



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224  
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OFFICE OF  
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MEMORANDUM FOR NORTH CENTRAL AREA COUNSEL  
(MSR:NCE:STP)

FROM: MICHAEL ARNER  
Senior Technical Reviewer  
(CC:PA:CBS)

SUBJECT:

This responds to your federal tax lien priority question concerning the above referenced taxpayer.

LEGEND

M Corp. = .

H = .

T =

Amount A =

B Corp. =

M =

Amount B =

Date A =

Date B =

Date C =

Date D =

Date E =

Date F =

Date G =

Amount C =

Amount Z =

BACKGROUND

The taxpayer sold all of the stock in M Corp. to T, who elected himself as the new president of the corporation. The taxpayer received as payment a note from the corporation ("M Corp. note"), promising to pay him Amount A.

The taxpayer purchased B Corp. from M. As payment, M received a note from the taxpayer for Amount B. As security, the taxpayer assigned M a security interest in the M Corp. note, but M both failed to file or record a security interest or take possession of the M Corp. note.

The taxpayer and his wife filed a bankruptcy case. Nothing is known about this bankruptcy case, other than the debtors were discharged on Date A, and the bankruptcy case was closed on Date B. (

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On Date C and Date D , the Service filed Notices of Federal Tax Lien ("NFTL") in H.

On Date E, a revenue officer served a notice of levy on M Corp. to seize the taxpayer's property and rights to property, namely, the remaining payments on the M Corp. note. On Date F, M Corp. honored the levy and paid the Service Amount Z.

On Date G the taxpayer defaulted on a payment of Amount C to M, who now requests that the levy be partially released and Amount C be remitted to M. M's theory is that M has a security interest in the note that primed the federal tax lien.

## DISCUSSION

I.R.C. § 6321(a) states, "the lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice" has been filed.

Section 6323(h)(1) defines a security interest as an "interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth."

In this case, M contends that M has a security interest that was in existence and protected under local law against a subsequent judgment lien arising out of an unsecured obligation, even though M's security interest was never perfected by filing. Specifically, M argues that M's security interest fits within an exception to the filing requirement, Minn. Stat. Ann. § 336.9-302(1)(e), which states that filing is not required for "an assignment of accounts which does not alone or in conjunction with other

assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor.” (Emphasis added.) The purpose of this subsection was to protect assignees of accounts receivable who receives casual or isolated assignments.

Section 336.9-302(1)(e), however, does not apply to this case, as M fails to have an account for two different reasons. First, Minn. Stat. §336.9-106 defines an account, in part, as “any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper.” (Emphasis added.) In this case, the taxpayer had a right to payment for the sale of his stock, which is not a payment for goods sold. See Minn. Stat § 336.9-105(h) (excluding money, documents, and instruments from the definition of goods). Second, an account cannot be evidenced by an instrument, and an instrument is defined, in part, at Minn. Stat. § 9-105(i) as any writing which evidences a right to the payment of money. In this case, the taxpayer received a note, which is an instrument, and precludes M from arguing that M had an account. Thus, section 336.9-302(1)(e), which applies only to accounts, cannot apply to this case, as there are no accounts.

We understand that M also argues that the seminal case of Standard Lumber Co. v. Chamber Frames, Inc., 317 F. Supp. 837 (E.D. Ark. 1970) applies to this case, but we think that Standard Lumber does not apply to this case. In Standard, the taxpayer sold picture frames to K-Mart and had an account receivable for \$2,212.20. The taxpayer assigned the K-Mart account receivable to Standard Lumber Company, which failed to file a financing statement. The Service then filed a NFTL against all of the taxpayer’s property and rights to property. In a subsequent interpleader action, Standard Lumber Company argued that its unfiled security interest primed the federal tax lien, because it fell within the filing exception of section 336.9-302(1)(e). The district court agreed with Standard Lumber Company, reasoning that Standard Lumber Company had received a security interest in an account receivable that did not have to be filed to be perfected. This district court, decision, however, does not apply to the present case, because, as previously discussed, there is no account receivable.

Finally, M cannot have a perfected security interest because M failed to take possession of the M Corp. note. Minnesota law provides that an assignee of a security interest in a promissory note can perfect its security interest only by taking possession of the note.<sup>1</sup> See Lovett v. Schuster, 633 F.2d 98, 105 (8<sup>th</sup> Cir. 1980) (interpreting Minnesota law and holding that security interest in note is perfected only by taking possession). See e.g., Clark v. Valley Federal Savings and Loan, 966 F.2d 1338, 1341 (10<sup>th</sup> Cir. 1992); Peoples Bank v. McDonald, 743 F.2d 413, 416 (6<sup>th</sup> Cir. 1984) (cases discussing possession for perfection of notes). That is because Minn. Stat. § 336.9-304(1) provides, in part, that a security interest in an instrument, such as a note, can be perfected only by taking possession of the instrument. Accordingly, M has only an

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<sup>1/</sup> In limited circumstances, it is possible under section 336.9-304(4) and (5) to have a perfected security interest in a note for 21 days without obtaining possession, but this exception is not relevant to the present discussion.

unperfected security interest in the M Corp. note, as M failed to obtain possession of that note.

In conclusion, M fails the requirement of section 6323(h)(1)(a) requiring M to have an interest that has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation. Thus, under section 6323(a), the Service's NFTL primes M's prior but unperfected security interest. M cannot successfully argue that "first in time, is first in right," as Congress has specifically defined the term security interest, and M fails to have such an interest. Consequently, the Service cannot remit Amount C to her under the theory that M had a perfected security interest that primes the NFTL.

This document is not to be cited as precedent. I.R.C. § 6110(k)(3). If you have any questions, please contact the attorney assigned to this case, who can be reached at (202) 622-3610.