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THE SILENT LIEN AND THE BANKRUPTCY TRUSTEE

2000

A CLE Presentation

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Under Federal tax law, if a taxpayer neglects or refuses to pay a tax after demand, **the tax (including any interest, penalty, and costs) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to the taxpayer.** IRC § 6321. This is the well known proverbial “**silent tax lien**” as it requires no recordation or even separate notice to the taxpayer to be effective, and is generally unknown to anyone except the IRS and the delinquent taxpayer.

Further, as clearly indicated, the silent lien attaches to all property and rights to property belonging to the taxpayer. This lien arises at the time the assessment and demand on the taxpayer is made, and continues until the liability for the assessed amount is satisfied or becomes unenforceable by reason of the statute of limitations. IRC § 6322; In re Barnett, 62 B.R. 638 (Bankr. D. Md. 1986). However, until a Notice of Federal Tax Lien is filed in accordance with IRC § 6323(f), the Federal silent lien remains unperfected and unsecured.

The effect of a silent lien under the Bankruptcy Code has produced interesting litigation and problems for Trustees. Under the definition section of the Bankruptcy Code, a silent lien that arises upon assessment qualifies as a **statutory lien**, i.e., a lien arising solely by force of statute. 11 USC § 101(53). These statutory liens are addressed specially by the Bankruptcy Code under the Trustee avoidance provision of § 545, the preference provisions of § 547(c)(6), and the distribution provisions of § 724(b)(1). So what deference or effect, if any, must be accorded these silent liens by a Trustee in bankruptcy?

Addressing that answer requires an inquiry into what just status the Trustee has in the bankruptcy case. Under IRC § 6323(a) any person who acquires an interest in property valid under local law against subsequent purchasers without actual knowledge will, in a contest with the USA/IRS, prevail over an unrecorded Federal tax lien. However, such person must give “adequate and full consideration in money or money’s worth” for the acquired interest. IRC § 6323(a); Treas. Reg. § 301.6323(h)-1(f)(1)-(4). Since the Trustee does not give consideration for the property of the estate, it would appear that the Trustee would not be accorded the status of a bona fide purchaser so as to take the property or rights to property free of the silent tax lien.

11 U.S.C. § 545 (2), however, provides that:

The trustee may avoid the fixing of a statutory lien on property of the Debtor to the extent that such lien-

(2) is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such purchaser exists.

This provision of the bankruptcy code would appear to create the status of “**hypothetical bona fide purchaser**” for a Trustee.

Similarly, under § 547(c)(6) “the Trustee may not avoid a [preferential] transfer that is the fixing of a statutory lien that is not avoidable under § 545. Eliminating the double negatives, the provision provides the Trustee can only avoid as a preference a statutory lien if it is avoidable under the § 545 “hypothetical BFP” test. Similarly under § 724(b), property in which the estate has an interest and that is subject to a lien that is not avoidable under Title 11 and that secures an allowed claim for a tax, or proceeds of such property, can be subordinated to various priority creditors.

Although the most common silent lien is an assessed Federal tax liability, the Federal silent tax lien is not the most bothersome for Trustees. In 1966 the Internal Revenue Code was amended adding IRC § 6323 which requires the perfection of a Federal tax lien by recording it; thus creating a clear bright line test as to whether a Trustee can avoid the lien in his role as a hypothetical BFP. However, just how far that hypothetical status carries the Trustee is still subject to much debate.

The 5th Circuit in In re Stanford, 826 F.2d 353 (5th Cir.1987) held that the recording requirement in IRC § 6323(f) to make a Federal tax lien enforceable against a subsequent purchaser did not eliminate

the secured status of all unrecorded statutory tax liens, particularly those in favor of state entities.

In the Bankruptcy Code, Congress specifically provided the conditions under which statutory liens on a debtor's property could be avoided by the trustee in bankruptcy; Congress could have allowed a trustee to avoid all unrecorded liens or all unrecorded state tax liens, but did not do so. ... In effect, Congress largely left the question to state law...

Id. at 355.

Accordingly, if a state elects to make tax liens on realty enforceable against subsequent BFP's, § 545 incorporates that state's standard and would accord secured status under § 506(a) to the state silent lien. So clearly not all silent liens are avoidable and the Trustee cannot rely solely on Federal law, either tax or bankruptcy, for the Trustee's avoidance powers, but must also be aware of state and local law on the rights of statutory liens against bona fide purchasers.

Similarly, the Trustee's hypothetical BFP status has its limits. Within the 6th Circuit's case of first impression, In re Walter, 45 F.3d 1023 (6th Cir. 1995), the Trustee tried to use his § 545(2) power of avoidance to challenge a perfected tax lien on a vehicle. The Court, after acknowledging that a Trustee "steps into the shoes of a hypothetical bona fide purchaser", pulled the Trustee up short by also holding:

Whether a bona fide purchaser may avoid a statutory lien is a matter that is left to State or Federal lien law. Thus, where a statutory lien is created by State law, State law governs in determining whether the lien can be avoided by a bona fide purchaser, and the characteristics of a bona fide purchaser will also be determined by State law.

Id. at 1029.

Although the case turned on the fact that the IRS lien was properly perfected, the Court noted various State statutory liens that did not require perfection and which would defeat a Trustee's hypothetical BFP status. See In re Tape City, USA, Inc., 677 F.2d 401 (5th Cir. 1982) (Louisiana vendor's privilege is a statutory lien that has no formal perfection requirements). "Thus, where a bona fide purchaser is without the power to avoid a lien because the controlling law requires something more than mere bona fide purchaser status for protection, the Trustee also is without power to avoid the lien." Walter at 1034.

In conclusion, although a Trustee is most commonly faced with Federal tax liens, these liens, whether silent or perfected, pose less of a concern to Trustee's than the seldom seen State tax liens. These State and local tax liens will be accorded statutory lien status under the Bankruptcy Code and may not be avoidable because they have no recording requirement. They may also be superior to the interests of a bona fide purchaser under State law, or may require more than hypothetical bona fide purchaser status in the Trustee to be avoided. Thus, Trustee's should be most weary of unusual claims for secured status by State and local authorities.