The title examiner then signs the opinion and it constitutes his contract with his client.

We should first notice the several types of federal taxes which constitute liens on real property. There is the general lien for taxes against all property.¹ This lien arises "at the time the assessment is made." It will be seen that this lien is a secret lien and is good against anyone with certain exceptions. The lien continues "until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time."² The time for collection of the tax is within six years after the assessment of the tax,³ unless no return or a false return has been made, or time has been extended by agreement.⁴

An estate tax is imposed upon the gross estate of the decedent.⁵ In general, the "gross estate" means all of the assets of the decedent, except expenses of administration. There is a limitation upon the lien of the estate tax of ten years.⁶ Transferees, those to whom any of the assets of the decedent are transferred, are personally liable for the tax, to the extent of the value of the property received.⁷ It is to be noted that property which has been conveyed to a transferee is divested from the tax in the hands of a "bona fide purchaser, mortgagee, or pledgee." The tax is not divested in the hands of a "judgment creditor." As will be mentioned later, a judgment creditor is protected as against certain liens as to which notice must be filed in order to constitute a lien.⁸ The real estate lien of the estate tax may be released by the Secretary.⁹ In order to secure this

¹ INT. REV. CODE OF 1954 § 6321.

² INT. REV. CODE OF 1954 § 6322.

³ INT. REV. CODE OF 1954 § 6502.

⁴ INT. REV. CODE OF 1954 § 6503(d).

⁵ INT. REV. CODE OF 1954 § 2001.

⁶ INT. REV. CODE OF 1954 § 6324(a)(1).

⁷ INT. REV. CODE OF 1954 § 6324(a)(2).

⁸ INT. REV. CODE OF 1954 § 6323.

⁹ INT. REV. CODE OF 1954 § 6325.

release, it is only necessary to convince the Secretary that there are sufficient other assets to satisfy the tax.

Gift taxes are imposed upon the subject of the gift, when the size of the gift exceeds the allowable exemptions.¹⁰ Like the estate tax, the limitation on the gift tax is ten years from the date of the gift.¹¹ The donee of the gift is personally liable to the value of the extent of the gift.¹² Again, as in the case of the estate tax, the subject of the gift is divested of the liens in the hands of a "bona fide purchaser, mortgagee, or pledgee."¹³ Likewise, the lien may be released by the Secretary, upon a proper showing.¹⁴

Federal law also provides for a special lien for liquor taxes.¹⁵ This lien applies only to specific property used in connection therewith and is, ordinarily, not of concern to the title examiner, unless the tract of land is used for a distillery, storage, etc.¹⁶

There are also tax claims in the case of bankruptcies and insolvencies.¹⁷ These taxes are not ordinarily involved in title examinations.

Of paramount importance to the title examiner is the question of priorities of Federal taxes as against other liens or claims to the real estate. The general lien for all taxes imposed by Section 6321¹⁸ is prior to all other liens, except those specifically protected by Section 6323.¹⁹ Those specifically protected against the secret lien are purchasers, mortgagees, pledgees, and judgment creditors. As to these classes, the Federal lien must be filed in accordance with the Recording Acts of the specific state. In Iowa, this is provided by Section 335.11.²⁰ Strict interpretation of Federal tax liens is indicated by the following quotation from Justice Jackson in the case of *United States v. Security Trust & Savings Bank*:

My conclusion from this history is that the statute [§ 6323] excludes from the provisions of this secret lien those types of interests which it specifically included in the statute [mortgagees, pledgees, purchasers, and judgment creditors] and no others.²¹

The United States Supreme Court has rather consistently adhered to the common law rule of "first in time, first in right".

We believe that priority of these statutory liens is determined by another principle of law, namely, "the first in time is the first in right." As stated by Chief Justice Marshall . . . "The principle is believed to be universal, that a prior lien gives a prior claim, which is entitled to prior satisfaction out of the subject it binds. . . ."²²

To be prior to the federal lien, however, the competing lien must constitute a "property right" and must be "choate"—complete and specific. Mechanic's liens, attachments, *lis pendens*, etc., are not sufficiently "choate".²³

¹⁰ INT. REV. CODE OF 1954 §§ 2501-2524.

¹¹ INT. REV. CODE OF 1954 § 6324(b).

¹² INT. REV. CODE OF 1954 § 6324(b).

¹³ INT. REV. CODE OF 1954 § 6324(b).

¹⁴ INT. REV. CODE OF 1954 § 6325.

¹⁵ INT. REV. CODE OF 1954 § 5004.

¹⁶ INT. REV. CODE OF 1954 § 5004(a) (1).

