

CALIFORNIA TAX LAWYER



Image of almond trees in bloom in the Central Valley.

ARTICLES

- 4** Improved Guidance for Nonprofit Organizations Utilizing New Markets Tax Credits to Better Serve Low-Income Communities
- 13** Economic Nexus Threatens Water's Edge Elections: A Legislative Proposal for Relief
- 21** California's Per Partner Penalty: A Proposal for Reform to Encourage Compliance but Not Unfairly Punish
- 29** A Review of 2016 California Tax Law Legislation
- 32** 2017 Sacramento Delegation

The San Diego Chapter of the Young Tax Lawyers ("SDYTL") is planning four events in the coming months, including a networking mixer, a panel discussion about moving into different areas of tax law, the nuts and bolts of international law, and a "year in review" event. For more information on upcoming San Diego YTL events, please contact Co-Chairs Paula Oliveira Brunoro at pbrunoro@brunorolaw.com or Ryan M. Moore at rmoore@hcesq.com.

Quick Point

"I Call Dibs!": Priority of Purchase Money Mortgages (PMMs) Over Internal Revenue Service (IRS) Tax Liens

A tax lien arises upon the assessment of taxes to protect the IRS' interest when a taxpayer owes it money. Not all tax liens are created equally, though. The normal rule is "first in time is first in right," meaning that whoever files first, gets paid first. However, there are certain policies that upset the default rule, including administrative deference to purchase money mortgages ("PMMs"). PMMs have priority over IRS tax liens even if the IRS files its lien before the PMM. The rationale is easy to understand: if the IRS gives PMM priorities, lenders loan money, taxpayers buy homes, and the IRS has the possibility of gaining an interest if the property increases in value above the amount of the outstanding mortgage.

United States v. Heptner, W.D. Fla. No. 8:15-cv-1125 June 15, 2016, explored the issue of what qualifies as a PMM. The IRS argued that its typical deference to PMMs was inapplicable because the loan at issue did not qualify as a PMM. According to the IRS, the loan was not a PMM because it was unrecorded. The Tax Court disagreed with the IRS. The Court held that Revenue Ruling 68-57 (which gives PMMs priority over IRS tax liens) only requires the PMM to be "valid" under state law. The Tax Court then turned to Florida law to determine whether a PMM must be recorded to be valid. In Florida, a mortgage

can be valid without recordation. Thus, it was immaterial that the lender did not record the PMM.

What would be the result in California? California statutes require certain instruments to be recorded. A mortgage is not one of those instruments. A mortgage can be valid as between the parties even if it is unrecorded. Thus, if a parent loans a child money to buy a house but does not get around to doing the paperwork, the mortgage would be valid as between the parent and child. Unrecorded instruments are valid against third parties if the third party had notice of it. Given this background, it is difficult to predict how the Tax Court would come out because the Revenue Ruling does not specify against whom the mortgage must be valid: the parties themselves or third parties? You can imagine the Tax Court saying that no statute requires a mortgage to be recorded, so the PMM is valid. It is also feasible for the court to say that the PMM was invalid as to the IRS because it was unrecorded and the IRS did not have notice. As with all interesting questions, the answer is unclear.

So, at the end of the day, what does this case teach us? First, the Tax Court will look to state law to see if a PMM is "valid." Second, the best practice is always to record the PMM; however, if you fail to record you may not be out of luck depending upon the state you live in.

-Ashley B. Kerins, San Diego, CA

For additional information on any of the Standing Committees and their activities, please contact one of the officers of the committee. Please refer to the Taxation Section Leadership Directory, infra, for contact information for the various committees. For information on how to join any of the Standing Committees, please see the Taxation Section Overview, supra.