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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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MEMORANDUM FOR ASSOCIATE AREA COUNSEL - LAGUNA NIGUEL

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FROM: Alan C. Levine
Chief, Branch 1 (Collection, Bankruptcy & Summonses)
CC:PA:CBS

SUBJECT: Redemption of Property Sold at Foreclosure Sale

This Chief Counsel Advice responds to your EMAIL dated June 5, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUES

1. Is there tension between the literal terms of I.R.C. § 7425(d)(1) and Treas. Reg. § 301.7425-4(a)(3) as to whether a Notice of Federal Tax Lien ("NFTL") must be properly filed more than 30 days before a nonjudicial such sale in order for the Internal Revenue Service ("Service") to have a right of redemption?
2. Whether a NFTL filed outside of the chain of title still meets the requirements of I.R.C. § 6323(f)(4)?

CONCLUSIONS

1. There is no tension between the literal terms of section 7425(d)(1) and section 301.7425-4(a)(3). Both provisions require that the tax lien be extinguished in order for the Service to have a right of redemption.
2. A NFTL that is filed outside of the chain of title does not meet the requirements of section 6323(f)(4).

FACTS

The pertinent facts are the following: On _____, the Service assessed tax liabilities against the wife. On _____, the husband and wife quitclaimed their personal residence to their daughter. On _____, the Service filed a NFTL reflecting the wife's tax liability; this NFTL was outside the chain of title of the grantor-grantee index because the property had been quitclaimed prior to the filing of the NFTL. In _____, the mortgage company, whose lien on the personal residence was senior to the federal tax lien, properly notified the Service that it would be conducting a nonjudicial sale, and subsequently sold the personal residence. The Service is now considering whether it can redeem the property.

LAW AND ANALYSIS

Tension between the statute and the regulation

We do not think there is any tension between the section 7425(d)(1) and section 301.7425-4(a)(3), as they both recognize that the Service may redeem only when its federal tax lien has been extinguished.

I.R.C. § 7425(b) divides the effect of nonjudicial sales into two categories. First, subsection (b)(1) provides the only situation in which the NFTL will not be extinguished: a senior nonjudicial sale of property will not extinguish the junior federal tax lien only if the NFTL was properly filed more than 30 days before such sale and the United States is not given proper notice of such sale. If the NFTL is not properly filed more than 30 days before such sale or the United States is given proper notice of the sale, the federal tax lien will be extinguished. The rationale for the position taken in the regulations is fully explained in 1974 TM LEXIS 3, T.D. 7430.

Second, subsection (b)(2) addresses the converse situation, explaining the situations in which the federal tax lien will be extinguished by a nonjudicial sale. The most common situation is described in subsection (b)(2)(A) which provides that a tax lien will be extinguished if "notice of such lien or such title was not filed or recorded in the place provided by law for such filing more than 30 days before such sale."

Section 7425(d)(1) provides the Service with a right of redemption as follows: "In the case of real property to which subsection (b) applies to satisfy a lien prior to that of the United States, the Secretary may redeem such property within the period of 120 days from the date of such sale or the period allowable for redemption under local law, whichever is longer."

Treas. Reg. § 301.7425-4(a)(3) clarifies the effect of section 7425(d)(1):

In the event a sale does not ultimately discharge the property from the tax lien (whether by reason of local law or the provisions of section 7425(b)), the provisions of this section do not apply because the tax lien will continue to attach to the property after the sale. In a case in which the Internal Revenue Service is

not entitled to a notice of sale under section 7425(b) and § 301.7425-3, the United States does not have a right of redemption under section 7425(d). However, in such a case, if a tax lien has attached to the property at the time of the sale, the United States has the right of redemption, if any, which is afforded to any similar creditors under the local law of the place in which the property is situated.

At page five, your draft memorandum states that “the literal terms of I.R.C. § 7425(d)(1) appear to give the United States a right of redemption whenever there is a foreclosure of a lien senior to the federal tax lien.” (Emphasis added.) We disagree, as this statement suggests that the Service could redeem when a foreclosing senior lienor failed to give notice to the Service. (In such a situation, assuming that the Service had properly filed its NFTL more than 30 days prior to the sale, the Service would still have its tax lien, so it could not redeem the property.) In our opinion, the literal terms of section 7425(d)(1), which reference section 7425(b), limit the Service’s right of redemption to situations in which the tax lien has been extinguished. In other words, the definition of redemption presupposes that the junior lien has been extinguished. See G. Nelson, Real Estate Finance Law § 7.2 (1993).

