

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Technical Services (Collection), St. Louis
SE:S:C:AIQ:TSA:MC:GP6 Mail Stop 5333 STL
Attention: Phil Kovace

from: Associate Area Counsel (SB/SE), St. Louis

subject: Priority of estate tax lien

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

LEGEND

A:

B:

C:

D:

ISSUES

The question raised in your request for advice concerns the priorities of the United States and A in a parcel of real estate which had been included in B's estate.

CONCLUSION

The lien interests of the United States in the subject real estate have been divested in relation to the interests of A.

FACTS

According to your request for advice, B died on C. Included in the property owned by B at the time of his death was a parcel of real estate which B had owned in joint tenancy with his wife, who predeceased B. Therefore, at his death, B was the sole owner of the property. Prior to his death, however, B had executed a "beneficiary deed" with respect to such property in favor of his son. At B's death, the property passed to his son pursuant to the beneficiary deed.

Subsequent to his acquisition of the subject real property, B's son obtained a loan from A and pledged the property as collateral for the loan. A properly filed a deed of trust with respect to such loan. B's son is in default of that loan, and A has referred the matter to their counsel for initiation of a foreclosure action. A's attorney is aware, however, of the so-called "estate tax statutory lien" against the property which came into existence on the death of B; and, as a result, according to your request for advice, "is reluctant to proceed with a non-judicial sale since the statutory estate tax lien may prime the deed of trust he is seeking to foreclose." At present, there is an assessed balance of estate tax due from B's estate in the amount of D.

LAW AND ANALYSIS

Since the property in question was subject, at the time of B's death, to a beneficiary deed, the property was properly included in B's estate under I.R.C. § 2038 as a revocable transfer. Pursuant to I.R.C. § 6324(a)(1), because there exists a balance due on the estate tax liability, there is a lien against such property (as well as all other property which was included in B's estate). That lien has a duration of ten years from the date of death. In addition to the lien created by section 6324(a)(1), I.R.C. § 6324(a)(2) imposes personal liability for the unpaid estate tax against, *inter alia*, a "beneficiary who receives...property included in the gross estate under sections 2034 through 2042, inclusive, to the extent of the value, at the time of the decedent's death, of such property...." As noted above, the subject property was included in B's estate pursuant to section 2038. As a result, B's son is personally liable for that portion of the unpaid estate tax which is equal to the value of the subject property. That, however, does not answer the question at hand.

Section 6324(a)(2) goes on to provide, in relevant part, that "[a]ny part of such property transferred by...such...beneficiary...to a purchaser or holder of a security interest shall be divested of the lien provided in paragraph (1) and a like lien shall then attach to all the property of such...beneficiary...except any part transferred to a purchaser or a holder of a security interest." The question to be resolved is whether the pledge of the

subject real property by B's son to A as collateral for a loan constitutes a "transfer" within the meaning of section 6324(a)(2).¹ In our opinion, it does.²

The word "transferred," as included in the phrase "transferred by...such...beneficiary...to a...holder of a security interest[,]" is not defined in either section 6324 or the regulations thereunder; and granting a security interest in property (through a pledge of such property as collateral), does not actually "transfer" the property to the holder of the security interest. In other words, a secured party, unlike a purchaser, does not acquire any ownership interest in the pledged property. It is, however, the position of the Office of Chief Counsel that in interpreting the phrase "transferred by...such...beneficiary...to a...holder of a security interest" in section 6324, one must look to I.R.C. § 6323(h)(1). In that Code section, the term "security interest" is defined as "any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability." (Emphasis added.)

In other words, if a third party creditor is granted a section 6323(h)(1)-type security interest in property to which a section 6324 lien has attached, that property shall be considered "transferred" to the holder of the security interest for purposes of section 6324(a)(2). This conclusion is based on the premise that to read "transferred" in section 6324(a)(2) as requiring the physical transfer, or transfer of legal title, would essentially result in reading "holder of a security interest" out of section 6324. Further, there is nothing in the legislative history which suggests that the term "holder of a security interest" in section 6324 should be construed differently from, or inconsistently with, that term as defined in section 6323(h)(1).³

¹ Your request for this advisory opinion states the following: "So, the question is: Does the statutory estate tax lien arising under IRC 6324(a) have to be recorded before it prevails against a deed of trust, in the same manner that a statutory assessment lien on income tax (for example) has to be recorded; or does the statutory estate tax lien come first regardless of what may be recorded subsequently?" In simplest terms, "there is no provision for recording §6324 liens, while §6321 liens, although effective without recordation, gain additional force if recorded." 5 Boris Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 137.6.1 (2d ed. 1993) (footnote omitted)

² We do not question that A is the holder of a security interest against the property by the fact that the deed of trust was properly recorded. See I.R.C. § 6324(c)(2) (for purposes of section 6324, a holder of a security interest is defined in I.R.C. § 6323(h)(1)).

³ Section 6324(a), in its present form, was enacted in 1966. Reviewing its predecessor might appear to shed some light on the issue at hand. Prior to 1966, section 6324(a)(2) contained similar "divestment of lien" language in the event a decedent's property was "transferred" to, *inter alia*, a "bona fide purchaser, mortgagee, or pledgee, for an adequate and full consideration in money or money's worth...." In Rev. Rul. 56-144, 1956-1 C.B. 563, it is stated that "[a]s used herein, a 'bona fide purchase, mortgagee, or pledgee' is one who, in acquiring the particular property, deals at arm's length, as between strangers, and pays a full and adequate consideration in money or money's worth." (Emphasis added.) From this, it could perhaps be concluded that the word "transferred" connotes the actual acquisition of property; i.e., that the property is surrendered to the holder of a security interest in such property. That conclusion, however, is not the position of this office.

The case of In re C.R. Druse, Sr., Ltd., 82 B.R. 1013 (Bankr. D. Neb. 1988), lends support for the above conclusion. In Druse, one of the issues was whether certain property which had been included in a decedent's estate was divested of the section 6324(a) lien. The property there in question had been transferred by the decedent's heirs/transferees to the debtor, and "[t]he parties [did] not dispute that [the] property [had been] included in the decedent's gross estate by operation of Sections 2034 to 2042." Id. at 1015.

Subsequent to the debtor's receipt of the property in question in Druse, the debtor "mortgaged a portion of [the] property to the Federal Land Bank and [later] mortgaged another parcel to the Home Federal Savings and Loan." 82 B.R. at 1014. In finding that the property in question had been divested of the section 6324 lien, the Druse Court first noted that "[t]he plain language of the statute states that if the Sections 2034 to 2042 property is transferred to a security interest holder, the Section 6324 lien is divested." 82 B.R. at 1015. From this premise, the Druse Court concluded, admittedly without any analysis of the word "transferred," that "[w]hen debtor entered into the security agreements with the Federal Land Bank and Home Federal Savings and Loan, the property subject to [those] security agreements became divested of the Section 6324 liens by operation of Section 6324(a)(2)." 82 B.R. at 1016.

Accordingly, for the reasons set forth above, the I.R.C. § 6324(a) lien in question has been divested to the extent of the security interest held by A in the property pledged by B's son as collateral for the loan he received from A.⁴

As it appears that no further action is required of this office in this case, we are closing our file.

Michael W. Bitner
Associate Area Counsel
(Small Business/Self-Employed)

⁴ Of course, to the extent the value of the subject property exceeds the balance of the loan held by A, the section 6324 lien remains in place. Further, not only is B's son personally liable for that portion of the unpaid estate tax which is equal to the value of the subject property (as noted above), I.R.C. § 6324(a)(2) provides a "like-lien" against B's son's property.