

Nothing is Certain but . . . : Tax Liens and the Judgment Creditor

By James C. Eschen

A client had an award from the Department of Labor Standards Enforcement for unpaid wages to enforce. He wanted fast action—the employer was liquidating and had posted the company's equipment on eBay. Fortunately, a sheriff's levy or two would go a long way to paying him what he was due.

But the Secretary of State's website¹ showed bad news. Like many employers not paying their employees, this one was not paying other bills, either. Specifically, it had outstanding tax liens to the Internal Revenue Service and the Franchise Tax Board. Any money that my client got from a sheriff's levy, and any fee I received, could well end up in Uncle Sam's pocket. We closed the file—at least for the time being.

THE TAX LIEN'S CREATION AND BREADTH

When a taxpayer fails to pay "any tax" after demand, the Internal Revenue Code (title 26, United States Code ["I.R.C."]) creates a lien for any unpaid amounts, including not just the taxes but penalties, interests, and costs of collection.² The term "any tax" is broad, including more than just income taxes owed by the taxpayer. For example, the lien commonly arises from unpaid payroll taxes.³

The lien's purpose is to "insure prompt and certain collection of taxes due the United States from tax delinquents."⁴ Generally, the lien does not arise automatically when a taxpayer fails to pay but only



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upon the "assessment" of unpaid taxes.⁵ "Assessment of tax as defined consists of no more than the ascertainment of the amount due and the formal entry of that amount on the books of the secretary."⁶ The lien exists until the tax is paid or liability for it "becomes unenforceable by reason of lapse of time"—generally ten years from the date of assessment.⁷

Once the IRS assesses a taxpayer's delinquency, the lien extends to "all property and rights to property, whether real or personal, belonging to such person."⁸ This language "reveals on its face that Congress meant to reach every interest in property that a taxpayer might have."⁹ Although federal law determines priority, state law defines the rights the taxpayer has in the property.¹⁰ For example, the lien attaches to an escrow for a sale of a California liquor license because the license is property under state law.¹¹ The IRS enforces the lien by bringing a foreclosure action or by levying on the property.¹²

THE TAX LIEN'S PRIORITY

Once a tax lien arises, federal law governs the priority of competing liens.¹³ Even without recording, the tax lien is effective upon assessment against all persons.¹⁴ In the absence of a statutory exception, it takes priority over any other claim to property.¹⁵ Even workers who have not received their wages must defer to an IRS lien.¹⁶

Internal Revenue Code section 6323 sets forth the exceptions to that priority.¹⁷ Section 6323(a) provides exceptions based on priority of recording, but the exceptions in subdivisions (b) and (c) apply regardless of recording. For example, subdivision (b) (4) creates an exception for personal property sold at a casual sale; yard-sale enthusiasts need not fear trouble with the IRS should their counterparties' property be subject to a tax lien.

Under section 6323(a), the lien is not valid "against a purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor" until the IRS files notice of it. The notice is filed in the office within a state or county as directed by state law.¹⁸ Under California law, Federal tax liens are recorded in the same way as state tax liens.¹⁹ Tax liens on real property, like any instrument affecting real property, are recorded with the county recorder.²⁰ Tax liens on personal property, like UCC financing statements, are filed with the Secretary of State.²¹ California's Government Code sets forth strict requirements for the filings' contents,²² but those requirements do not apply to federal liens.²³ Instead, federal law determines whether a filing gives adequate notice of an IRS lien.²⁴

FINDING TAX LIENS

Anyone enforcing a civil obligation therefore should take the time early to make sure there are no tax liens. No one wants to end up with a worthless judgment or, worse, to take the trouble to levy on the defendant's property only to have the IRS come after the client.²⁵ Unfortunately, searching for a pre-existing tax lien may require more than just typing the defendant's name into the Secretary of State's or county recorder's websites.²⁶

A tax-lien filing need not state the taxpayer's exact or true name.²⁷ The Internal Revenue Code requires only that a lien on real property be filed so that a "reasonable inspection" of the index of deeds will disclose it.²⁸ The courts seem to apply the same "reasonable inspection" test to liens on personal property.²⁹ Thus a filing identifying the taxpayer as "Hudgins Masonry, Inc." perfected the lien against an individual, Michael Steven Hudgins, and filings under "Davis's Restaurant" and "Daviss [*sic*] Restaurant" were effective against the Davis Family Restaurant.³⁰

In measuring a search's reasonableness, the Ninth Circuit Bankruptcy Appellate Panel has applied the standard of an ordinary prudent person, not of a professional title searcher.³¹ It held that what is reasonable can vary from place to place, depending on the search facilities maintained in the office where the tax lien is filed.³² In particular, it held that a reasonable inspection in Clark County, Nevada, required only a search by the taxpayer's exact name.³³

