

Lesson 8

JUDICIAL AND NONJUDICIAL FORECLOSURES AND SALES

(March 2012)

CONTENTS

I. INTRODUCTION	1
II. OBJECTIVES	2
III. DISCHARGES IN JUDICIAL PROCEEDINGS.....	2
A. 28 U.S.C. § 2410 – Judicial Sales: U.S. Named in Suit.....	2
B. I.R.C. § 7425(a) – Judicial Sales: U.S. Not Named in Suit	3
C. Administrative Discharges (General)	3
1. When Available	3
2. How Obtained	4
IV. DISCHARGES IN NON-JUDICIAL PROCEEDINGS.....	4
A. I.R.C. § 7425(b) and (c)	4
B. "Non-judicial Sale" Defined	5
V. NOTICE OF SALE REQUIREMENTS (I.R.C. § 7425(b)(1) & (c)(1)).....	6
A. When Required	6
B. When Not Required	7
C. Timing.....	7
D. Postponements of Sales.....	7
E. Form.....	7
F. Contents	7
G. Adequacy and Acknowledgment	8
VI. SALE OF PERISHABLE GOODS	8
A. Perishable Goods Defined.....	8
B. Notice Requirements.....	9
VII. CONSENT TO SALE.....	9
VIII. DISCHARGE APPLICATION	10

I. INTRODUCTION

Prior to the Federal Tax Lien Act of 1966, a junior federal tax lien could be discharged on foreclosure of a senior lien. See, e.g., United States v. Brosnan, 363 U.S. 237 (1960). This occurred in—

- Plenary judicial actions, and
- Non-judicial actions, e.g. -
 - Foreclosures pursuant to power of sale contained in security instrument.
 - Foreclosures by a judicial officer pursuant to judgment entered by a "confession of judgment" signed by debtor.

Revised (March, 2012)

Discharge of the junior federal tax lien often occurred without the United States being made a party to the proceeding or having actual notice of the non-judicial action. It was impossible for the Service to take steps to protect the interests of the United States under such circumstances.

Congress addressed these problems in section 7425 of the Internal Revenue Code, which greatly increased the rights of the United States in such cases. See Elias v. Commissioner, 100 T.C. 510 (1993).

II. OBJECTIVES

At the end of this lesson you will be able to:

- Identify when a federal tax lien may be discharged in the course of a judicial or non-judicial foreclosure by a third party;
- Explain the notice requirements which must be met in order for a foreclosure sale to effect a discharge of a federal tax lien; and
- Identify various administrative steps available to effect discharge in appropriate cases without litigation.

III. DISCHARGES IN JUDICIAL PROCEEDINGS

A. 28 U.S.C. § 2410 – Judicial Sales: U.S. Named in Suit

1. Under 28 U.S.C. § 2410, the United States may be named a party in certain civil actions or suits, in state or federal court, if the United States has or claims a lien on the real or personal property that is the subject of the suit. This waiver of sovereign immunity extends to:

- a) Quiet title actions
- b) Foreclosures
- c) Partitions
- d) Condemnations
- e) Interpleaders

2. If the United States is joined as a party, the junior tax lien is discharged if the litigation produces that result; local law controls whether to discharge the lien. However, an action to foreclose a mortgage or other lien, naming the United States as a party under section 2410, must also seek a judicial sale of the property in order for the tax lien to be discharged. 28 U.S.C. § 2410(c).

3. If the lien being foreclosed is junior to the federal tax lien, the federal tax lien is unaffected by the judicial proceeding unless the United States agrees otherwise. Rodriguez v. Escambron Dev. Corp., 740 F.2d 92, 99 (1st Cir. 1984); Berlin v. United States, 535 F. Supp. 298 (E.D.N.Y. 1982).

