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 Redeeming from tax sales: Bevan v Socal Communications Sites, 2003

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When lienor foreclosed on debtor’s property, which was also subject to IRS lien, and eliminated IRS’s right of redemption in that property by paying to IRS amount owed by debtor to IRS, lienor did not become equitably subrogated to IRS claim.

Bevan v Socal Communications Sites, LLC (In re Bevan) (9th Cir 2003) 327 F3d 994

The Bevans owned property in Malibu subject to a loan secured by a deed of trust, of which Socal was the beneficiary. The IRS had a lien, junior to Socal’s, on the property for $60,000. After the Bevans filed a voluntary Chapter 13 petition, the IRS filed a proof of claim with the bankruptcy court for $60,000. After obtaining relief from the automatic stay, Socal foreclosed and obtained the property for $573,000 by bidding in the secured debt. Under 26 USC §7425(d)(1), the IRS could redeem the property if it paid Socal the full amount that Socal had bid at the foreclosure sale, plus interest and expenses that exceeded income Socal had received from the property. To avoid the IRS redemption, Socal paid the IRS the full amount owed and the IRS amended its bankruptcy claim to zero. Then, claiming it was equitably subrogated to the IRS’s right of redemption, Socal filed a proof of claim for the amount it paid to the IRS to obtain a release of the right of redemption. The bankruptcy court agreed with Socal and that decision was affirmed by the district court.

The Ninth Circuit reversed, holding that this was not, “by any stretch of the imagination, a proper case for equitable subrogation.” Under the doctrine of equitable subrogation, a person who pays off a prior lien may be equitably subrogated to the position of the prior lienholder as against a later lienholder. However, Socal did not pay off a prior lien on the Malibu property and then seek to be subrogated to the position of the prior lienholder. Although Socal may have decided that the property was such a good buy that it could afford to pay the full amount of the Bevans’ taxes to the IRS to preclude redemption, if Socal were to succeed, it would entirely frustrate the purpose of the redemption statute, which is designed to prevent a windfall to a foreclosure purchaser. The IRS redemption right is intended to protect the taxpayer, who would otherwise be liable to the IRS for unpaid taxes but would have lost the excess profit from the sale of his or her real property. The court concluded (327 F3d at 998):

We need not be hierophantic to divine the fact that Socal preferred keeping the Malibu property to receiving the full amount owed by the Bevans. So be it. But, considering Congress’s beneficent purpose in conferring a right of redemption upon the IRS, we also need not be rhadamanthine to decide that it would be inequitable to permit Socal to “get a windfall at the expense of” the Bevans.

THE EDITOR’S TAKE: A junior creditor who learns that her security is about to be sold at a senior nonjudicial foreclosure sale can appear at the sale and bid up, if she believes that the property is worth more than the senior debt; or she can hope that, as a sold-out junior, she can sue her debtor and recover against some of his other assets. And when the junior
creditor is the IRS, it has the third choice of redeeming the property after the sale and getting title to the property by paying what the purchaser paid for it.

As with post-sale redemption after judicial foreclosure sales, one result of this procedure is—or is supposed to be—to raise the bidding in order to deter the senior selling creditor from underbidding: The lower the senior bids, the more likely it is that a redemptioner will redeem and re-take the property. The selling senior can avoid redemption by bidding high enough to generate a surplus, which will pay the junior off and also raise the cost of redemption high enough to make it undesirable.

Socal’s selling strategy in this case was not to bid enough to generate a surplus to cover the junior IRS lien, but instead to go to the IRS after the sale and pay off its junior lien—another effective way of eliminating the risk of redemption. But just as Socal could not have asserted a claim against the debtor for any amount it overbid (had it followed that strategy), so also it could not make that same claim under the guise of equitable subrogation. Since the property was apparently worth enough to cover both liens (why else would Socal pay that much to deter redemption?), Socal did not suffer in having its claim rejected. What it got was worth all that it paid. Indeed, had Socal’s claim been allowed, it would have had a true “double recovery”—buying the property cheap and then recovering back what it paid for it.

P.S. The court, in its somewhat lighthearted opinion, concludes by asserting that it sought to be neither “hierophantic” nor “rhadamanthine” in reaching its result. To spare you the effort, I looked these words up in the dictionary: A hierophant is an interpreter of sacred mysteries and a rhadamanth is a rigidly severe judge. (I hope you do not find me too temerarious or verbigerative in telling you all this.) —Roger Bernhardt