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Federal Tax Liens on Real Estate

BY GEORGE T. EVANS*

This discussion of the subject assigned to me (War Legislation and Its Effect on Property Rights) will not cover the broad field indicated by the title. Time does not permit it. In fact what I have to say will be confined to a single case decided by the Supreme Court of the United States January 4, 1943, in what seems to be a "bombshell" opinion, the full significance of which perhaps is not fully appreciated by some lawyers engaged in passing upon real estate titles. The case to which I have referred is *Detroit Bank v. United States*, 317 U. S. 329; 87 L. ed., No. 6, 266, 63 Sup. Ct., No. 5, 297.

The main question under examination may be stated thus: Does the United States have a valid, though unrecorded, lien for federal estate tax on real estate passing through the taxable estate of a decedent, which may be enforced within ten years from the date of the decedent's death against a good-faith mortgagee (without notice) who has foreclosed against mortgagor-heirs, who in good faith and without notice of the claim of the United States, mortgaged the property after distribution of the estate?

The Supreme Court has said that the answer is "Yes" in its opinion above cited. Its reasoning will appear below. The facts and the law in summary form were as follows:

A man named Paul, living in Detroit, Michigan, owned real estate with his wife as tenants by the entirety. He died leaving an estate large enough to be subject to federal estate tax. A federal estate tax return was prepared and filed for his estate but none of the real estate owned by Mr. Paul and his wife as tenants by the entirety was included in the gross estate for federal estate tax purposes. The tax shown due by the return was paid. The estate was closed and distributed. Part of the real estate was, apparently, conveyed by Mrs. Paul to her children. Subsequently the children and Mrs. Paul mortgaged the real estate to the Detroit bank, defaulted, and the bank foreclosed and took title to the real estate.

The United States proposed an estate tax deficiency against the estate of the decedent, was apparently unable to effect collection of the tax in any other manner, and so brought suit in the United States District Court pursuant to Section 3207 R. S. to foreclose its lien derived under Section 315 (a) of the REVENUE ACT OF 1926, now Section 827 (a) of the INTERNAL REVENUE CODE. The defendant was the mortgage bank.

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The laws of Michigan provided for the filing of notices of tax liens in the offices of the registrar of deeds in the counties of that state.

Section 3186 R. S., now Sections 3670 to 3672, inclusive, of the INTERNAL REVENUE CODE (hereinafter called the "Code") provided a lien for unpaid taxes of any kind (after demand therefor) in favor of the United States, but contained the limitation that "such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice of such lien shall be filed by the Collector in the office of the clerk of the district court of the district within which the property subject to lien is situated * * *" and it further provided that where any state had by legislation required the filing of notice of lien in the office of the registrar or recorder of deeds, "then such liens shall not be valid in that state against any mortgagee, purchaser or judgment creditor until such notice shall be filed."

None of the conditions imposed by Section 3186 R. S., or by the corresponding sections of the Code, had been met by the United States.

Section 315 (a) of the REVENUE ACT OF 1926, the statute actually before the court, which is identical with subsisting Section 827 (a) of the Code, was as follows:

"Unless the tax is sooner paid in full, it shall be a lien for ten years upon the gross estate of the decedent, except that such part of the gross estate as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof, shall be divested of such lien. If the Commissioner is satisfied that the tax liability of the estate has been fully discharged or provided for, he may, under regulations prescribed by him, with the approval of the Secretary, issue his certificate, releasing any or all property of such estate from the lien herein imposed."

In this situation the defendant bank alleged that it was the victim of a secret lien which, if enforced against it, in the circumstances of the case, would violate the Fifth Amendment to the Constitution of the United States. Said the court, in part:

"Section 3186 refers only to liens which are made such by that section. Section 315 (a) authorizes the lien for estate taxes and makes no reference to R. S. 3186, or to any requirement for recording notice of lien. The lien of R. S. 3186 is upon all the property of the person liable for the tax, while the lien of §315 (a) attaches only to the property included in and taxed as the gross estate not used to pay administration expenses. The lien of R. S. 3186 continues until the tax liability is paid while the lien of §315 (a) continues for ten years from the death of the decedent. Of particular significance is the difference in time when the

liens attach under the two sections. Under R. S. 3186 there is no lien and no notice can be recorded until there has been a demand by the collector and a refusal to pay it by the taxpayer. Under §315 (a) as has been stated, the lien arises on the death of the decedent and becomes effective against purchasers and mortgagees without assessment or demand and obviously before it would be possible to record a notice of lien under the provisions of R. S. 3186.

"* * * Moreover it is not without significance that Congress, in enacting a gift tax in the Revenue Act of 1932, provided in §510 of that Act that the gift tax should be a lien on the property passing to the donee, using words almost identical to these of §315 (a). The committee reports state that 'by this provision there is imposed a lien additional to that imposed by section 3186 of the Revised Statutes' H. Rep. No. 708, 72d Cong. 1st Sess. 30; Sen. Rep. No. 665, 72d Cong. 1st Sess. 42. This history and the differences between the provisions already noted, would seem to compel the conclusion that §315 (a) was intended to operate independently of R. S. 3186, and that the estate tax lien created by the former is not subject to the latter's requirement of recordation. * * *

"Petitioner (the bank) also insists that the statute violates the Fifth Amendment by authorizing an unrecorded tax lien against the property mortgaged to it and withholding such a lien against innocent purchasers of property which a decedent had transferred *inter vivos* in contemplation of death. Unlike the Fourteenth Amendment, the fifth contains no equal protection clause and it provides no guarantee against discriminatory legislation by Congress. * * * Even if discriminatory legislation may be so arbitrary and injurious in character as to violate the due process clause of the Fifth Amendment, * * * no such case is presented here." (Stone, C. J., in *Detroit Bank v. U. S.*, 317 U. S. 329; 87 L. ed., No. 6, p. 266, 63 Sup. Ct., No. 5, 297, Jan. 4, 1943.)

One justice did not participate but the decision was unanimous among those who did.

The property involved in the *Detroit Bank* case was held during the decedent's life by himself and his wife as tenants by the entirety. But that is of utterly no significance so far as the opinion goes. The decision stands simply and squarely for the proposition that for unpaid federal estate tax or federal gift tax the United States has a valid lien, subsisting for ten years from the date of death or gift, though unrecorded, which is good and valid against bona fide purchasers or mortgagees for value who acted in good faith and without notice. This should be of especial interest to lawyers passing upon titles to real estate.