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X. PROPERTY

"Expenses Necessarily Incurred" in Calculating the Federal Government's Redemption Price Under 28 U.S.C. § 2410(d)

The Federal Tax Lien Act of 1966[1] modernizes the internal revenue laws regarding federal tax liens and other creditors' interests[2] by improving the status of secured private creditors[3] while protecting the federal government's tax lien. The Act gives the United States the right to redeem[4] property sold under foreclosure of a mortgage senior to a federal tax lien[5] and provides a method for calculating the redemption price which the Government must tender to the foreclosure sale purchaser to effect such redemption.[6] Although a federal right of redemption has existed since 1931,[7] its exercise by the Government was ineffective.[8] Thus, the Act provides detailed guidelines

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[1] Pub. L. No. 89-719, 80 Stat. 1125 (1966), *codified in* 26 U.S.C. §§3505, 6322-25, 6331-32, 6334-35, 6337-39, 6342-43, 6502-03, 6532, 7402-03, 7424-26, 7505-06, 7810; 28 U.S.C. §2410 (1970).

[2] *See* S. REP. No. 1708, 89th Cong., 2d Sess. 1 (1966), *reprinted at* 1966 U.S. CODE CONG. & AD. NEWS 3722 [hereinafter cited as 1966 U.S. CODE CONG. & AD. NEWS.]

[3] 1966 U.S. CODE CONG. & AD. NEWS, *supra* note 2, at 3723.

[4] There are two types of redemption; an equity of redemption, and a statutory right of redemption. The former is the mortgagor's pre-foreclosure right to remove the encumbrance from his title by tendering the amount of the obligation secured by the mortgage to the mortgagee. Conversely, the statutory right of redemption permits persons having a legal interest in the mortgaged property to redeem it after a foreclosure sale. The distinguishing characteristic of the statutory right is that the foreclosure sale price, rather than the amount of the obligation, is the amount which must be tendered to effect redemption. State statutes add various amounts to this price. *See* 4 A. CASNER, AMERICAN LAW OF PROPERTY §16.8 (1952)[hereinafter cited as CASNER]; G. OSBORNE, MORTGAGES §307 (2d ed. 1970)[hereinafter cited as OSBORNE]. *Compare* CAL. CIV. PRO. CODE §702 (West Supp. 1975) *with* IOWA CODE ANN. §628.11 (1950).

The statutory right of redemption has four essential features. The statutes specify who may redeem, the redemption price, the time during which the right exists, and provisions as to the order and effect of redemption. CASNER, *supra* §16.174; OSBORNE, *supra* §307. *See, e.g.*, N.D. CENT. CODE §23-24-01 through -16 (Repl. Vol. 1974).

[5] INT. REV. CODE OF 1954, §7425(d).

[6] 28 U.S.C. §2410(d)(1970), which provides that the Government must tender the amount paid by the purchaser at the foreclosure sale, six percent interest per annum on that amount, and any excess of "expenses necessarily incurred in connection with [the] property over . . . the income from such property . . . ." 28 U.S.C. §§2410(d)(1), (2), (3).

[7] *See* Act of Mar. 4, 1931, ch. 515, §4, 46 Stat. 1529; Act of June 25, 1948, ch. 646, 62 Stat. 972. Under the 1948 Act, 28 U.S.C. §2410(c) provided that "[w]here a sale of real estate is made to satisfy a lien prior to that of the United States, the United States shall have one year from the date of sale within which to redeem."

[8] Two cases contributed significantly to the erosion of the Government's right of redemption. In First Nat'l Bank & Trust Co. v. MacGarvie, 22 N.J. 539, 126 A.2d 880,

under which the United States may redeem property sold under foreclosure of a mortgage senior to its tax lien.[9] The Fourth Circuit was the first federal court of appeals to consider the application of the redemption price provisions of § 2410(d).[10] The Fourth Circuit's dependence upon broad equitable principles to resolve the problems in *Equity Mortgage Corp. v. Loftus*[11] raises several questions.

