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NON-JUDICIAL FORECLOSURES AND THE FEDERAL TAX LIEN ACT OF 1966

by

Fred A. Sanders* and Atwood McDonald**

IN 1966, Congress enacted the Federal Tax Lien Act.¹ This Act (hereinafter called the Act of 1966) deals with many areas in an attempt to accommodate the needs of legitimate credit transactions with the collection of the revenues by the United States.² This Article will consider only non-judicial foreclosures of liens on real estate where the United States is a junior tax lien holder. Primary emphasis will be placed upon foreclosures of deeds of trust in Texas.

I. THE ACT OF 1966

Although the Government prevailed in many tax lien cases in the courts prior to the Act of 1966,³ one setback it received was in the area of foreclosure. In *United States v. Brosnan*,⁴ which involved a non-judicial sale and a sale under confession of judgment where the Government had no notice of such foreclosures, it was held that adherence to state foreclosure procedures was sufficient to defeat a junior federal tax lien. The Court stated that, insofar as possible, federal law should adopt "state law governing divestiture of federal tax liens, except to the extent that Congress may have entered the field."⁵ This result was contrary to judicial foreclosure proceedings where the Government was a junior tax lienholder. In such case it received notice of the sale and had the right for one year to redeem.⁶ Where no special notice was required to be given to junior lienholders, as in Texas under deed of trust foreclosure with power of sale, the junior tax lien of the Government was treated as any other junior lien would be treated under state law.⁷

One of the basic considerations in amending the Internal Revenue Code in the foreclosure area seems to be that the interest of the Government as a junior lienholder should not be extinguished without notice. The Senate Committee Reports state:

[W]here the interests of junior lienors may be eliminated without notice, it appears that the interests of the Government are not presently sufficiently

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¹ Federal Tax Lien Act of 1966, Pub. L. No. 89-719, 80 Stat. 1125 (codified in scattered sections of 26, 28 U.S.C., and 40 U.S.C. § 270a(d) (1966)).

² Plumb, *The New Federal Tax Lien Law*, 22 Bus. Law. 271 (1967).

³ *Id.* at 293.

⁴ 363 U.S. 237 (1960).

⁵ *Id.* at 241.

⁶ Act of June 25, 1948, ch. 646, § 2410(c), 62 Stat. 972.

⁷ *United States v. Brosnan*, 363 U.S. 237 (1960); *United States v. Boyd*, 246 F.2d 477 (5th Cir.), cert. denied, 355 U.S. 889 (1957); *Trust Co. v. United States*, 3 F. Supp. 683 (S.D. Tex. 1933).

protected. Although legitimate local considerations may preclude requiring the Government (in other than plenary proceeding) to be joined as a party for its interests under a tax lien to be discharged, there does not appear to be any reason why in these cases there should not be a timely notice of the proceedings to the Government where notice of its tax lien is on file. The requirement of notice gives the Government an opportunity to review its position and determine the appropriate action without placing an undue burden on a foreclosing creditor.⁸

In an attempt to correct the evil described in the Committee Reports, section 7425 was added to the Internal Revenue Code by the Act of 1966.⁹ This section provides that if notice of the tax lien is on file for more than thirty days prior to the sale, and if notice of such sale is given to the Internal Revenue Service in writing by registered or certified mail or by personal service, not less than twenty-five days prior to such sale, then the non-judicial sale will have the same effect on the tax lien as is provided by state law with respect to other junior liens.¹⁰ In such case the Government may redeem the property within a period of 120 days from the date of such sale or the period allowable for redemption under state law, whichever is longer.¹¹

The notice of the sale is to be given to the district director for the internal revenue district in which the sale is to be conducted.¹² Generally, the notice must state the name and address of the persons submitting the notice of the sale, a copy of each Notice of Federal Tax Lien, a description of the property, the date, time, place, and terms of the proposed sale, the amount of the obligation sought to be enforced, and a description of other expenses which may be charged against the sale proceeds.¹³

In the event the notice of the tax lien was not properly recorded for more than thirty days prior to the sale, there is no notice requirement under the Act of 1966, and the federal tax lien is treated as any other junior lien in the non-judicial foreclosure of a senior lien.¹⁴ However, where a non-judicial foreclosure of a lien senior to that of a federal tax lien has occurred without notice to the Government, and where the junior tax lien has been recorded more than thirty days prior to the sale, then the statute provides that such sale shall "be made subject to and without disturbing such lien or title."¹⁵

The Act of 1966 has created some new problems, particularly in states such as Texas which have had no redemption statute. Some lending institutions may continue to follow their pre-Act of 1966 bidding practices. Many such institutions have followed a general practice of bidding in

⁸ U.S. CODE CONG. & AD. NEWS, 89th Cong., 2d Sess., vol. 3, at 3748 (1966).

