



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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MEMORANDUM FOR ASSOCIATE AREA COUNSEL, KANSAS CITY

FROM: Mitchel S. Hyman
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SUBJECT:

This responds to your July 15, 2002, request for advice. This document may not be cited as precedent. I.R.C. § 6110(k)(3).

ISSUE:

If the taxpayer sells his right of redemption under state law to a third party, does the federal tax lien filed prior to the sale encumber the right of redemption and the redeemed real property?

CONCLUSION:

The federal tax lien encumbers the taxpayer's right of redemption because it is property and rights to property under I.R.C. § 6321, and the sale of this right to the third party does not remove the federal tax lien. Also, when the third party redeems the real property, the federal tax lien attaches to it.

FACTS:

Bank held the first mortgage on the taxpayer's real property; the Internal Revenue Service ("Service") filed junior Notice of Federal Tax Liens ("NFTL") encumbering the taxpayer's real and personal property. I.R.C. § 6323(f)(1)(A)(i), (ii). Bank filed a lien foreclosure suit in state court naming the United States as a defendant and seeking a judicial sale of the real property. See 28 U.S.C. § 2410(a), (c). In the ensuing judicial sale of the property, the bank purchased the property. Subsequently, a third party purchased the taxpayer's right of redemption under state law and redeemed the property from the bank. The Service chose not to exercise its right to redeem the property within the 120 day time period specified by 28 U.S.C. § 2410(c). The question arises whether in the absence of a redemption under section 2410(c), the Service can

nonetheless collect from the property by relying on the attachment of the tax lien to the taxpayer's right to redeem the property under state law.

LAW AND ANALYSIS:

Section 6321 provides that a federal tax lien encumbers all of a taxpayer's property and rights to property.

I.R.C. § 7425(a) provides that a federal tax lien may be extinguished on encumbered property when a senior lienor judicially forecloses upon it and names the United States as a party.

In this case, because the senior lienor named the United States as a party under section 2410(a), the judicial foreclosure and sale of the real property extinguished the federal tax lien. An entirely different question, however, is the effect of the federal tax lien encumbering the taxpayer's right of redemption.

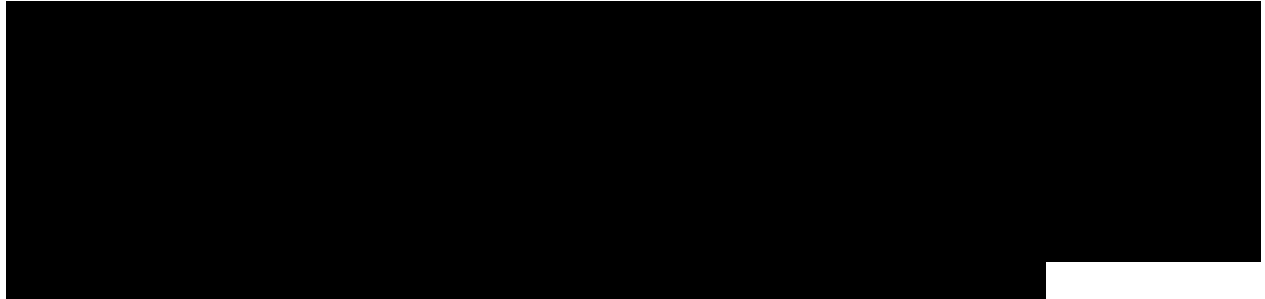
The underlying question is whether the taxpayer's right of redemption constituted property and rights to property to which the federal tax lien attached. We believe the right of redemption constituted property and rights to property. In determining a taxpayer's property and rights to property, the Supreme Court has articulated a two-part test. See United States v. Craft, 122 S. Ct. 1414, 1422-25 (2002); Drye v. United States, 528 U.S. 49, 58 (1999). See also United States v. National Bank of Commerce, 472 U.S. 713 (1985); Aquilino v. United States, 363 U.S. 509 (1960); United States v. Bess, 357 U.S. 51 (1958). First, a taxpayer's interests or rights must be determined under state law. Second, one must determine whether such interests or rights are property or rights to property under the Internal Revenue Code. In this case, the taxpayer had the right under state law to transfer his right of redemption for valuable consideration, which he did. These state law interests constitute property and rights to property under section 6321. Drye, 528 U.S. at 60-61. See also, Little v. United States, 704 F.2d 1100, 1106 (9th Cir. 1983) (holding that federal tax lien attached to right of redemption purchased by the taxpayer).

Given that the federal tax lien encumbered the taxpayer's right of redemption and that the Service filed a NFTL prior to the taxpayer's sale of that right, it follows that the third party purchased a right of redemption encumbered with a federal tax lien. 1/ Bess, 357 U.S. at 57 (tax lien follows transferred property). When the third party exercised the right of redemption, the federal tax lien reattached to the real property. This is because

1/ I.R.C. § 6323(a) does not aid the third party purchaser because that section provides that the federal tax lien shall not be valid against a purchaser until a NFTL has been properly filed. Here, the Service properly filed NFTLs under section 6323(f)(1)(A) for both the real and personal property prior to the sale of the right of redemption to the third party.

when a right to property encumbered by a federal tax lien comes into fruition, the federal tax lien encumbers the underlying property. See Drye, 528 U.S. at 61 (federal tax lien attaching to the taxpayer's right to inherit at the decedent's moment of death encumbered the actual funds subsequently distributed by the administrator).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



If you have any questions, please call the attorney assigned to this case at