Revised (March, 2012)

B. I.R.C. § 7425(a) – Judicial Sales: U.S. Not Named in Suit

1. Section 7425(a) of the Code provides that if the United States is not named a party to a suit allowed under 28 U.S.C. § 2410, a judgment or judicial sale pursuant to such a judgment shall be subject to and without disturbing the federal tax lien on the property (real or personal), if a notice of lien has been properly filed at the time the suit is commenced. Section 7425(a)(1).
2. However, if a notice of lien is not on file at the time the proceeding is commenced, or if the law makes no provision for such filing (e.g., estate and gift tax liens), the judgment or judicial sale will discharge the lien from the subject property, if local law where the property is situated so provides. Section 7425(a)(2).
3. If the United States is improperly named as a party, the result is the same as if the United States were not joined. Treas. Reg. § 301.7425-1(c)(1).
4. If the judicial sale discharges the federal tax lien, the United States may claim the sales proceeds (less costs) with the same priority it had on the property sold. The claim must be made before the distribution of sales proceeds is ordered. Section 7425(a) (flush language). The claim may be made by intervening in the action under section 7424.
5. Some courts have held that the failure of a mortgagee to comply with the notice provisions of section 7425 before it conducts the foreclosure sale and purchases the property, causes the mortgage lien to be extinguished and the federal tax lien to be elevated from its junior status. See United States v. Polk, 822 F.2d 871 (9th Cir. 1987); Southern Bank of Lauderdale v. Internal Revenue Service, 770 F.2d 1001 (11th Cir. 1985). State law determines whether mortgage liens are extinguished upon foreclosure, and whether a purchaser at foreclosure is subrogated to the foreclosing mortgagee. The law on these points remains somewhat unsettled. See Tompkins v. United States, 946 F.2d 817 (11th Cir. 1991); Colorado Property Acquisitions v. United States, 894 F.2d 1173 (10th Cir. 1990).

C. Administrative Discharges (General)

1. When Available

a) Foreclosing mortgagees may avail themselves of the administrative discharge provisions of section 6325(b), which allows the Internal Revenue Service (the “Service”) to issue a certificate of discharge when—

- (1) The value of the property is at least double the amount of the unsatisfied liability and all other prior liens;

(2) Partial payment is made equal to the value of the Service's secured interest in the property;

(3) The secured interest in the property has no value; or

(4) The Service's lien is to be paid out of sale proceeds on the property.

b) This is a highly desirable result, and should be encouraged, because it avoids unnecessary litigation. It is desirable from the purchaser's perspective because the right of redemption accruing to the United States under 28 U.S.C. § 2410(c) is eliminated.

2. How Obtained

a) A conditional commitment letter is issued by the Service prior to the judicial foreclosure sale. Upon conclusion of the foreclosure proceeding, payment of the amount determined to be the value of the lien interest, if any, is made and a certificate of discharge issued.

b) Look for changes in the value of the government's interest between the time the letter is issued and the property is sold. (This contingency should be covered in the conditional commitment letter.)

c) If the United States has already been named a party in a suit, a certificate of discharge can still be issued. However, the plaintiff should agree to dismiss the United States in return for the conditional commitment. The U.S. Attorney should be notified of the issuance of the certificate.

IV. DISCHARGES IN NON-JUDICIAL PROCEEDINGS

A. I.R.C. § 7425(b) and (c)

1. Section 7425(b) provides that if the United States has or claims a lien (or title derived from enforcing a lien) on property, a sale of that property in a non-judicial sale will not discharge a junior federal tax lien or defeat a title derived from enforcing the lien, if—

a) Notice of the lien (or title) was properly filed more than 30 days before the date of sale; and

b) The United States is not given at least 25 days written notice of the sale pursuant to section 7425(c)(1). Russell v. United States, 551 F.3d 1174 (10th Cir. 2008), cert. denied, 130 S.Ct. 95 (2009) (state law remedies and lien priority rules held preempted by section 7425(b))

Revised (March, 2012)

structure where United States not given 25 days notice of sale) (citing Security Pacific Mortgage Corp. v. Choate, 897 F.2d 1057 (10th Cir. 1990)).

c) The general rationale for notice to the United States of the sale is to allow the government to “review its position and determine the appropriate action.” United States v. Beauchamp, 611 F. Supp. 2d 194 (D. R.I. 2009) (quoting S. Rep. No. 1708, 89th Cong., 2d Sess., reprinted in 1966 U.S.C.C.A.N. 3722, 3748).

2. However, if a notice of lien (or title) was not on file for more than 30 days (or the law makes no provision for such filing), or notice of the sale is required and is timely given, the non-judicial sale discharges the federal tax lien (or defeats title), if that is the effect upon junior interest holders under state law. I.R.C. § 7425(b)(2).

