



Nov 04, 2019

Categories:

[Blockchain and Digital](#)

[Assets](#)

[Blogs](#)

IRS Lien Litigation Holds Lessons For Transaction Counsel

A lien in favor of the Internal Revenue Service (“IRS”) attaches to all the indebted party’s interest in all the indebted party’s assets. 26 U.S.C. Section 6321.^[1] See [IRS Liens, After Acquired Property and the Doctrine of Choateness](#). As against other lienors and certain other protected parties, the Internal Revenue Code provides for IRS lien priority if the IRS has provided notice of its lien, which is accomplished by the public filing of the lien.^[2] Once the notice has been filed, priority of the IRS’ lien depends on the nature of the asset in dispute and the protection granted to the non-IRS claimant as against outside claimants (sometimes called the “seizing judgment lien creditor test”). See 26 U.S.C. Subsections 6323(b) through (e).

In *Bennett v. Bascom, et al.*, the Sixth Circuit Court of Appeals considered the rights of (i) the indebted taxpayer, (ii) a receiver appointed for the two limited partnerships (the “LPs”) controlled by the taxpayer, (iii) an asset purchaser who dealt with the receiver, (iv) the partnership’s unperfected secured creditor, and (v) the IRS. *Bennett v. Bascom, et al.*, United States Court of Appeals for the Sixth Circuit Case No. 18-5422 decided on Sept. 16, 2019.^[3]

The fact pattern in *Bennett* is common. I have seen it often as counsel for a lender who deals with defaulting borrowers. Mr. Bennett was a business owner. Mr. Bennett died^[4] while he was: (i) indebted to the IRS; (ii) the majority owner and general partner of the LPs; and (iii) indebted to the LPs. It appears that Mr. Bennett took cash from the LPs but failed to use that cash to pay his taxes. It is not uncommon for a business owner who owes money to have multiple creditors, and that situation has several implications. See [Joinder of Claims in Commercial Foreclosure Litigation is a Choice](#). The *Bennett* decision offers good lessons for these situations.

The LPs were placed into a state court receivership. The receiver then sold the LPs’ assets. Apparently, those sale proceeds exceeded the LPs’ debts since a portion of the sale proceeds were payable to Mr. Bennett due to his ownership interests in the LPs. It

will not surprise you to discover that these funds became the subject of a litigated dispute. It is too bad that the claimants could not reach a prompt resolution of their dispute because the IRS eventually became involved and the situation then became truly difficult for all the original litigating parties.[\[5\]](#)

The first decisions made by the *Bennett* court are not related to the IRS' lien but are good reminders to transaction counsel:

- A dispute arose between the asset purchaser and others interested in the LPs regarding exactly which of the LPs assets were sold by the receiver. Apparently, the receiver's sale agreement was unclear as to whether the asset purchaser obtained all the LPs' operating assets or all the LPs' assets including the right to collect the debts owed to the LPs by Bennett. The dispute here is who had the right to collect from Mr. Bennett's estate the receiver's sale proceeds that would inure to Mr. Bennett on account of his ownership of the LPs. Did those funds go to the asset purchaser or to the others interested in the LPs? The federal district court in Kentucky ruled in favor of the asset purchaser on this issue. Hence, the right to collect Mr. Bennett's debt to the LPs was transferred to the purchaser by the receiver's sale. The ambiguity in the receiver's sale is surprising since I expect the receiver's sale was approved by a court order and so the terms of the sale were public. Hence, the asset purchaser and other interested parties could / should have known or clarified exactly what assets were being sold by the receiver[\[6\]](#);
- The asset purchaser is trying to recover from Bennett the funds it paid for the LPs' assets, including debt owed by the LPs' general partner, Bennett. If the transaction had been planned differently, Bennett's right to sale proceeds and his obligations to the LPs could have been netted against each other before the purchaser paid those funds to the receiver – perhaps by simply reducing the purchase price by the amount that would inure to Bennett. Had this been done, those funds would never have been paid to the receiver and there would have been no *res* over which to litigate with the IRS; and

- To secure payment of the debts owed to the LPs, Bennett granted to the LPs a security interest in his ownership interests in the LPs. The LPs did not perfect that interest and so the asset purchaser bought unsecured debts owed by Bennett to the LPs. I am not a transaction lawyer, but as a collection lawyer before I initiate foreclosure litigation, I check to be sure all collateral interests are properly perfected, including mortgages filed and security interests perfected.^[7] It seems that the receiver's sale asset purchaser might have done the same and bought a perfected secured debt owed by Bennett instead of a debt with an unperfected security interest.

Before the asset purchaser could enjoy its victory over others with interests in the LPs, the IRS asserted its right to the funds premised on its lien on Bennett's assets. The IRS asserted that it had a lien on Bennett's interest in the LPs and the proceeds of those interests, namely a portion of the receiver's sale asset proceeds. This argument by the IRS was bolstered by the fact that there was no perfected security interest against Bennett's interest in those LPs. Separately, the IRS could assert that its lien attached to the proceeds that came into Bennett's estate before they could be recovered by the asset purchaser who was an unsecured general creditor of that estate. If either IRS argument is correct, those funds cannot be transferred to the asset purchaser in payment of Bennett's debts to the LPs. The IRS related questions were (i) does the IRS' lien on Bennett's assets extend to Bennett's right to receive a portion of the asset sale proceeds from the receiver, and, if yes, (ii) can the asset purchaser fit its right to collect from Bennett into one of the protected creditor classifications of 26 U.S.C. Section 6323?