In *Equity Mortgage,* Mutual Federal Savings and Loan Association and Equity Mortgage Corporation held first and second deeds of trust, respectively, to property owned by Loftus. In 1967, the Government filed notice of its federal tax lien on the Loftus property,[12] which lien was junior to the interests held by Mutual and Equity.[13] Subsequently, Loftus defaulted on both Mutual's and Equity's notes. In order to prevent a foreclosure by Mutual and thus protect its own lien, Equity made payments on the Mutual note.[14] Equity then fore-

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modifying and aff'g 41 N.J. Super. 151, 124 A.2d 345 (Ch. Div. 1956), the New Jersey Supreme Court affirmed a lower court decision that the Government's tender of only the foreclosure purchase price was insufficient to effect redemption. The government argued that its right was a statutory right. The court, however, held that "it [was] not unreasonable to believe that had Congress intended that which the Executive Branch now seeks *it would not have confined itself to a single sentence expression."* 126 A.2d at 884 (emphasis added). *See* 28 U.S.C. §2410(c), *supra* note 7.

In United States v. Brosnan, 363 U.S. 237 (1960), *aff'g* 264 F.2d 762 (3d Cir. 1959), *and rev'g* 265 F.2d 862 (9th Cir. 1959), a divided Supreme Court held that tender of the purchase price was insufficient to effect redemption and that the "only apparent purpose [of § 2410(c)] [was] to lift the bar of sovereign immunity." 363 U.S. at 246.

In response to these two cases, Congress enacted the redemption provisions in §7425(d) and §2410(d), clearly creating a scheme of statutory redemption. *See* Panzer, *The Federal Tax Lien Act of 1966: Some Practical Considerations for Mortgagees,* 39 PENN. B.Q. 92, 93 (1967); Plumb, *Federal Liens and Priorities—Agenda for the Next Decade I,* 77 YALE L.J. 228, 297-98 (1967).

[9] *See* Equity Mortgage Corp. v. Loftus, 323 F. Supp. 144, 150-53 (E.D. Va. 1970), for a discussion of the legislative history of §7425(d) and §2410(d).

[10] 28 U.S.C. §2410(d)(1970).

[11] 504 F.2d 1071 (4th Cir. 1974), *rev'g and remanding,* 323 F. Supp. 144 (E.D. Va. 1970).

[12] The government filed notice of its tax lien in the circuit court for Virginia Beach. 504 F.2d at 1074. *See* INT. REV. CODE OF 1954, §§6321, 6323(f)(1)(A)(i); VA. CODE ANN. §55-142.1(a) (Repl. Vol. 1974).

[13] Equity's deed of trust was recorded on June 15, 1966, and Mutual's was senior to it. Notice of the federal tax lien was not filed until June 15, 1967. 504 F.2d at 1073. Therefore, both deeds of trust were protected as against the tax lien. *See* INT. REV. CODE OF 1954, §§6323(a), (b)(1)(B), (h)(1). *See also* 1966 U.S. CODE CONG. & AD. NEWS, *supra* note 2, at 3734; H.R. REP. NO. 1884, 89th Cong., 2d Sess. 4, 35 (1966).

[14] Equity's pre-foreclosure payments to Mutual totaled $1790. 504 F.2d at 1073. In addition to the issue raised in *Equity Mortgage,* these payments raise questions as to Equity's right of subrogation. *See* text accompanying notes 47-54 *infra.*

closed on its deed of trust and purchased the property,[15] subject to the outstanding balance on Mutual's note. Under Virginia law, the foreclosure sale extinguished the federal tax lien and satisfied Loftus' obligation to Equity to the extent of the purchase price less the expenses of the sale,[16] giving Equity the right to seek a deficiency judgment against Loftus for the unsatisfied amount.[17] Following its foreclosure, Equity offered to transfer the property to the Government for both that unsatisfied amount and the amount of its payments to Mutual.[18] The Government, however, rejected this offer and exercised its right of redemption under Internal Revenue Code of 1954 §7425(d),[19] tendering to Equity the foreclosure sale purchase price plus interest thereon, pursuant to the formula in §2410(d).[20] Equity rejected the Government's tender because it did not include the pre-foreclosure and redemption period payments by Equity to Mutual, which were necessary for the preservation of Equity's interest in the property. Nevertheless, the Government recorded a certificate of redemption;[21] Equity filed a suit to quiet title[22] against both Loftus and the United States.[23]

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[15] 504 F.2d at 1074. *See* INT. REV. CODE OF 1954, §7425(b)(2).