⁹ INT. REV. CODE OF 1954, § 7425.

¹⁰ *Id.* §§ 7425(b), (c); 6 CCH 1970 STAND. FED. TAX REP. reg. § 400.4-1(b), ¶ 5784A-1.

¹¹ INT. REV. CODE OF 1954, § 7425(d); 6 CCH 1970 STAND. FED. TAX REP. reg. § 400.5-1, ¶ 5784A-2. In Texas, tax liens are filed with the County Clerk of the county where the real estate is located. TEX. REV. CIV. STAT. ANN. art. 6644 (1969). Certificates of redemption are also filed with the County Clerk. *Id.* art. 6644a.

¹² 6 CCH 1970 STAND. FED. TAX REP. reg. § 400.4-1(c), ¶ 5784A-1.

¹³ *Id.* reg. § 400.4-1(f).

¹⁴ INT. REV. CODE OF 1954, § 7425(b)(2)(A).

¹⁵ *Id.* § 7425(b)(1).

property for less than the amount of the mortgage indebtedness. With or without notice to the Government of a non-judicial foreclosure sale, such bidding practices will ultimately produce litigation which will answer the problems not answered by the Act of 1966.

II. REDEMPTION PRICE

If the tax lien of the Government has been recorded for more than thirty days, and if the required twenty-five-day notice of the non-judicial foreclosure of the senior lien is given to the Government, then the effect of such foreclosure on such junior tax lien is the same under state law as on any other junior lien.¹⁶ The Government has 120 days after such sale or the length of time allowed by state law, whichever is longer, to redeem the property.¹⁷ In addition to interest from the date of sale at six per cent per annum on the amount paid plus certain expenses incurred in connection with the property, and less certain income from the property, the amount the Government must pay to redeem is "the actual amount paid by the purchaser at such sale (which, in the case of a purchaser who is the holder of the lien being foreclosed, shall include the amount of the obligation secured by such lien to the extent satisfied by reason of such sale)"¹⁸ The Temporary Regulations follow the statute, but add "legally satisfied by reason of such sale."¹⁹ The third example in the Temporary Regulations shows the reasoning behind the addition of the word 'legally'; e.g., A owes B \$100,000; the loan is secured by a first mortgage. The Government has a junior tax lien on file for more than thirty days, and it receives the proper twenty-five-day notice of a foreclosure sale. B forecloses and bids \$50,000 at the sale. If the amount bid by B at the foreclosure is the amount *legally* satisfied, and if B has the right to take a deficiency judgment for the difference between the amount bid (\$50,000) and the amount owed by A to B (\$100,000), then the Temporary Regulations provide that the Government may redeem for \$50,000, whether B seeks a deficiency judgment or not.²⁰ This third example affects the bidding practices of many institutions in Texas foreclosing by deed of trust with power of sale because the bidding practice of many has been to bid less than the amount of the mortgage due.

Prior to the Act of 1966, the statute did not prescribe the amount to be paid by the Government when it had the right to redeem after a judicial foreclosure.²¹ In cases prior to the Act of 1966 where the Government had the right to redeem in non-redemption states, the federal law was contrary to the solution adopted by the Act of 1966. In *United States*

¹⁶ *Id.* §§ 7425(b)(2)(C), (c)(1). In Texas such junior lien is discharged. E.g., *Hampshire v. Greaves*, 104 Tex. 620, 143 S.W. 147 (1912); see TEX. REV. CIV. STAT. ANN. art. 3810 (1966). Also, in Texas it is generally true that the mortgagee can sue for deficiency between the amount credited on the note at the foreclosure sale and the remaining amount of the mortgage, e.g., *Langever v. Miller*, 124 Tex. 80, 76 S.W.2d 1025 (1934).

¹⁷ INT. REV. CODE OF 1954, § 7425(d).

¹⁸ 28 U.S.C. § 2410(d) (Supp. V, 1969).

¹⁹ 6 CCH 1970 STAND. FED. TAX REP. reg. § 400.5-1(c)(1)(i), ¶ 5784A-2 (emphasis added).

²⁰ *Id.* reg. § 400.5-1(c)(2) (example 3).

²¹ Act of June 25, 1948, ch. 646, § 2410(c), 62 Stat. 972.

*v. Brosnan*²² the Third Circuit held that where the Government was to redeem property which was bid in at a foreclosure suit by the mortgagee for less than the amount of the debt, a tender of the amount bid at the foreclosure sale was insufficient. The court said, "One who seeks to redeem is proceeding on the hypothesis that the mortgage has never been foreclosed as to him. He can lift the mortgage only by paying it in full."²³ This reasoning was supported by state court decisions.