3. Notwithstanding the notice requirement, the Service, upon prior application, may consent to a sale of the property free and clear of the federal tax lien (or title). See section 7425(c)(2); Treas. Reg. § 301.7425-3(b).

4. As a general rule, the third-party purchaser at the foreclosure sale may be subrogated to the rights of the foreclosing lienor to the extent of the amount paid. See local law.

5. Right of redemption -- section 7425(d): The United States may redeem property within 120 days of a sale to which section 7425(b) applies (or within the time allowed under local law for redemption, whichever is longer).

a) The amount to be paid is determined under the formula set out in 28 U.S.C. § 2410(d).

b) A certificate of redemption must be recorded under local law. See Real Estate Equity Strategies, LLC v. Internal Revenue Service, 540 F.3d 860 (8th Cir. 2008) (even assuming an untimely redemption by the United States, a mortgage holder that failed to tender sufficient redemption funds under applicable state law lacked right to contest Service’s certificate of redemption).

B. "Non-judicial Sale" Defined

1. Treasury Regulation section 301.7425-2(a) states that a non-judicial sale is a sale made pursuant to—

a) An instrument creating a lien on the property sold;

b) A confession of judgment on the obligation secured by an instrument creating a lien on the property sold; or

c) A statutory lien on the property sold.

2. The term includes, but is not limited to, the divestment of the taxpayer's interest in property, either real or personal, which occurs: (a) by operation of law, (b) by public or private sale, (c) by forfeiture, or (d) by termination under provisions contained in a contract for a deed or a conditional sales contract. Treas. Reg. § 301.7425-2(a).

3. Examples:

a) Tax sales under statutory liens. See Kasdon v. G.W. Zierdon Landscaping, Inc., 541 F. Supp. 991 (D. Md. 1982), aff'd sub nom Kasdon v. United States, 707 F.2d 820 (4th Cir. 1983).

b) Strict foreclosures. See Galesi v. United States, 406 F. Supp. 623 (D. Vt.), aff'd, 544 F.2d 606 (2d Cir. 1976) (decision adverse to the United States). Compare United States v. Fernandez, 82-1 U.S.T.C. (CCH) ¶ 9212 (D. P. R. 1981) (foreclosure was judicial sale), with Myers v. United States, 647 F.2d 591 (5th Cir. 1981) (foreclosure was non-judicial sale).

c) Forfeitures. Section 7425(c)(4) explicitly includes a forfeiture of a land sales contract as a non-judicial sale of property. See Orme v. United States, 269 F.3d 991 (9th Cir. 2001).

d) Mortgages or deeds of trust with powers of sale. See Zink v. United States, 82-1 U.S.T.C. (CCH) ¶ 9277 (S.D. Tex. 1981).

e) Uniform Commercial Code "self-help" provisions concerning secured interests in personal property.

V. NOTICE OF SALE REQUIREMENTS (I.R.C. § 7425(B)(1) & (C)(1))

A. When Required

A notice of sale is required only if a notice of federal tax lien has been filed in the proper place for more than 30 days before the date of sale. For this purpose the "date of sale" is—

1. For public sales, the day the sale is held;
2. For a private sale, the date the title to the property is transferred; and

3. For cases not involving a public or private sale, the date junior liens are divested under local law. Treas. Reg. § 301.7425-2(b).

B. When Not Required

No notice of sale is required if notice of the tax lien has not been filed; there are no provisions for filing (e.g., estate and gift tax liens); or the notice has been on file less than 31 days before the sale. Government agencies (VA, FHA, SBA, etc.) do not give notice, but apply for certificate of discharge.

C. Timing

Notice of the sale must be given not less than 25 days before the sale date. The provisions of sections 7502 and 7503 apply in determining the date of the notice. Treas. Reg. § 301.7425-3(a)(1).

D. Postponements of Sales

1. If notice has been given, notice of the postponement must be given in the manner prescribed by local law.
2. If notice would not be required if the sale occurred on the originally scheduled date, notice must be given if--
 - a) More than 30 days elapse between the original date of sale and the new date of sale, and
 - b) A notice of tax lien is filed more than 30 days before the new date of sale.
3. See examples in Treas. Reg. § 301.7425-3(a)(2)(iii). See also Baldwin County Sav. and Loan Assn. v. IRS, 921 F.2d 1229 (11th Cir. 1991).