Counsel looking for tax liens, however, should not rely on the BAP's ruling by searching only by the debtor's exact name. What one court held is reasonable in Clark County may not be reasonable elsewhere using other search mechanisms.³⁴ In addition, BAP decisions have limited precedential effect; they may not bind even the bankruptcy courts themselves.³⁵ Finally, reasonableness may require counsel to search under any name by which the judgment debtor has done business with the client, even if not the debtor's true name.³⁶

STATUTORY PRIORITY FOR ATTORNEY'S LIENS

Although both subdivisions (a) and (b) appear to have exceptions of interest to counsel for judgment creditors trying to collect in the face of a tax lien, only subdivision (a) actually does. Section 6323(a) provides that "[t]he 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 thereof which meets the requirements of subsection (f) has been filed by the Secretary." (Emphasis added.) Hence, the judgment lien creditor—and its counsel—will have priority over an unrecorded tax lien.

Section 6323(b)(8) may also let counsel representing judgment creditors baselessly get their hopes up. Subdivision (b)(8) exempts attorney's liens upon judgments or settlements, even after notice of the lien has been filed.³⁷ "[T]he attorney who helped to generate the funds has priority in order to procure a judgment that benefits the taxpayer which ultimately benefits the government through the creation of additional assets."³⁸ An attorney's lien falls within the exception if (1) a fund was created out of a judgment or settlement of a claim; (2) local law would recognize the existence of a lien; and (3) the amount of the lien reflects the extent to which their efforts reasonably contributed to the award.³⁹

But, according to the few courts that have addressed the issue, the attorney-lien exception benefits only attorneys representing delinquent taxpayers, not those enforcing claims against them.⁴⁰ This result seems to flow from the language of section 6323(b)(8), which requires a “judgment that benefits the taxpayer,” not one that benefits the taxpayer’s creditor. The statute gives the taxpayer’s attorney the incentive to generate a judgment that benefits the taxpayer and thus the government by creating an asset from which delinquent taxes can be paid.⁴¹ Evidently, the attorney for a creditor who compels the liquidation of the delinquent taxpayer’s assets gets no credit for creating a fund from which the government can collect.

STATE TAX LIENS

California also imposes liens for unpaid taxes, including state income taxes.⁴² Government Code section 7150 *et seq.* creates the procedure for the perfection and enforcement of all California state tax liens. Like federal law, state law exempts several types of property interests from the liens, including judgment liens filed with the Secretary of State or recorded before the filing or recording of the tax lien.⁴³

California’s liens differ from federal liens in two ways, one favorable and one unfavorable to the taxpayer’s other creditors. The favorable difference is the treatment of money, whether in cash or in the bank. The state tax lien is not valid against creditors acquiring an interest in or receiving the taxpayer’s money.⁴⁴ Nor does it extend to funds levied from the taxpayer’s bank account.⁴⁵ However, this exception does not apply if the judgment creditor and the taxpayer have colluded to defraud the state.⁴⁶

The unfavorable difference is the lien’s duration. A state lien, like the federal lien, is initially enforceable for ten years.⁴⁷ But filing or recording it makes it enforceable for ten years after filing or recording.⁴⁸ Like a judgment, the lien may then be renewed for another ten years by re-filing or re-recording before its expiration.⁴⁹ The tax is conclusively presumed paid, and the lien extinguished, after thirty years.⁵⁰

THE JUDGMENT CREDITOR’S OPTIONS

A judgment against someone against whom there are tax liens is not necessarily worthless. The judgment-lien

holder may pay the tax liability owed, either voluntarily or involuntarily, and become subrogated to the IRS’s or the State’s rights against the taxpayer.⁵¹ The judgment creditor may also wait until the lien expires, up to ten years for the (generally larger) federal lien and up to thirty years for the (generally smaller) state lien. However, a patient judgment creditor must take care to renew its judgment with the court and the liens with the county recorder and the Secretary of State.⁵²

CONCLUSION

If you represent a creditor, you should search early and often—and in many places and under many variations of the debtor’s name—for tax liens to ensure that the creditor and you are not wasting time and money. And, if there is no tax lien, you should try to get a judgment, and then judgment liens, as soon as possible to have priority over subsequent tax liens (and other creditors). A tax lien does not erase all of the creditor’s hope, but it certainly must be considered when deciding how to proceed.

