

IS A PERFECTED SECURITY INTEREST IN A DEPOSIT ACCOUNT A DEFENSE TO A FEDERAL TAX LEVY?

When a bank holds a perfected security interest in a deposit account and then receives a federal tax levy on that account, it is important that the bank act in a timely manner or it may find itself barred from asserting a wrongful levy claim by the statute of limitations.

Section 6321 of the Internal Revenue Code (I.R.C.) gives the United States the authority to place a lien in favor of the United States upon all property and rights to property that belong to a person that neglects or refuses to pay taxes after demand.

When a bank is in possession of or obligated with respect to the levied upon property, it must surrender the property, the rights to the property or discharge their obligation unless the property is subject to attachment or is part of a judicial process.

A lien imposed by section 6321 is generally not valid against any purchaser, holder of a security interest, mechanic's lienor or judgment lien creditor until the IRS files its Notice of Federal Tax Lien ("NFTL"). If however, a NFTL has been filed, a bank may assert that a lien is not valid on a savings deposit, share or other account if it can show that the bank made the loan without actual notice or knowledge of the existence of such a lien and the loan is secured by that account.

In response to an NFTL a bank may assert that the NFTL is not valid in a formal or informal manner. The IRS may be contacted, and in an exercise of administrative discretion, may elect to release the levy if the bank can prove a superior interest. A bank may also elect to assert its interest in the account by filing a wrongful levy suit against the government to have the levy released.

Such an action must be taken within nine months from the date of the levy or the bank waives its right to file a wrongful levy action. It is important that the bank act when they receive notice or have knowledge of an NFTL being filed, because if the bank fails to take action, it runs the risk of being held liable for the value of property or rights not surrendered and absent reasonable cause; a penalty equal to fifty percent of that sum.

The argument of superiority of the bank's lien is not a defense to a NFTL. The courts have found there to be only two valid defenses to a federal tax levy. The first is that the levied-upon party is neither in possession of nor obligated with respect to the taxpayer's property or rights to property. The second is that the taxpayer's property is subject to a prior judicial attachment or execution. However, if the bank claims a superior perfected interest it must file a wrongful levy suit within nine months of the levy. If it fails to do so within nine months it is barred by the statute of limitations.