¹⁷ 11 U.S.C. § 104(a), 31 U.S.C. § 191 (1958).

¹⁸ INT. REV. CODE OF 1954 § 6321.

¹⁹ INT. REV. CODE OF 1954 § 6323.

²⁰ IOWA CODE § 335.11 (1958).

²¹ *United States v. Security Trust & Sav. Bank*, 340 U.S. 47, 53 (1950).

²² *United States v. City of New Britain*, 347 U.S. 81, 85 (1954).

²³ See *United States v. City of New Britain*, 347 U.S. 81 (1954), *United States v. Gilbert Associates*, 345 U.S. 361 (1953), and *United States v. Security Trust & Sav. Bank*, 340 U.S. 47 (1950), for further discussion of "choateness."

"Open-end" mortgages and construction liens probably do not come within the protection of Section 6323²⁴ as to future advances.²⁵ Purchase money mortgages should qualify as prior to federal liens, regardless of notice, since the federal lien attaches only to taxpayer's property, under Section 6321. A purchase money mortgage is regarded as a limitation on the property which the purchaser takes at the time he executes the mortgage.²⁶

A complicated and confusing rule in regard to assigning priority to competing liens is known as the "circuitry" rule. It may often happen that a Federal lien is junior to a mortgage, but the mortgage may, in turn, be junior to a State tax on the mortgaged property. In such a case, the mortgage is satisfied from the property to the extent of its value, less the prior State lien, and the balance, if any, is applied to the federal lien. This is illustrated in the case of *United States v. New Britain*.²⁷ The Iowa rule which seems to follow the reasoning of the federal case, is found in *Burns v. Burns*.²⁸

A somewhat recent phenomena in the ownership of Iowa property is the tendency to hold titles in joint and survivorship conveyances. In the case of property so held, the survivor takes title by virtue of the original conveyance. The property is not subject to disposal by will or to dower rights. A judgment against one of the joint owners can only be enforced while such judgment debtor is alive. Upon his death, the survivor takes free from such judgment. The same rule holds as to the enforcement of liens against one of the joint owners. Unless enforced during his lifetime by levy and sale, which constitutes a "severance", the survivor takes free from all such liens.²⁹

It should be borne in mind that the personal exemptions, as provided by State law for a taxpayer, do not apply as against federal tax liens, and the taxpayer is entitled only to such exemptions as are provided by federal law in Section 6334.³⁰

In summary, one who examines abstracts of title to real estate is ordinarily concerned only with federal liens, notice of which have been filed, then the question is whether competing liens are prior in date, to such notice. But if title examination is for any person other than a purchaser, or mortgagee, the examiner should probably add a caution to warn his client against the possibility of "secret" federal liens. If the real estate is in the process of probate administration, the examiner is, of course, charged with notice of possible estate taxes. If there has been a transfer in "contemplation of death" within three years of death, the Estate tax will presumptively constitute a lien.³¹ If there has been a transfer by way of gift within ten years, the gift tax will constitute a lien, assuming, of course, that the subject of the gift exceeds the allowable exemptions.³²

²⁴ INT. REV. CODE OF 1954 § 6323.

²⁵ See Rev. Rul. 56-41, 1956-1 CUM. BULL. 562. See also, *United States v. City of New Britain*, 347 U.S. 81 (1954); Plumb, *Federal Tax Collection and Lien Problems*, 13 TAX L. REV. 459, 494-95 (1958).

²⁶ *United States v. New Orleans & O.R.R.*, 79 U.S. 362 (1870).

²⁷ 347 U.S. 81 (1954).

²⁸ 233 Iowa 1092, 11 N.W.2d 462 (1943).

²⁹ See Annot., 111 A.L.R. 171 (1937).

³⁰ INT. REV. CODE OF 1954 § 6334.

³¹ INT. REV. CODE OF 1954 § 2035.

³² INT. REV. CODE OF 1954 § 6423(b).

Or, if the deceased owner of real estate had retained a life interest therein, then the remainderman comes into possession only upon the death of the life tenant, then the estate tax constitutes a lien. Any transfer which takes effect upon the death of the grantor, is subject to the federal estate tax.⁸³ In closing, let me say again that the title examiner is not primarily concerned with whether or not there is a federal tax, or its size. He is concerned with whether such taxes constitutes a lien on real estate and their relative priority. I have attached hereto a list of general references or bibliography which go into great detail on these tax lien matters. If you will read carefully and digest these subjects, then you can qualify as a "tax specialist."

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⁸³ INT. REV. CODE OF 1954 § 2036.