In *First National Bank & Trust Co. v. MacGarvie* the New Jersey supreme court stated:

I don't think Congress meant any such inequitable and unconscionable thing as to allow the Government, at any time up to a year after sale, to come in, offer what was paid at the foreclosure sale, and immediately assume the position of senior lienholder, pushing everyone else into the background and thus, by wiping out the foreclosure bid, gain an advantage which it could never get at the foreclosure sale, or before it, by redeeming without paying the amount of the mortgage, the interest, the fees, and everything else that might be due to the senior lienor.²⁴

Texas also follows such prior law. An early Supreme Court case, *Whitehead v. Fisher*, held, "That one who redeems after foreclosure sale must pay the full amount of the mortgage debt . . . even though the land on foreclosure sale sold for a lesser sum."²⁵ The court, in dictum, stated that if a third party had purchased the property at the foreclosure sale, then upon redemption, the third party would be entitled to the sum he had paid, with interest, and the original mortgagee would be entitled to the balance due on the debt after subtracting the sum received by him upon the former sale.²⁶

The position of the Government as to the redemption price provided by the Act of 1966 also fails to take into account the doctrine of mortgagee in possession. This doctrine has many facets which govern the relationships between mortgagors and mortgagees.²⁷ One facet of this equitable doctrine provides that where a mortgagee is lawfully in possession of the mortgaged property, he has the right to retain possession until the debt due him is fully paid even though the debt may be barred by the statute of limitations.²⁸ Different theories have developed as to when a mortgagee is

²² 264 F.2d 762 (3d Cir. 1959), *aff'd on other grounds*, 363 U.S. 237 (1960).

²³ *Id.* at 766.

²⁴ 41 N.J. Super. 151, 157, 124 A.2d 345, 348 (Ch. 1956), *modified & aff'd*, 22 N.J. 539, 126 A.2d 880 (1956).

²⁵ 64 Tex. 638, 643 (1885).

²⁶ *Id. Accord*, *Collins v. Riggs*, 81 U.S. (14 Wall.) 491 (1871); *Hart v. Jackson St. Baptist Church*, 224 Ala. 64, 139 So. 88 (1932). However, the position taken by the temporary regulations seems to follow the pattern in states which provide for redemption after sale. See G. OSBORNE, *MORTGAGES* 888 (1951); M. SHERMAN, *MORTGAGE AND REAL ESTATE INVESTMENT GUIDE* (1970 ed.) (see § 8(e) under each state listing); Plumb, *Federal Liens and Priorities—Agenda for the Next Decade III*, 77 YALE L.J. 1104, 1177 (1968); Comment, *Statutory Redemption in Colorado: 1965 Amendments*, 39 COLO. L. REV. 127 (1966).

²⁷ 5 H. TIFFANY, *REAL PROPERTY* 309-57 (3d ed. 1939); Note, *Rights and Duties of a Mortgagee in Possession*, 35 COLUM. L. REV. 1248 (1935); Note, *Mortgagee in Possession—Exercise of Dominion and Control—Tort Liability*, 7 U. PITT. L. REV. 345 (1941); Note, *Mortgagee in Possession and Marketable Title Under Section 46 of The New York Civil Practice Act*, 5 SYRACUSE L. REV. 246 (1954).

²⁸ E.g., *Stouffer v. Harlan*, 68 Kan. 135, 74 P. 610 (1903); *Willoughby v. Jones*, 151 Tex. 435,

lawfully in possession.²⁹ However, the doctrine has been applied most frequently to foreclosure sales invalid as to an interest holder in the land and the mortgagee then lawfully enters upon the land after such sale.³⁰ The doctrine is applicable whether the mortgagee or another purchases at the foreclosure sale.³¹ Furthermore, the theory of subrogation is applicable in the case of a foreclosure sale to a third party invalid as to an interest holder in the land. In such case the third-party purchaser becomes subrogated to the rights of the mortgage holder. In *Browne v. King* the Texas supreme court said:

Equity in such case will treat the mortgage as still in force, and the purchaser at the sale, by subrogation to the rights of the original holder, may in a proceeding with proper parties disregard the first sale and then have the premises resold, so that the rights of all parties may be protected and in force.³²

When a mortgagee completes a deed of trust foreclosure in Texas after giving the Government the required twenty-five-day notice, under section 7425(b)(2) and Texas law,³³ the junior tax lien is discharged and the Government then has 120 days within which to redeem. It could be argued that if the Government does have the right to redeem the property for the amount *legally* satisfied by the foreclosure sale, *i.e.*, the amount bid, that the Government would become fee owner subject to a lien of the mortgagee for the unpaid amount of its mortgage. This argument is questionable, since the doctrine of mortgagee in possession might not be applicable. The foreclosure with notice to the Government is not ineffective as to the Government's junior tax lien. Instead, the foreclosure effectively defeats the junior tax lien and gives the Government a right of redemption.³⁴ Yet because of the doctrine's equitable nature, the doctrine could be applied by the courts and not contradict the language of the Act of 1966.