ENDNOTES

- 1 <http://www.sos.ca.gov/business-programs/ucc/acct/acct-login.asp>. (This search page is beyond a paywall.)
- 2 I.R.C. § 6321.
- 3 **Sec., e.g.,** *United States v. Speers*, 382 U.S. 266, 267 (1965).
- 4 *United States v. Sec. Trust & Sav. Bank of San Diego*, 340 U.S. 47, 51 (1950).
- 5 I.R.C. § 6322.
- 6 *United States v. Dixieline Financial, Inc.*, 594 F.2d 1311, 1312 (9th Cir. 1979).
- 7 I.R.C. §§ 6322, 6502(a)(1); *United States v. Hemmen*, 51 F.3d 883, 887 (9th Cir. 1995) (citing earlier version of section 6502). An agreement between the taxpayer/debtor and the government can change the time period. I.R.C. § 6502(a)(2).
- 8 I.R.C. § 6321.
- 9 *Drye v. United States*, 528 U.S. 49, 56 (1999).
- 10 *Business Title Corp. v. Div. of Labor Law Enforcement*, 17 Cal.3d 878, 885 (1976), quoting *Aquilino v. United States*, 363 U.S. 509, 513 (1960).
- 11 *Id.* at 887-888. The United States’ tax claim therefore had priority over wage claims, even though at that time, California Business and Professions Code

- section 24074 provided that wage claims were entitled to first priority, and federal tax claim only third priority after wage claims and the claims of secured creditors. (Section 24074 now provides federal tax liens first priority.)
- 12 *U.S. v. Hemmen, supra*, 51 F.3d at 887, citing I.R.C. §§ 6331(a), 7403.
 - 13 *Business Title Corp. v. Div. of Labor Law Enforcement, supra*, 17 Cal.3d at 884, citing *Aquilino v. U.S., supra*, 363 U.S. at 512-514.
 - 14 *Aluisi v. Kolkka*, 459 F.Supp.2d 1015, 1017 (E.D. Cal. 2006).
 - 15 *Id.*
 - 16 *Business Title Corp. v. Div. of Labor Law Enforcement, supra*, 17 Cal.3d at 889.
 - 17 *Aluisi v. Kolkka, supra*, 459 F.Supp.2d at 1017.
 - 18 I.R.C. § 6323(f)(1).
 - 19 Gov't Code § 27330.
 - 20 Gov't Code § 7171(a).
 - 21 Gov't Code §§ 7171(b), 7220, 7222, 27330.
 - 22 Gov't Code §§ 7171(c), 7221.
 - 23 *United States v. Union Central Life Ins. Co.*, 368 U.S. 291, 294 (1961).
 - 24 *Id.*
 - 25 Pity the judgment creditors in *Quist v. Wiesener*, 327 F.Supp.2d 890 (E.D. Tenn. 2004) (United States has priority on proceeds of judgment creditor's garnishment), and *Tony Thornton Auction Serv., Inc. v. United States*, 791 F.2d 635, 638-639 (8th Cir. 1986) (notice against only Husband is sufficient to give United States priority as to property held by Husband and Wife as tenants by the entirety).
 - 26 See *Buenting v. Crystal Cascades Civil, LLC (In re Crystal Cascades Civil, LLC)*, 398 B.R. 23, 29-31 (Bankr. D. Nev. 2008), *aff'd*, *United States v. Buenting (In re Crystal Cascades Civil, LLC)*, 415 B.R. 403 (9th Cir. B.A.P. 2009).
 - 27 See *United States v. Crestmark Bank (In re Spearing Tool and Mfg. Co.)*, 412 F.3d 653, 657 (6th Cir. 2005), *cert. denied*, 549 U.S. 810 (2006); *Buenting v. Crystal Cascades LLC, supra*, 398 B.R. at 29-31 (describing numerous cases holding what is and is not sufficient); *cf.* Com'l Code §§ 9503(a)(1), (5), 9506(a)-(c); *Pankratz Implement Co. v. Citizens Nat. Bank*, 281 Kan. 209, 217, 130 P.3d 57, 63 (2006) (UCC filing not retrieved from a search using the debtor's true name is "seriously misleading" and ineffective, regardless of the searcher's diligence); *Official Committee of Unsecured Creditors v. Suna Bros., Inc. (In re Tyringham Holdings, Inc.)*, 354 B.R. 363, 368 (Bkrcty. E.D. Va. 2006) (same).
 - 28 I.R.C. § 6323(f)(4); See *Quist v. Wiesener, supra*, 327 F.Supp.2d at 894.
 - 29 See *U.S. v. Crestmark Bank, supra*, 412 F.3d at 656.
 - 30 *Hudgins v. IRS (In re Hudgins)*, 967 F.2d 973, 976-977 (4th Cir. 1992); see *Tony Thornton Auction Serv. v. U.S., supra*, 791 F.2d at 639. For more examples of erroneous identifications that did or did not effectively perfect a tax lien, see *Buenting v. Crystal Cascades LLC, supra* 398 B.R. at 29-30. Contrast the liberal interpretation in favor of the IRS to the strict interpretation against private creditors under the Uniform Commercial Code.
 - 31 *United States v. Buenting (In re Crystal Cascades Civil, LLC)*, 415 B.R. 403, 411 (9th Cir. B.A.P. 2009).
 - 32 *Id.*
 - 33 *Id.* at 411-412.
 - 34 See *Green Pastures Christian Ministries v. United States (In re Green Pastures Christian Ministries)*, 437 B.R. 465, 475 (Bankr. N.D. Ga. 2010) (reasonable search may not be limited to search only exact name).
 - 35 *Zimmer v. PSB Lending Corp. (In re Zimmer)*, 313 F.3d 1220, 1225 n.3 (9th Cir. 2002).
 - 36 *Trane Co. v. CGI Mechanical, Inc.*, 2010 WL 2998516 (D.S.C. July 28, 2010), at *10-11, citing *U.S. v. Crestmark Bank (In re Spearing Tool & Mfg. Co.)*, *supra*, 412 F.3d at 656.
 - 37 I.R.C. § 6323(b)(8).
 - 38 *Reed & Steven v. HIP Health Plan of Florida, Inc.*, 81 F.Supp.2d 1335, 1338 (S.D. Fla. 1999), citing *Park City Leasing, Inc. v. V.I.P. Mobile Phone Ctrs., Inc.*, 763 F.Supp. 140, 142 (E.D. Pa. 1991).
 - 39 *Id.*
 - 40 See *Park City Leasing, Inc. v. V.I.P. Mobile Phone Centers, Inc., supra*, 763 F.Supp. at 142.
 - 41 *Id.*
 - 42 Rev. & Tax. Code § 19221; Gov't Code § 7162, 7170(a). Government Code section 7162 defines the term "state tax lien": "State tax lien" means a lien created pursuant to Section 8048 of the Fish and Game Code, Section 3423 or 3772 of the Public Resources Code, Section 6757, 7872, 8996, 13610, 16063, 16810, 19221, 30322, 32363, or 38532 of the Revenue and Taxation Code, or Section 1703 of the Unemployment Insurance Code."
 - 43 Gov't Code § 7170(b)(4), (c)(5).
 - 44 Gov't Code § 7170(c)(4)(H), (M); Com'l Code § 9332(a); *cf.* *United States v. Mayor & Council of City of Baltimore*, 564 F.2d 1066, 1070 (4th Cir. 1977) (I.R.S. had priority to funds that city seized from