E. Form

Notice shall be given in writing by registered or certified mail or by personal service to the appropriate Service office. Treas. Reg. § 301.7425-3(a)(1). See Musick v. United States, 87-2 U.S.T.C. (CCH) ¶ 9632 (C.D. Ca. 1987). Actual notice cannot be substituted for written notice. Nat'l Cent. Bank v. United States, 78-2 U.S.T.C. (CCH) ¶ 9544 (M.D. Pa. 1978).

F. Contents

Treas. Reg. § 301.7425-3(d)(1) requires that the notice of sale include:

1. Name and address of person submitting notice;

Revised (March, 2012)

2. A copy of the notice of lien, or the following information from the notice: name and address of the taxpayer; date and place of filing of the notice; and Service office named in the notice;
3. Detailed description of the property;
4. Date, time, place, and terms of sale;
5. Approximate amount of secured obligations; and
6. Sales expenses and other costs which may be charged against the sale proceeds.

G. Adequacy and Acknowledgment

1. All notices must contain the name and address of the person submitting the notice. Notices lacking this information are considered inadequate for all purposes, and the Service's general obligation to provide written notice of a notice's flaws does not apply. Treas. Reg. § 301.7425-3(d)(2).
2. If the tax lien data (such as the Service office named in the lien and date and time the lien notice was filed) is missing from the notice, the Service may simply give notice of that fact without specifying other inadequacies and the notice is considered inadequate for all purposes. Treas. Reg. § 301.7425-3(d)(2).
3. Adequacy of the notice is conclusively presumed where the notice contains the name and address of the person submitting the notice, unless the person submitting the notice receives written notification of the inadequacy at least six days prior to the sale. Treas. Reg. § 301.7425-3(d)(2).
4. Acknowledgment of receipt of the notice by the Service will be provided upon request. Treas. Reg. § 301.7425-3(d)(3).
5. The Service may disclose to any person having a proper interest whether adequate notice was given. Treas. Reg. § 301.7425-3(d)(4).

VI. SALE OF PERISHABLE GOODS

Special rules apply to non-judicial sales of perishable goods. Section 7425(c)(3); Treas. Reg. § 301.7425-3(c).

A. Perishable Goods Defined

"Perishable goods" means any tangible personal property, which in the reasonable view of the person selling the property—

1. Is liable to perish; or
2. Become greatly reduced in price or value by keeping; or
3. Cannot be kept without great expense.

B. Notice Requirements

1. The notice criteria are the same as for nonperishable goods, except that the notice may be given at any time before the sale. (Note that notice could properly be mailed immediately before the sale.) The notice must also state the reasons for perishability.
2. The seller of the perishable goods must hold the proceeds of the sale (less costs) for not less than 30 days as a fund subject to the liens and claims of the United States (with the same priorities as before the sale). If the proceeds are not so held and the United States claims the funds within 30 days after the sale date, the seller is personally liable to the extent of the government's interest in the fund.
3. The buyer of perishable goods takes them free of the liens and claims of the United States, provided the notice requirements described above are met. The appropriate Service official needs to approve the ultimate seizure and sale of perishable goods.

VII. CONSENT TO SALE

1. Notwithstanding the notice of sale provisions of section 7425(c), the Service may consent to a sale of the property free of the lien (or title) of the United States. Section 7425(c)(2); Treas. Reg. § 301.7425-3(b).
2. The consent must be requested in writing and contain the same information that the notice contains. The consent application must also describe why the applicant wants the consent.
3. The request must be made before the sale.
4. The consent itself must be given in writing.
5. The consent may be based upon such limitations and conditions as the Service may require (e.g., payment of the tax).
6. The right of the United States to redeem the property is not affected by the consent. Treas. Reg. § 301.7425-4(a)(1).

VIII. DISCHARGE APPLICATION

Except in the case of applications by government agencies, applications for discharge will not be granted following a non-judicial foreclosure sale that discharges the federal tax lien. The discharge occurs by operation of law. Thus, the issuance of a certificate would be meaningless. Rev. Rul. 61-19, 1961-1 C.B. 715.

Note that on December 16, 2008, the Service issued Information Release 2008-141 to announce certain types of expedited lien-related relief for financially distressed homeowners. This Information Release addresses, among other things, expedited processing for requests to discharge or subordinate a lien.