The Government's position on redemption price after foreclosure should cause all mortgagees to reassess their bidding practices. Such position could cause serious hardships to mortgagees in Texas who have had no real familiarity with redemption statutes. Where the amount bid is less than the debt due, the Government's position would allow it a windfall, which, if

251 S.W.2d 508 (1952); *Robinson v. Smith*, 133 Tex. 378, 128 S.W.2d 27 (1939); *Conner Bros. v. Williams*, 130 Tex. 572, 112 S.W.2d 709 (1938); *Jasper State Bank v. Braswell*, 130 Tex. 549, 111 S.W.2d 1079 (1938); 4 AMERICAN LAW OF PROPERTY 175, 176 (A. Casner ed. 1952); 5 H. TIFFANY, REAL PROPERTY 303, 304 (3d ed. 1939); Note, *Mortgages—Mortgagee in Possession—Mode of Entry*, 16 TEXAS L. REV. 587 (1938).

²⁹ 4 AMERICAN LAW OF PROPERTY 176-80 (A. Casner ed. 1952); 5 H. TIFFANY, REAL PROPERTY 306-09 (3d ed. 1939). Compare *Jasper State Bank v. Braswell*, 130 Tex. 549, 111 S.W.2d 1079 (1938), with *Stouffer v. Harlan*, 68 Kan. 135, 74 P. 610 (1903), and *Sumner v. Sumner*, 217 App. Div. 163, 216 N.Y.S. 389 (1926).

³⁰ E.g., *Townshend v. Thomson*, 139 N.Y. 152, 34 N.E. 891 (1893); *Jasper State Bank v. Braswell*, 130 Tex. 549, 111 S.W.2d 1079 (1938); 4 AMERICAN LAW OF PROPERTY 304 (A. Casner ed. 1952). "A mortgagee assuming possession under color of foreclosure proceedings, believed by him to be valid, however defective they may be in fact, cannot be dispossessed without payment of the mortgage debt." 2 L. JONES, LAW OF MORTGAGES 221 (8th ed. 1928).

³¹ See 5 H. TIFFANY, REAL PROPERTY 304, 574-75 (3d ed. 1939).

³² 111 Tex. 330, 235 S.W. 522 (1922).

³³ E.g., *Hampshire v. Greeves*, 104 Tex. 720, 143 S.W. 147 (1921).

³⁴ INT. REV. CODE OF 1954, § 7425(b).

the property were sold to satisfy the tax lien in an amount greater than the redemption price, would correspondingly benefit the delinquent taxpayer, all at the expense of the mortgagee.

III. NON-JUDICIAL SALE WITHOUT NOTICE TO DISTRICT DIRECTOR

The Act of 1966 also provides that if the junior tax lien of the Government is properly recorded more than thirty days prior to a non-judicial foreclosure sale of real estate, but the required twenty-five-day notice is not given to the district director of such sale, then such non-judicial sale shall "be made subject to and without disturbing such lien or title [of the Government]"³⁵ It appears that some lending institutions do not check the tax lien records prior to foreclosure by deed of trust sale because administratively it is impractical. It can become an onerous and expensive task to check the tax lien records thirty days prior to sale and prepare and mail the required notices to the Government within five days. Some institutions, particularly on smaller mortgage debts, are taking the risk and completing their deed of trust foreclosures without notice. In such cases several important questions remain unanswered.

Right To Redeem. The Government has taken the position that if it receives no notice of the non-judicial foreclosure sale when its lien has been recorded for more than thirty days prior to the sale, it does not have the right to redeem. The Temporary Regulations state:

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 [regarding redemption] do not apply since the tax lien will continue to attach to the property after the sale.³⁶

The statutory language appears to be contrary to the position that the Government has taken. The Government has the right to redeem property which is sold "to satisfy a lien prior to that of the United States."³⁷ Where a lienholder prior to the tax lien of the Government is foreclosing his lien, it seems clear that such sale is made to satisfy a lien prior to that of the United States where the United States is or is not notified. A further requirement in order for the Government to have the right to redeem is that the provision of section 7425(b) must be applicable. This section merely spells out the effect of a non-judicial foreclosure where the junior tax lien has been or has not been on file for more than thirty days and where notice of the sale is given or is not given to the district director. The requirements of the statute are met and the right to redeem appears to exist even though the Government is not notified of the non-judicial foreclosure.³⁸

³⁵ *Id.* § 7425(b)(1).

