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MD: Fed Tax Lien subordinate to Mortgage Filed Thereafter

8 Jan 2015

A debtor owed federal taxes and the IRS issued a notice and demand for payment in December, 2004. Even though IRS had not yet recorded its tax lien, the effect of the notice was to give IRS a super-priority lien on all the debtor's property upon issuance of the notice and demand. This super-priority, however, is "not valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor" until there is an actual recordation [of the tax lien]. 26 U.S.C. § 6323(a). In January, 2005, the debtor executed and delivered a deed of trust. A few days later, the IRS filed its lien. Thereafter, the lender recorded its deed of trust.

The U.S. District Court for the District of Maryland, citing Md. Code Ann., Real Property § 3-201, held that the recordation of the deed of trust related back to its execution and delivery and thus gave priority to the Bank . Alternatively, the Court held that, even if the "relating back" doctrine were not available, Maryland law provides that the Bank received an equitable security interest at the time of the execution of the deed of trust, thus trumping the IRS, even if the Bank had never recorded its deed of trust.

The U.S. Court of Appeals for the 4th Circuit, in *In re Restivo Auto Body, Inc*. 2014 WL 5488166 (4th Cir. 2014) disagreed with the District Court, finding that, 26 U.S.C. § 6323(a) protects only those security interests "protected under local law" and that Md. § 3-101(a), provides that a deed of trust is not effective to protect a creditor unless it is "executed and *recorded*". Because the deed of trust had not yet been recorded at the time of the filing of the IRS lien, the deed of trust did not relate back to the date of execution and the doctrine would not provide priority to the deed of trust.

However, the Circuit Court did find persuasive the District Court's alternate grounds for upholding the priority of the Deed of Trust under the theory of equitable conversion, finding that 26 U.S.C. § 6323(h)(1)(A) recognizes state law principles of equitable conversion and that a security interest exists if the interest "has become protected under local law *against a subsequent judgment lien* arising out of an unsecured obligation". Maryland case law provides that a good-faith purchaser of real estate receives equitable interest in the property at the time of contract, even if unrecorded, and that this equitable interest is superior to the interest of any creditor obtaining judgment after execution of the contract. *Stebbins-Anderson Co. v. Bolton*, 117 A.2d 908, 910 (Md. 1955). Because a lienor or judgment creditor stands in the shoes of the debtor, if the debtor had already conveyed out an equitable interest in the real estate, a judgment lien (and, in this case, the IRS lien) is subject to that prior undisclosed equitable interest. *Washington Mut. Bank v. Homan*, 974 A.2d 376 (Md. Ct. Spec. App 2009). The court held that equitable conversion requires that "equity treats that as being done which should be done" and that Maryland law has held lenders should receive the same protections as are accorded good-faith purchasers. The Circuit Court noted that both Texas and New York have similar laws which accords priority to a lender with a deed of trust over subsequent lien creditors regardless of whether the deed of trust was recorded. The state recordation requirement is designed to protect purchasers and not lienors.

The Bank prevailed under the theory of equitable conversion, but the case serves as a reminder of the need to promptly record to take priority over subsequent good-faith purchasers. Further, lien creditors should be aware that their interests may be subordinate to unrecorded equitable interests.

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