The asset purchaser first tried to use Article 9 because Bennett's debts to the LPs were secured debts and secured creditors can be protected from IRS liens under 26 U.S.C. Section 6323(c). A requirement in section 6323(c)(B) is that the allegedly superior security interest be "protected under local law [here Kentucky law] against a judgment lien arising, as of the time of tax lien filing," (emphasis added). Seeking to meet this requirement, the asset

purchaser asserted (i) that the funds were held by the receiver or in escrow (and not Bennett), and (ii) the asset purchaser had demanded same in a manner that is analogous to strict foreclosure under Article 9. The trial court rejected this argument finding that the facts did not meet the requirements of a strict foreclosure under Article 9.[\[8\]](#)

Shifting to a different lane in the same “secured creditors are protected” argument, the asset purchaser asserted that its unperfected security interest in Bennett’s ownership of the LPs was nonetheless still “protected” as required by 26 U.S.C. Section 6323 from judgment liens because judgment liens cannot reach interests in LPs. The *Bennett* court agreed that judgment liens cannot attach to interests in partnerships under Kentucky law (this is common in several states); but the *Bennett* court held that interests in partnerships are subject to charging orders and charging orders constitute liens. So, the unperfected security interests in Bennett’s interest in the LPs was not “protected” from judgment lien creditors.[\[9\]](#)

Finally, the asset purchaser tried to obtain priority by attacking the IRS’ lien instead of asserting the priority of its own rights. The asset purchaser asserted that the IRS cannot have a lien on Bennett’s interests in the LPs because Kentucky law does not permit liens on interests in partnerships. The trial and appellate courts dispatched this argument without much consideration by noting that the IRS’ lien is no ordinary lien and federal law provides that the IRS lien attaches to all of the taxpayer’s property as directly stated in 26 U.S.C. Section 6321 (that section states in part that the amount owed “shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.”)

The attachment and priority of liens generally depends on facts that are set before litigation starts (unless that litigation is used to obtain the lien such as a charging order). For that reason, I am always pleased to work with our transaction and workout lawyers when they have work that might later involve litigation. As they say, “hindsight is 2020” and it can be unfair; still, involvement of a litigator should have been considered as the receiver’s sale was

planned since (i) Bennett's debt to the IRS was probably known through a claim against Bennett's estate and (ii) some of those involved must have known they were going to try to capture a portion of the asset sale proceeds before the IRS could get same.

Vince Mauer has a master's degree in Business Administration and passed the CPA exam. Licensed in Ohio and Iowa, he has represented financial institutions in litigation matters for over 30 years. For more information on this topic, contact Vince Mauer at vmauer@fbtlaw.com.

[1] The lien is complimentary to the payment priority rule in favor of taxes that applies in situations where a fiduciary is in control of the assets. See 31 U.S.C. Section 3713. See <https://www.blockchainandbanking.com/entity-receiverships-and-the-dangerous-federal-priority-statute> . The application of this statute is not discussed in the *Bennett* decision, but it might have been applicable if the court appointed receiver had failed to pay the IRS.

[2] 26 U.S.C. Section 6323(a) states in part "the lien imposed by [section 6321](#) shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed . . ."

[3] The *Bennett* case can be found at <http://business.cch.com/bfld/Bennett-091619.pdf> .

[4] The fact that Mr. Bennett is deceased had no impact on the analysis discussed herein.

[5] The receiver was appointed in a separate state court proceeding. If the parties could have reached a prompt resolution of their dispute in that context, this later federal court litigation involving the IRS might have been avoided.

[6] Since the receiver was appointed in a separate state court proceeding, the federal district court was not construing its own receiver sale approval order.

[7] See *Planning Commercial Collection Litigation: A Primer* <https://www.blockchainandbanking.com/planning-commercial-collection-litigation-a-primer> .

[8] Specifically, the *Bennett* court found that the asset purchaser had not accomplished a strict foreclosure on the funds because Bennett's estate did not accede to that action. The *Bennett* court said, "When dealing with nonjudicial foreclosure, courts have found that an objection to the foreclosure does not require any 'magic words.' *Blakely v. Tri-Cty. Fin. Grp., Inc.*, No. 08-cv-3783, 2010 WL 1286856, at *6 (N.D. Ill. Mar. 29, 2010). 'Any language that manifests an intention to reject the proposal of the creditor to retain possession of the collateral in satisfaction of the debt satisfies the requirements of the Uniform Commercial Code.' 68A Am. Jur. 2d Secured Transactions § 589; see also *Bluwav Sys., LLC v. Durney*, No. 09-13878, 2011 WL 5375200, at No. 18-5422, *Bennett v. Bascom* *2 n.3 (E.D. Mich. Nov. 7, 2011) (holding that '[s]trict foreclosure cannot be accomplished without the consent of the debtor')."

[9] The *Bennett* decision cites several decisions holding that in this context, "protected" means "perfected." Specifically, the *Bennett* court said: "Courts in the Sixth Circuit have equated the word 'protected' in § 6323(h)(1) with the word 'perfected.' In *Citizens State Bank*, a case applying Kentucky law, we held that § 6323(a) 'exclude[s] security interests which have not yet become perfected under local law.' 932 F.2d 490, 493 (6th Cir. 1991); see also *First Bancorp, Inc. v. United States*, 945 F. Supp. 2d 802, 813 (W.D. Ky. 2013) (applying Kentucky law to hold that, under § 6323(a), 'a private security interest has priority over a federal tax lien only if it attached to the property in question and was perfected prior to the filing of notice of the federal tax lien')."

© 2026 FBT Gibbons LLP. May be considered attorney advertising in some jurisdictions.