³⁶ 6 CCH 1970 STAND. FED. TAX REP. reg. § 400.5-1(b)(3), ¶ 5784A-2.

³⁷ INT. REV. CODE of 1954, § 7425(d)(1); see 28 U.S.C. 2410(c) (Supp. V, 1969), which overlaps with § 7425(d).

³⁸ The Committee Reports, U.S. CODE CONG. & AD. NEWS, 89th Cong., 2d Sess., vol. 3, at 3750 (1966), makes no distinction as to whether notice is or is not received by the Government under INT. REV. CODE of 1954, § 7425(b)(2)(C).

The reasoning behind such a position is not clear. The Government is giving up an added remedy, the right to redeem, which it did not have prior to the Act of 1966. Moreover, the right of redemption after sale in such cases could be an effective remedy to collect revenues. One possible reason for such position is that it is an attempt by the Government to avoid any argument that its rights in the property as a lienholder or any remedies it may have to enforce its lien would terminate upon the expiration of the redemption period after the foreclosure sale.³⁹

Remedies of Government To Enforce Junior Tax Lien. Assuming that the Government has no right of redemption when it receives no notice of a non-judicial foreclosure sale and that the property is still subject to the junior tax lien,⁴⁰ then what remedies does the Government have to enforce its lien? Presumably, the Government would contend that the foreclosure had never occurred, *i.e.*, the foreclosure sale was invalid.⁴¹ Several possibilities then exist: (1) The junior lien could continue until it became unenforceable by lapse of time.⁴² (2) The Government could levy upon the property.⁴³ In such case the owner of the property could sue the United States to enjoin a levy or sale,⁴⁴ or sue to recover such property wrongfully levied upon.⁴⁵ (3) The owner of the property could sue the United States to quiet title.⁴⁶ (4) The United States could institute suit to foreclose its lien.⁴⁷

The issue between the purchaser at the foreclosure sale and the Government could arise either when such purchaser sued the Government to quiet title or the Government sued to foreclose its lien under section 7403. In either event, the Government probably would ask that the property be sold pursuant to section 7403(c). Assuming the Government has no right to redeem in a no-notice situation, or, if it did, that the redemption period has expired, then it would appear that applicable state law would have a significant bearing on the outcome of the suit. In a Texas case, *Jasper State Bank v. Braswell*,⁴⁸ joint owners of real estate executed deeds of trust on certain real estate to secure notes to the bank. Several of the joint owners were declared bankrupt, and the bank bought the real estate from the trustee in bankruptcy, thinking that the property was free of all liens or any undivided interests. However, one mortgagor, Mrs. Bras-

³⁹ The statute, INT. REV. CODE of 1954, § 7425(b)(2) provides that the lien will not be disturbed. See discussion below at footnote 58.

⁴⁰ If the Government does have redemption rights under § 7425(d) in a no-notice situation, then presumably, its position would be that the lien continues in existence after the redemption period has run.

⁴¹ INT. REV. CODE of 1954, § 7425(b).

⁴² The general tax lien imposed by INT. REV. CODE of 1954, § 6321, arises at the time the assessment is made and generally continues for a period of 6 years. INT. REV. CODE of 1954, §§ 6322, 6502(a)(1); *cf. id.* § 6503. The date of assessment is the date that the officer of the Internal Revenue Service signs the summary record of assessment. *Id.* § 6203. Special liens are applicable to estate and gift taxes. *Id.* § 6324.

⁴³ See *id.* §§ 6331-44.

⁴⁴ *Id.* §§ 7426(a)(1), (b)(1).

⁴⁵ *Id.* §§ 7426(a)(1), (b)(2).

⁴⁶ 28 U.S.C. 2410(a)(1) (Supp. V, 1969).

⁴⁷ INT. REV. CODE of 1954, § 7403.