taxpayer during arrest and court later ordered forfeited).

- 45 Gov't Code § 7170(c)(4)(M); Com'l Code § 9332(b); cf. *United States v. Cache Valley Bank*, 866 F.2d 1242, 1245 (10th 1989) (funds bank set off from deposit account of delinquent borrower subject to lien).
- 46 Com'l Code § 9332(a), (b). Collusion requires that the creditor "was affirmatively engaged in wrongful conduct." *Amegy Bank Nat. Ass'n v. Deutsche Bank Corp.*, 917 F.Supp.2d 1228, 1239 (M.D. Fla. 2013), quoting U.C.C. § 8-503, com't 3; see *Ag Venture Fin'l Servs. v. Montagne (In re Montagne)*, 413 B.R. 148, 159-160 (Bankr. D. Vt. 2009) (citing the "acting in concert" test under Rest.2d, Torts § 876).

47 Gov't Code § 7172(a).

48 Gov't Code § 7172(b).

49 Gov't Code § 7172(c).

50 Cal. Const. art. XIII, § 30; Civ. Code § 2909; see *Alliance Mortgage Co. v. Rothwell*, 10 Cal.4th 1226, 1235 (1995) (payment of obligation generally extinguishes lien).

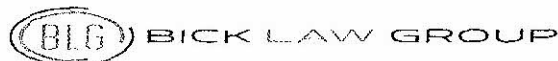
51 Civ. Code §§ 2903-2905; see *Riley v. Turpin*, 47 Cal.2d 152, 156-157 (1956).

52 Code Civ. Proc. §§ 683.120, 683.180, 683.190. The potential potholes in renewing judgments and judgment liens are beyond the scope of this Article. See, e.g., A. Ahart, ENFORCING JUDGMENTS AND DEBTS (Rutter 2013), §§ 6:85-6:90.

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