[16] At the foreclosure sale, Equity purchased the property for $1000. The property had a fair market value of $32,500. 504 F.2d at 1073-74. At that time, the principal balances on Mutual's and Equity's mortgages were $17,950 and $3210, respectively. The Government's tax lien was $17,200. *Id.*

[17] 504 F.2d 1071, 1074, 1076. *See* VA. CODE ANN. §55-59(13) (Repl. Vol. 1974). The amount to which Equity would be entitled under a deficiency judgment would be approximately $2400.

[18] The unsatisfied amount, $5200, included the remaining principal balance on Equity's mortgage, payments made by Equity to Mutual, and foreclosure expenses. 504 F.2d at 1074.

[19] INT. REV. CODE OF 1954, §7425(d).

[20] 28 U.S.C. §2410(d)(1970). The amount tendered by the government was $1019, including $1000 purchase price and $19 interest. 504 F.2d at 1074. *See* 28 U.S.C. §§2410(d)(1), (2). Between the time of foreclosure and the tender by the federal government—the redemption period—Equity made additional payments to Mutual totaling $560.

In theory, the statutory right's characteristic of requiring tender of only the purchase price plus interest was designed to force foreclosing mortgagees to bid their prices up to at least the amount of the debt secured by the mortgage or the value of the property, whichever was less. *See* CASNER, *supra* note 4, §16.8; OSBORNE, *supra* note 4, §8 at 17-18; W. PLUMB, FEDERAL TAX LIENS 284 (3d ed. 1972); Plumb, *Federal Liens and Priorities—Agenda for the Next Decade III,* 77 YALE L.J. 1104, 1174 (1968); Sanders and McDonald, *Non-Judicial Foreclosures and the Federal Tax Lien Act of 1966,* 24 SW. L.J. 815, 817-819 (1970).

[21] *See* INT. REV. CODE of 1954, §7425(d)(3)(B).

[22] *See* VA. CODE ANN. §55-153 (Repl. Vol. 1974).

[23] 323 F. Supp. 144, 146. Between the time of the Government's tender of the

The issue in *Equity Mortgage* was whether the amounts paid by Equity to protect its lien were to be included in the redemption price as "expenses necessarily incurred" under §2410(d)(3).[24] The district court held that the Government, to effectuate redemption, must tender the foreclosure sale price with interest plus the full amount remaining on Loftus' debt to Equity.[25] The Fourth Circuit reversed, holding that the Government must tender the purchase price with interest plus those amounts paid by Equity to Mutual to prevent Mutual's foreclosure.[26] In analyzing the language of §2410(d)(3), the Fourth Circuit considered the payments in three time periods: the pre-foreclosure payments, the redemption period[27] payments, and the payments made subsequent to the attempted redemption.

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redemption price and June, 1970, when litigation commensed, Equity had paid an additional $1650 to Mutual to prevent Mutual's foreclosing on its own deed of trust. 504 F.2d at 1074.

[24] The case also involved the question whether the district court correctly held that since Equity had offered to waive or transfer its rights against Loftus for reimbursement of the outstanding balance of his debt, the Government must tender the purchase price with interest *plus* the full amount of the debt still outstanding. The Fourth Circuit readily disposed of that issue with a literal reading of §§2410(d)(1) & (2). 504 F.2d at 1074-76. Since the obligation was satisfied only to the extent of the amount of the sale under §2410(d)(1), the court reasoned that the Government need only tender that amount ($1000) plus interest. The legislative history of the Federal Tax Lien Act supports this holding. *See* H.R. REP. No. 1884, 89th Cong., 2d Sess. 33 (1966). Furthermore, both the temporary Treasury regulations promulgated under the Act and the subsequently proposed regulations provide the same result. Temp. Treas. Reg. §400.5-1(c)(2) Example (3), 26 C.F.R. 400.5-1(c)(2) Example (3) (1975); Proposed Treas. Reg. §§301.7425-4(b)(1)(i), (ii); -4(b)(2)(i), (ii); -4(b)(5) Example (2), 40 Fed. Reg. 21974 (1975). A literal interpretation is also consistent with state statutory redemption provisions. *See, e.g.*, ARK. STAT. ANN. §51-1111 (Repl. Vol. 1971); KAN. STAT. ANN. §60-2414 (Cum. Supp. 1974); MICH. STAT. ANN. §27A.6063 (1962 Revision). *See also* CASNER, *supra* note 4, §16.8; OSBORNE, *supra* note 4, §307.