⁴⁸ 130 Tex. 549, 111 S.W.2d 1079 (1938); Note, *supra* note 28.

well, was not in bankruptcy, and her interests in the properties were not affected by the bankruptcy. The bank acquired only the interests of the joint owners who were declared bankrupt. The bank took possession of the properties without the consent of Mrs. Braswell. The note of Mrs. Braswell to the bank and the lien securing it became barred by the statute of limitations prior to the time she brought suit in trespass to try title to secure her undivided interest. The court held:

It is settled in this state that a mortgagee who has purchased the land at foreclosure sale, irregular or void as to the mortgagor (or as to one having title under the mortgagor) and who has taken possession under and in reliance upon such foreclosure and purchase, may retain possession against the suit of the mortgagor, or one holding under him, until his debt is paid.⁴⁹

Such right exists even though the debt is barred by the statute of limitations. The court then remanded the case to the trial court with directions that if Mrs. Braswell amended her pleadings and actually tendered her pro rata portion of the indebtedness, then she would be entitled to a judgment for her undivided portion of the properties. Otherwise, she would take nothing by her suit and title would vest in the bank, the mortgagee in possession.

The doctrine of mortgagee in possession is applicable not only to the mortgagee who purchases at a foreclosure sale invalid as to a mortgagor or other interest holder, but also to third parties who may purchase. In *Browne v. King*⁵⁰ the court held that a third party was subrogated to the rights of a mortgagee in possession and stated in dictum that before the mortgagor could recover the property, the full amount of the mortgage debt would have to be paid and distributed between the mortgagee and the third-party purchaser, so that the purchaser would be paid his purchase money and the mortgagee the remaining balance of his debt.⁵¹

As the non-judicial foreclosure without notice to the Government may be invalid as to the junior tax lien, it appears, under Texas authority, that the mortgagee as purchaser at the foreclosure sale, or a third-party purchaser who would be subrogated to the rights of such mortgagee, would be a mortgagee in possession in relation to the Government's continuing lien interest. The remedy of the Government in response to the defense of a plea of mortgagee in possession would be either to have the property sold pursuant to an order of court⁵² or to pay the full amount of the mortgage.⁵³ However, in such cases, there is no statutory authority allowing the Collector of Internal Revenue to pay the amount of the

⁴⁹ *Jasper State Bank v. Braswell*, 130 Tex. 549, 557, 111 S.W.2d 1079, 1083 (1938).

⁵⁰ *Browne v. King*, 111 Tex. 330, 235 S.W. 522 (1922).

⁵¹ The *Browne* theory of subrogation was favorably discussed in the *Jasper State Bank* case.

The Texas decisions extend the equitable right to third persons, as well as to mortgagees, who purchase at void foreclosure proceedings, by treating the mortgage as still in effect and subrogating the purchaser to the rights of the mortgagee to the extent of the purchase money paid at the foreclosure sale.

Jasper State Bank v. Braswell, 130 Tex. 549, 558, 111 S.W.2d 1079, 1083 (1938).

⁵² INT. REV. CODE of 1954, § 7403(c).

⁵³ E.g., *Jasper State Bank v. Braswell*, 130 Tex. 549, 111 S.W.2d 1079 (1938).

mortgage.⁵⁴ He has the power to redeem property under section 7425(d), and a revolving fund is created by section 7810⁵⁵ for statutory redemptions under section 7425(d) only. Therefore, if the property were not sold pursuant to section 7403(c), the results of failing to tender the amount of the mortgage could be fatal. A judgment removing the junior tax lien of the Government as a cloud on title could follow.⁵⁶

As the doctrine of mortgagee in possession is an equitable one, if the court decreed a sale of the property under section 7403(c), the logical result would be to apportion to the mortgagee the full amount of the mortgage indebtedness. The excess, if any, would then be paid to the Government to satisfy its junior lien interest.⁵⁷ Under the reasoning of the *Browne* case,⁵⁸ if a third party had purchased at the foreclosure sale, the full amount of the mortgage debt should be apportioned between that purchaser to the extent of his purchase price, and the balance of the mortgage, to the extent covered by the proceeds of the sale would be paid to the mortgagee; any excess would be paid to the Government. If the proceeds of the sale of the property would be exhausted by payment to the mortgagee in possession or other senior lienholder, then the court should enter an order extinguishing the junior tax lien.⁵⁹

⁵⁴ Under INT. REV. CODE of 1954, § 7403(c), where the Government holds a first lien on property, it may bid up to the amount of its lien plus expenses of sale. See *Report of Committee on Relative Priority of Government and Private Liens*, 2 REAL PROPERTY, PROBATE & TRUST J. 96, 115 (1967).

⁵⁵ INT. REV. CODE of 1954, § 7810 provides for a revolving fund of \$1,000,000 which the Government may use for redemption.