In any event, your memorandum correctly concluded that Treas. Reg. § 301.7425-4(a)(3) makes “clear that the right of redemption under I.R.C. § 7425(d)(1) is limited to situations in which (1) the foreclosure sale results in the extinguishment of the federal tax lien, and (2) a notice of federal tax lien was properly filed more than thirty days prior to the foreclosure sale.” (Emphasis added.)

Chain of title

Given that the Service’s right of redemption requires that a NFTL be properly filed, the next consideration is whether the Service’s NFTL in this case was properly filed when it was filed outside the chain of title.

I.R.C. § 6323(f)(4) provides the rules for filing the NFTL for real property:

(A) [If] under the laws of the State in which the real property is located, a deed is not valid against a purchaser of the property who (at the time of the purchase) does not have actual notice or knowledge of the existence of such deed unless the fact of filing of such deed has been entered and recorded in a public index at the place of filing in such a manner that a reasonable inspection of the index will reveal the existence of the deed, and

(B) there is maintained ... an adequate system for the public indexing of Federal tax liens, then the notice of lien referred to in subsection [6323(a)] shall not be treated as meeting the filing requirements under paragraph (1) unless the fact of filing is entered and recorded in the index referred to in subparagraph (B) in such

a manner that a reasonable inspection of the index will reveal the existence of the lien.

In TKB International, INC. v. United States, 995 F.2d 1460 (9th Cir. 1993), the Ninth Circuit interpreted section 6323(f)(4) to conclude that the NFTLs that were filed outside of the chain of title did not meet the requirements of section 6323(f)(4), so the purchaser of the property prevailed under section 6323(a). In discussing the chain of title, the Ninth Circuit concluded that a purchaser had a duty to look beyond the grantor-grantee index when documents in the chain of title put the purchaser on notice. “We require that as to documents that are in the actual chain of title the searcher must at least look at such documents as may have current effect and must then act on the notice imparted.” Id. at 1465. Looking to the chain of title, the Ninth Circuit concluded that there was nothing requiring further investigation by the purchaser: a deed from one corporation to another corporation, indicating the apparent payment of the full market value, did not indicate a fraudulent transfer.

At page 12, your draft memorandum argues that TKB may be interpreted to conclude that the Service’s NFTL in the present case met the requirements of section 6323(f)(4). We disagree. You state “In the present case, we believe that anyone examining the quitclaim deed from the taxpayers to [their daughter], which indicated that the transfer was without consideration, would know that [the daughter] was not a purchaser under I.R.C. § 6323(a) and (h)(6).”¹ While this may be true, section 6323(f)(4) requires that the NFTL be filed in the chain of title to be effective in order to prime a subsequent purchaser. In this case, the NFTL was not filed in the chain of title. Also, TKB, in a corollary to section 6323(f)(4), provides that the actual purchaser must look at the documents in the chain of title and cannot ignore inquiry notice of a fraudulent conveyance. The TKB corollary, however, does not help the Service in this case, as a quitclaim deed from parents to a child should not be interpreted to suggest a fraudulent conveyance. Indeed, if the Service took the position that a transfer of property from a parent to a child indicated a fraudulent conveyance, it would place an onerous burden on purchasers and undermine the certainty of deeds in the Ninth Circuit.

At page 13, your draft memorandum offers a second reason why the Service’s NFTL meets the requirements of section 6323(f)(4). “Secondly, anyone examining the county records would also note that [the wife’s] NFTL filed on June 16, 1996 recited that the tax liabilities at issue were assessed on April 22, 1996, prior to the date of the quitclaim deed. Therefore, anyone examining the county records would be on notice that an undivided one-half interest in the subject property was still encumbered by a federal tax lien in excess of \$4,000,000.00.” The problem with this theory is that it assumes that a

¹ You cite the dicta in footnote 3 in TKB for the proposition that the purchaser’s actual knowledge is relevant for determining the priority of the tax lien as against the purchaser. We disagree, as discussed infra, and think that the purchaser’s knowledge is not a factor in determining priority under section 6323(a).

purchaser has some duty to search outside of the chain of title. In this case, the Service filed its NFTL outside of the chain of title, and consequently, fails the requirements of section 6323(f)(4). Also, in Litigation Guideline Memorandum GL-1, we took the position that a purchaser primes an unrecorded or improperly recorded NFTL even if the purchaser had prior knowledge that the assessment lien encumbered the property. In other words, unlike section 6323(b)(1)(A) which considers whether the purchaser had actual notice or knowledge of the tax lien, the priority rule in section 6323(a) does not consider the actual notice or knowledge of the purchaser.

In conclusion, because the NFTL was not filed in the chain of title, we think that the NFTL was not properly filed before the nonjudicial sale of the property. Consequently, the Service has no right to redeem the property in this case.

Please call if you have any further questions.