[25] 323 F. Supp. at 155. The debt remaining was the amount not satisfied by the foreclosure sale on the debt secured by the mortgage upon which Equity foreclosed. The payments made by Equity to Mutual were not included in that amount, but the district court concluded that it was "both equitable and just that Equity Mortgage should be compensated by the Government." *Id.* at 156.

[26] 504 F.2d at 1076. The amounts paid by Equity to Mutual were not added to the debt owed by Loftus to Equity, as the district court seemed to indicate. Thus, the court required the Government to tender the purchase price, $1000, with interest, $19 and the total amounts paid by Equity to Mutual, $4100. *See* note 27 *infra*. The possibility that Equity might have been subrogated to Mutual's rights to the extent of those payments also existed, and the district court so held.

[27] The redemption period runs from the date of the foreclosure sale until the Government causes a certificate of redemption to be recorded. However, the Government has only 120 days in which to redeem. INT. REV. CODE OF 1954, §§7425(d)(1), (2), (3)(c).

The circuit court held that the principle against unjust enrichment denied the Government any free benefit from Equity's pre-foreclosure payments, which not only protected Equity's interest but also preserved the Government's ability to acquire Equity's interest through redemption.[28] The court also held that the redemption period payments were "expenses necessarily incurred" in maintaining Equity's title to the property.[29] Finally, the court held that the Govern-

[28] 504 F.2d at 1077. The Fourth Circuit first noted that Equity's pre-foreclosure payments served to protect its own lien and those junior to it, including the Government's tax lien. The court then stated that although the legislative history indicated that the purchaser could only recover expenses incurred *after* the foreclosure sale, the principal against unjust enrichment required a broader reading of §2410(d)(3). Holding that Equity's preservation of its lien also preserved the Government's ability to exercise its right of redemption and acquire that interest which Equity had already acquired at the foreclosure sale, the court reasoned that if Equity had induced Mutual to forego collection until Equity could foreclose, then those payments made by Equity to Mutual would become redemption period payments and be within the literal meaning of the statute. The Fourth Circuit therefore held that it would be unjust to not compensate Equity for the payments it had made to Mutual prior to foreclosure. *Id.* This analysis by the Fourth Circuit, however, overlooked the fact that the Government could have exercised its right of redemption against Mutual had the latter chosen to foreclose before Equity. INT. REV. CODE OF 1954, §7425(d). Therefore, Equity's pre-foreclosure payments did not preserve the Government's ability to exercise its right of redemption. The proposed Treasury regulations under §7425(d) expressly reject the result reached by the Fourth Circuit. *See* text accompanying notes 40-46 *infra.*

[29] 504 F.2d at 1077. The holding that the redemption period payments were "expenses" was the crux of the problem in *Equity Mortgage Corp. v. Loftus.* The legislative history of §2410(d)(3) and the foremost commentator on federal tax liens offer no assistance in determining the meaning of "expenses" in the statute. *See* W. PLUMB, FEDERAL TAX LIENS 284 (3d ed. 1972); Plumb, *Federal Liens and Priorities—Agenda for the Next Decade III,* 77 YALE L.J. 1104, 1180 (1968). In those states permitting statutory redemption, 9 of the 23 states surveyed include payments made to a senior lienor during the redemption period in the amount that must be tendered to effect redemption. *Compare* ALA. CODE, tit. 7, §732 (1960); CAL. CIV. PRO. CODE §702 (West Cum. Supp. 1974); COLO. REV. STAT. ANN. §§38-39-101 to -103 (1973); KAN. STAT. ANN. §60-2414 (Cum. Supp. 1974); MINN. STAT. ANN. §582.03 (West 1947); NEV. REV. STAT. §21.210 (1973); N.D. CENT. CODE §28-24-07 (Repl. Vol. 1974); S.D. COMPILED LAWS ANN. §21-52-14 (1969); WYO. STAT. ANN. §1-481 (Cum. Supp. 1975) *with* ARIZ. REV. STAT. §12-1285 (1956); ARK. STAT. ANN. §51-1111 (Repl. Vol. 1971); IDAHO CODE §§11-402, -403 (Cum. Supp. 1975); ILL. ANN. STAT. ch. 77, §20 (Smith-Hurd Cum. Supp. 1975); IND. ANN. STAT. §34-2-29-7 (Burns 1973); IOWA CODE ANN. §628.11 (1950); MICH. STAT. ANN. §§27A.6063-64 (Rev. 1962); MO. ANN. STAT. §443.410 (Vernon 1952); MONT. REV. CODE ANN. §93-5835 (Repl. Vol. 1963); N.M. STAT. ANN. §§24-2-10 through 21 (Cum. Supp. 1973); TENN. CODE ANN. §64-810 (1955); UTAH R. CIV. PRO. 69(f)(3)(1953); WASH. REV. CODE ANN. §6.24.10 (West Cum. Supp. 1974); WISC. STAT. ANN. §297.11, .13 (1958).