⁵⁶ E.g., *Jasper State Bank v. Braswell*, 130 Tex. 549, 111 S.W.2d 1079 (1938). In *Willoughby v. Jones*, 151 Tex. 435, 251 S.W.2d 508 (1952), the foreclosure was assumed to be void because of insufficient legal descriptions used in foreclosure proceedings. The mortgagor, in a trespass to try title suit, failed to recover because he failed to tender the amount of the mortgage debt to the mortgagee in possession. The court held that the mortgagor waived any rights of tender when he failed to tender in the face of a plea of mortgagee in possession by the mortgagee.

⁵⁷ *Miners Sav. Bank v. United States*, 110 F. Supp. 563 (M.D. Pa. 1953); *Bank of America v. United States*, 84 F. Supp. 387 (S.D. Cal. 1949); see *Pipola v. Chicco*, 274 F.2d 909 (2d Cir. 1960).

⁵⁸ *Browne v. King*, 111 Tex. 330, 235 S.W. 522 (1922).

⁵⁹ *Miners Sav. Bank v. United States*, 110 F. Supp. 563 (M.D. Pa. 1953); see *United States v. Morrison*, 247 F.2d 285 (5th Cir. 1957); *United States v. Boyd*, 246 F.2d 477 (5th Cir.), cert. denied, 355 U.S. 889 (1957). In the *Boyd* case, the court discussed § 7403(c), and stated:

Merely because the statute speaks in terms of foreclosure does not compel the court to use that remedy. If under controlling legal principles, the lien does not exist, if it has been lost, if the property is not that of the taxpayer, if the Federal tax lien is junior to undisputed prior liens which will exhaust the full value of the property, a decree of foreclosure would be neither appropriate nor effective. A court required by the express terms of the statute to adjudicate all matters, the merits of all claims to and liens upon the property and, in the event of a sale, distribute the proceeds in accordance with the findings respecting the interests of all parties and the United States . . . has the full capacity, and corresponding duty, to assure that the liens and interests are effectually respected in accordance with the court's determination of validity, rank and priority.

Id. at 481-82.

A possible alternative to enforcement of the junior tax lien under § 7403(c) is that if the Government has the right of redemption under § 7425(d) (which it disclaims), even though it received no special notice of the non-judicial sale other than afforded other junior lien holders, then at the expiration of the applicable redemption period, the Government's interest in the property would be terminated. The argument could be made that the junior tax lien should continue after the foreclosure sale for a reasonable length of time. In view of the general tenet of the law that title to real estate should be fully alienable, a reasonable time could be the redemption period that the Government has under § 7425(d). See, e.g., *O'Conner v. Thetford*, 174 S.W. 680 (Tex. Civ. App. 1915), error ref.; 4A THOMPSON, REAL PROPERTY 602-21 (1961). The basic

When the Government enforces its junior tax lien pursuant to section 7403 and requests the property to be sold free of liens pursuant to section 7403(c), the doctrine of mortgagee in possession should be applicable. In *Bank of America v. United States*⁶⁰ the mortgagee had bid in the property at an amount less than its mortgage and the court ordered the property sold pursuant to the predecessor of section 7403(c). It was held that the proceeds would first be allocated to the mortgagee to the full extent of his mortgage. However, the opinion seems to be based upon California law which prevented the mortgagee from taking a deficiency judgment. The courts should apply the doctrine of mortgagee in possession so that the proceeds of sale would first be applied to pay the mortgage in full.

IV. DISCHARGE OF THE PROPERTY FROM TAX LIEN

Section 6325 was amended substantially by the Act of 1966 to give the Internal Revenue Service the power to release a tax lien, discharge a piece of property from a tax lien, or subordinate a tax lien. The lien may be released if the liability for the amount assessed has been fully satisfied or has become legally unenforceable,⁶¹ or if there is furnished a bond acceptable to the United States.⁶² A tax lien may be subordinated if there is paid an amount equal to the amount of the lien or interest to which the tax lien is subordinated, or if the subordination will ultimately be beneficial to the collection of the tax liability.⁶³ Furthermore, a particular piece of property may be discharged from a tax lien: (1) if property subject to the lien remaining after the discharge is at least double the amount of the unsatisfied liability secured by such lien and the amount of all other liens upon such property which have priority over such lien;⁶⁴ (2) if there is paid to the Government an amount not less than the value of the interest of the United States in the property to be discharged;⁶⁵ (3) if the Government's interest has no value;⁶⁶ or (4) if an agreement is reached with the Government that the proceeds of sale of the property are to be held as a fund subject to liens and claims of the United States.⁶⁷

The mortgagee or the third party who purchased the property at the non-judicial foreclosure sale when no notice was given to the Government,

evil of terminating the Government's junior tax lien without notice which existed prior to the Act of 1966 would be remedied to some degree by interpreting § 7425(b) and § 7425(d) to give the Government the new right under the Act of 1966 to redeem the property for the applicable period of time, and further interpreting the statute to provide that at such time its lien would be extinguished.

