

ID: CCA_2009042910231220

Number: **200922049**

Office:

Release Date: 5/29/2009

UILC: 6321.00-00

From:

Sent: Wednesday, April 29, 2009 10:23:23 AM

To:

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Subject: RE: SITLP - MN Claimant Info

The below text (from a training manual) should explain "first in time is first in right." Please let me know if you have any questions. I will send a separate e-mail regarding exemption and superpriority issues.

Thanks,

PRIORITY OF FEDERAL TAX LIEN: "FIRST IN TIME, FIRST IN RIGHT"

- A. Certain priorities are established by statute. See, e.g., I.R.C. ' 6323. Where a competing lien does not have statutory priority, the basic rule in determining the priority of liens is often referred to as "**first in time, first in right.**" United States v. City of New Britain, 347 U.S. 81 (1954).
- B. **First in time, first in right.** Under federal common law, before another lien can compete with the tax lien, the competing lien must be "choate."
 1. A **choate** lien is one that is specific and perfected.
 - a. **Specific** means that the lien attaches to specific property or property rights of the taxpayer.
 - b. **Perfected** means nothing more need be, or can be, done by the lien claimant.
 2. If the competing lien is choate before the federal tax lien arises, the competing lien is entitled to priority. United States v. City of New Britain, 347 U.S. 81 (1954). Under the New Britain test for choateness, the lien must be specific as to:
 - a. **The identity of the lienor.** United States v. Knott, 298 U.S. 544 (1936).

- b. **The amount of the lien.** United States v. Waddill, Holland & Flinn, Inc., 323 U.S. 353 (1945).
- c. **The identity of the property** to which it attaches. United States v. Gilbert Associates, Inc., 345 U.S. 361 (1953).

C. The determination of when any lien becomes choate is a federal question.

- 1. The federal tax lien arises on the date of assessment. I.R.C. §§ 6321 & 6322.
- 2. An inchoate lien, which is later perfected, does not take priority over a federal tax lien which arose before the competing lien is perfected. United States v. Security Trust & Savings Bank, 340 U.S. 47 (1950).
 - a. State law determines whether the competing creditor has taken all the steps necessary under state law to perfect the lien (e.g., filing in the right place, using the correct certificate, etc.)
 - b. If a lien is inchoate under state law, it will not be choate for federal purposes.
 - c. United States v. Security Trust & Savings Co., 340 U.S. 47 (1950), stands for the proposition that a state-created lien cannot be given retroactive effect, that is, if an attachment or garnishment occurred prior to the assessment of a federal tax, the attachment or garnishment lien became choate only after the assessment was made, and the state statute gave the lien retroactive status to the time of attachment or garnishment, the state determination will be ignored for priority purposes.
 - d. Judicial decisions, such as divorce decrees, cannot prime federal tax liens.
- 4. The fact that the taxpayer's property is encumbered by a prior choate lien cannot prevent attachment of the federal tax lien to taxpayer's property. The pre-existing lien is important only in considering the right to priority.

D. **State Tax Liens**

- 1. **Basic Rule:** A state or local tax lien is entitled to priority over a federal tax lien only if it is a choate lien prior to the

time the federal tax lien arises. United States v. City of New Britain, 347 U.S. 81 (1954). But see In re WPG, Inc., 282 BR 66 (D.D.C. 2002) (District of Columbia sales tax lien had superpriority over prior choate federal tax lien in Chapter 11 bankruptcy case, where D.C. superpriority statute constituted federal law).

- a. A state's characterization of its tax liens as choate is not conclusive for federal tax lien purposes. Illinois ex. rel. Gordon v. Campbell, 329 U.S. 362 (1946). See also In Re Priest, 712 F.2d 1326 (9th Cir. 1983), mod. 725 F.2d 477 (1984), holding a state law ineffective which stated that a tax lien arose when the tax return was "due and payable" on the date the return was required to be filed. A state-created lien arises when the state takes administrative steps to fix the taxpayer's liability - mere receipt of a tax return is insufficient. Minnesota v. United States, 184 F.3d 725 (8th Cir. 1999).
 - b. State and local tax liens cannot achieve priority over the Federal tax lien by being characterized under state law as judgments. United States v. Gilbert Associates, Inc., 345 U.S. 361 (1953).
 - c. Real property taxes and special assessments may be entitled to superpriority status under section 6323(b)(6). However, a state law which characterizes a state lien as having priority or superpriority status is not controlling.
2. When does a state tax lien become choate? Under City of New Britain, supra, it becomes choate when the identity of the lienor, the property subject to the lien, and the amount of the lien are established.
- a. The identity of lienor requirement is met when the tax is assessed.
 - b. The specificity of amount requirement is met when the assessed tax is enforceable by levy.
 - c. The specificity of the property subject to the lien is the most difficult requirement to meet.
 - d. Despite the common origin of the choateness requirements, the Supreme Court held in United States v. Vermont, 377

U.S. 351 (1964), that divestiture of title or possession did not apply in lien priority contests. Thus, a local tax lien enforceable without a judicial proceeding and attaching to "all property and rights to property, whether real or personal, belonging to" the taxpayer, will prevail over a subsequently arising federal tax lien even though the local tax lien has not been enforced by seizure or sale.

3. **Priority determination.** In determining priority between a federal tax lien and a local tax assessment, compare the date the federal tax lien was assessed with the date the local tax assessment was filed. If the local tax was first, then look at the taxing statute to ascertain whether it is choate in the federal sense.
4. Another example of a competing lien which must meet the choateness test to take priority over a subsequent federal tax lien is a lien given under local law for unpaid rent (**landlord=s lien**). This lien attaches to tenant's or lessee's property located on landlord's premises.