The proposed Treasury regulations, while reaching the same result as the Fourth Circuit, do not consider them within the meaning of "expenses necessarily incurred" in §2410(d)(3). *See* text accompanying notes 31-38 *infra.*

ment must tender those payments made by Equity subsequent to the purported redemption, because the Government would have had to continue making payments to protect the interest it had acquired from Equity.[30]

While the court relied on the equitable principle against unjust enrichment and a liberal reading of 28 U.S.C. §2410(d)(3), the regulations under Internal Revenue Code §7425(d), proposed by the Treasury Department in response to the *Equity Mortgage* problem, provide explicit guidelines for calculating the Government's redemption price.[31] Although the regulations resolve the issue presented in *Equity Mortgage,* they do not deal with problems which may arise outside the facts of the case.

The proposed Treasury regulations suggest a conclusion consistent with the Fourth Circuit's with regard to the payments made during the redemption period; they expressly exclude such payments as "expenses necessarily incurred." The formula in §2410(d) consists of three elements: the foreclosure sale purchase price,[32] the interest thereon,[33] and the excess of expenses incurred from maintaining the property over income from the property.[34] One subsection of the proposed regulations provides for expenses incurred in maintaining the property,[35] while a separate sub-section provides for inclusion in the redemption price of amounts paid following foreclosure to senior lienholders.[36] The definitional sub-sections also indicate the redemption

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[30] 504 F.2d at 1078. Although Equity had rejected the Government's tender as insufficient, the Government, nevertheless, recorded a certificate of redemption. 504 F.2d at 1074. *See* INT. REV. CODE OF 1954, §7425(d)(3). The court reasoned that "Mutual must be paid by someone, or else it would foreclose its superior lien and wipe out whatever interest Equity and the government might have." 504 F.2d at 1078. Therefore, the equitable principle against unjust enrichment required the Government to reimburse Equity if it eventually perfected its tender of the redemption price. *Id.* A more reasonable interpretation of post-redemption payments results from a consideration of the 120-day limit on the redemption period. *See* text accompanying notes 57-60 *infra.*

[31] Proposed Treas. Reg. §301.7425-4(b), 40 Fed. Reg. 21972-74 (1975). The regulations, when finally adopted, will supersede the temporary regulations, Temp. Reg. §400.5-1, 26 C.F.R. 400.5-1 (1975), which are silent as to the meaning of "expenses" in §2410(d)(3). Preamble to Proposed Regulations under INT. REV. CODE OF 1954, §7425(d), 40 Fed. Reg. 21965-66 (1975).

[32] INT. REV. CODE OF 1954, §2410(d)(1).

[33] INT. REV. CODE OF 1954, §2410(d)(2).

[34] INT. REV. CODE OF 1954, §2410(d)(3).

[35] Proposed Treas. Reg. §301.7425-4(b)(1)(iii) requires that "[t]he amount . . . equal to the excess of (a) the expenses necessarily incurred to maintain [the] property . . . over (b) the income from such property . . . ." must be included in the redemption price.

[36] Proposed Treas. Reg. §301.7425-4(b)(1)(iv) requires that "the amount . . . of a

period payments are not within the ambit of §2410(d)(3) "expenses."[37] Furthermore, the method of obtaining reimbursement for expenses incurred in maintaining the property differs significantly from the method of obtaining reimbursement for redemption period payments to a senior lienholder.[38] Thus, both the structure and the procedure of the proposed regulations indicate that the Treasury Department does not consider redemption period payments similar to Equity's as "expenses necessarily incurred" under §2410(d)(3). Nevertheless, under the proposed regulations, the Government must include such payments in the amount it tenders to effect redemption under §7425(d).[39]

Furthermore, the proposed regulations expressly exclude pre-foreclosure payments to a senior lienholder from §2410(d)(3) "expenses,"[40] with the exception that such payments will be included in the redemption price as part of the "amounts actually paid" under §2410(d)() if certain conditions are met.[41] Despite the bar imposed by

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payment made by the purchaser . . . after the foreclosure sale to a holder of a senior lien" must be included in the redemption price.