⁶⁰ 84 F. Supp. 387, 388 (S.D. Cal. 1949).

⁶¹ INT. REV. CODE OF 1954, § 6325(a)(1).

⁶² *Id.* § 6325(a)(2).

⁶³ *Id.* § 6325(d); see 6 CCH 1970 STAND. FED. TAX REP. reg. § 400.2-1(c), ¶ 5784A-2.

⁶⁴ INT. REV. CODE OF 1954, § 6325(b)(1).

⁶⁵ *Id.* § 6325(b)(2)(A). The Act of 1966 allows the Government to consider the forced sale value of the property in determining the value of the Government's interest. Prior to the Act of 1966, the Government could only consider fair market value. *Report of Committee on Relative Priority of Government and Private Liens*, 2 REAL PROPERTY, PROBATE & TRUST J. 96, 109 (1967).

⁶⁶ INT. REV. CODE OF 1954, § 6325(b)(2)(B).

⁶⁷ *Id.* § 6325(b)(3); see Rev. Proc. 68-9, 1968-1 CUM. BULL. 756, concerning the procedure to be followed when the sales proceeds are to be escrowed and held subject to the claims of the Government.

and who then wishes to dispose of the property, will find that his title is clouded by the junior tax lien and will have to try to make some arrangement with the Government under section 6325. Perhaps the simplest solution would be to pay the Government the value of its interest and have the property discharged from the lien.⁶⁸ Although the Government has not published its position, the administrative practice experienced by the authors is similar to the Government position under section 7425(d), providing for redemption. If, for example, the purchase price at the foreclosure were \$25,000 and the mortgagee were entitled to take a deficiency judgment against the mortgagor under state law, then the amount to be paid would be the difference between \$25,000 and the fair market value of the property, if greater, at the time the property was to be discharged from the lien. The Government requires proof of the value of the land at such time. In order to secure a discharge, if the value of the land at the date of the proposed discharge were \$150,000, then the owner would have to pay \$125,000, the difference between the \$25,000 bid and the \$150,000 fair market value (not to exceed the amount of the tax). Thus, the Government and the delinquent taxpayer receive the windfall not only to the extent of the underbidding, but also to the extent of the increase of the value of the land, if any, after the foreclosure sale. The mortgagee suffers the loss.

The administrative practice in this area seems wrong. The Government has some statutory authority for its confiscatory policy when it has the right to redeem under section 7425(d), but it has no such authority to buttress its position here. The Government's interest is fully protected if it is paid only the value of the property over and above the amount of the remaining mortgage indebtedness. Further, if the reasoning of the *Brosnan*⁶⁹ case is applicable, the amount to be paid should be governed by consideration of local law. The purchaser at the foreclosure sale or his successors in title should have the full protection of the doctrine of mortgagee in possession and should not be required to sacrifice because of underbidding. The Government should change its administrative practice.

V. CONCLUSION

The Act of 1966 leaves many unanswered questions and presents problems, particularly in those states which have not had redemption statutes. As has been pointed out elsewhere,⁷⁰ if it was the intent of Congress to protect debtors from underbidding at non-judicial foreclosure sales, perhaps there should be federal legislation to accomplish such objective. However, if that was the intent, Congress should have attacked such practice directly, rather than indirectly through a tax statute.

In those cases where the non-judicial foreclosure sale occurred without notice to the Government, the Government should accept administratively

⁶⁸ INT. REV. CODE OF 1954, § 6325(b)(2)(A).

⁶⁹ *United States v. Brosnan*, 363 U.S. 237 (1960).

⁷⁰ Plumb, *Federal Liens and Priorities—Agenda for the Next Decade III*, 77 YALE L.J. 1104, 1178 (1968).

that it is entitled only to the excess of the proceeds that the property might bring over the full amount of the mortgage indebtedness, regardless of what was bid at the foreclosure sale. To attempt to apply the purchase price provided for in a redemption situation to a non-redemption situation has no statutory basis. In both the administrative discharge practice under section 6325 and in judicial sales under section 7403(c), the Government's only legitimate interest in the property is the excess over and above the full mortgage indebtedness.

Finally, all lending institutions should consider the perils of underbidding at foreclosure sales, regardless of whether the Government has received the twenty-five-day notice. If such practice is followed and the Government redeems the property, the mortgagee could lose substantial value. If no notice of the foreclosure sale is given to the Government, the mortgagee can expect real administrative problems with the Government when a future sale of the property is contemplated.