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Federal Tax Liens In Foreclosure Proceedings

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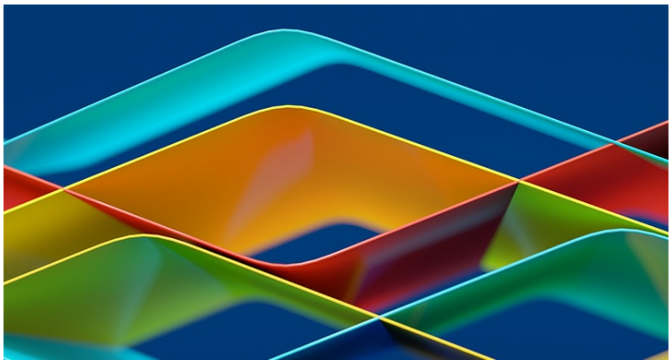

Henkel v. Triangle Homes is a North Carolina Court of Appeals case with dueling tax foreclosure proceedings involving the same property. One foreclosure proceeding was for unpaid municipal taxes and the other for unpaid federal taxes. Both proceedings resulted in foreclosure sales, but the deeds went to different high bidders. In determining who had good title to the property, the case teaches us about the priority of local and federal tax liens and the statutory obligation to notice the United States in a foreclosure involving property subject to a federal tax lien.

In this case, the Internal Revenue Service ("IRS") had recorded two tax liens against real property in Avery County. Later, the Village of Sugar Mountain obtained a third lien for unpaid property taxes on the same property and sought to foreclose its tax lien. A federal statute requires notice be given to the United States but, for reasons unknown, the Village provided no notice. The Village commenced a judicial foreclosure and had a sale on November 13, 2013, at which it was the high bidder.

At the same time, the IRS was pursuing a federal tax levy on the property. On November 14, 2013, there was a foreclosure sale under the federal tax lien. At that sale, Mr. Henkel purchased the property.

Meanwhile, Triangle Homes filed an upset bid in the Village's judicial foreclosure. Under North Carolina law, there is a 10-day upset bid period after a foreclosure sale during which anyone can bid on the property by offering to purchase the property for at least 5% greater than the previous high bid and by depositing a bid deposit of 5% of the upset bid with the Clerk of Court. Triangle Homes complied with the upset bid requirements and no one filed another upset bid. Triangle Homes paid the final purchase price and received a Commissioner's Deed to the property. Triangle Homes recorded its deed on April 7, 2014.

Over in the federal tax lien foreclosure, Henkel paid the balance of the purchase price to the IRS and received a Form 2435 Certificate of Sale of Seized Property. Six months later—after the 180-day redemption period expired—he received a Deed from the IRS. Henkel recorded his deed on June 6, 2014.

At this point, Triangle Homes and Henkel each had a recorded deed to the property. Who had good title?

Triangle Homes argued that it did because it was the first to record a deed. North Carolina is a "pure race" state and generally the first person to record an interest in land holds an interest superior to all other unrecorded conveyances. Not so fast, said the Court of Appeals. North Carolina's "race to the courthouse" rule was not dispositive because of the recorded federal and municipal tax liens.

First, the court pointed out that generally municipal tax liens are superior to federal tax liens, regardless of when the federal tax lien is recorded. Second, foreclosure typically extinguishes all junior liens, so when the Village foreclosed, it could have wiped out the federal tax liens. But for a foreclosure sale to be valid on property subject to a federal tax lien, the senior lien holder—the Village in this case—must provide the United States with notice before the sale. The Village failed to notice the United States, so the federal tax liens remained undisturbed. As a result, the deed the Village provided to Triangle Homes conveyed the property subject to the federal tax liens.

Lenders should be aware that this notice requirement also applies in a non-judicial foreclosure by power of sale under a deed of trust if the property is subject to a federal tax lien. Furthermore, the United States also may redeem the property within 120 days after the sale.

The federal tax lien foreclosure sale was done under federal law, which allows the owner or any person with an interest in the property to redeem the property within 180 days after the sale. Triangle Homes had an interest in the property under its deed, so it could have redeemed the property by paying the federal taxes within the 180 days. But it did not, so it forfeited any rights it had to the property. Henckel, on the other hand, purchased the property in the federal tax lien foreclosure sale, so his claim was superior to Triangle Homes' claim, and he became "the owner in fee simple" after the 180 days ran.

To sum up, local tax liens trump federal tax liens. In any foreclosure involving property subject to a federal tax lien, the United States must receive notice. You can extinguish a junior federal tax lien if you provide proper notice to the United States. And if you are selling or purchasing property subject to a federal tax lien in foreclosure, be aware of the federal statutory redemption periods.

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