[37] Expenses incurred in maintaining the property include "rental agent commissions, repair and maintenance expenses, utilities expenses, legal fees incurred after the foreclosure sale and prior to redemption in defending the title acquired through the foreclosure sale, and a proportionate amount of casualty insurance premiums and ad valorem taxes." Proposed Treas. Reg. §301.7425-4(b)(3)(i). In contrast, "payments made by a purchaser . . . to a senior lienor" are included in the redemption price under an entirely separate provision. Proposed Treas. Reg. §301.7425-4(b)(4)(i).

[38] Maintenance expenses are included in the redemption price at the discretion of the IRS district director. Proposed Treas. Reg. §301.7425-4(b)(3)(ii). In contrast, the district director must notify a purchaser of his right to claim reimbursement for payments made to a senior lienholder. Proposed Treas. Reg. §301.7425-4(b)(4)(ii). Thereafter, the purchaser must submit a written, itemized statement of the amounts paid, Proposed Treas. Reg. §301.7425-4(b)(4)(ii)(A), and a written waiver of his rights arising under local law with respect to those payments. Proposed Treas. Reg. §301.7425-4(b)(4)(ii)(B). One of the rights arising under local law is that of subrogation. *See* text accompanying notes 47-54 *infra.*

[39] Proposed Treas. Reg. §301.7425-4(b)(1)(iv), -4(b)(4).

[40] Proposed Treas. Reg. §301.7425-4(b)(3)(i) provides, in part: "Expenses incurred by the purchaser prior to the foreclosure sale are not considered under this subparagraph." Furthermore, the sub-section which provides for inclusion of payments made to a senior lienholder in the redemption price specifically limits the inclusion to payments made during the redemption period. Proposed Treas. Reg. §301.7425-4(b)(4)(i). *But see* CAL. CIV. PRO. CODE §702 (West Cum. Supp. 1975).

[41] Proposed Treas. Reg. §301.7425-4(b)(2)(ii) provides, in part:

> If, prior to the foreclosure, payments have been made by the foreclosing lienholder to a holder of a superior lien, the payments are included in the actual amount paid to the extent they give rise to an interest which is legally satisfied by reason of the foreclosure sale.

Such a result would not occur in an *Equity Mortgage* situation, however, because

the proposed Treasury regulations under Internal Revenue Code §7425(d), §6323(e)(6) of the Code[42] apparently grants priority over the federal tax lien to such pre-foreclosure payments. Because Mutual's lien also had priority over the federal tax lien,[43] the amounts paid by Equity on that lien would have been entitled to priority over the federal tax lien under §6323(e)(6).[44] However, the legislative history and the regulations proposed under §6323(e)(6) indicate that such payments may merely be added to the debt of the paying lienor.[45] Thus, Equity's pre-foreclosure payments may have been added to its debt. Since the foreclosure sale purchase price did not satisfy the original debt under Virginia law, such pre-foreclosure payments did not give rise to an interest "legally satisfied" by the sale and therefore should not have been included in the Government's redemption price.[46] In addition to the possible priority protection of pre-foreclosure payments afforded by §6323(e)(6), §6323(i)(2) of the Code[47] and the regulations proposed thereunder provide protection for such payments by subrogation.

With regard to the Government's right of redemption, the doctrine of subrogation is important under two sets of circumstances. First, in an *Equity Mortgage* situation, if a second mortgagee satisfies the obligation held by a first mortgagee to protect his own interest, he would be entitled to subrogation to all the rights of the first mortgagee under the common law doctrine of subrogation.[48] Thus, if Eq-

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Equity's payments to Mutual were not treated as part of the debt owed by Loftus and therefore did not give rise to an interest legally satisfied by the foreclosure sale. 504 F.2d at 1074, 1076.

[42] INT. REV. CODE OF 1954, §6323(e)(6).

[43] *See* note 13 *supra.*

[44] INT. REV. CODE OF 1954, §6323(e)(6) provides:

> (e) Priority of Interest and Expenses—If the lien imposed by section 6321 [federal tax lien] is not valid as against a lien or security interest, the priority of such lien or security interest shall extend to—
>
> . . .
>
> (6) amounts paid to satisfy any lien on the property to which the lien or security interest relates, but only if the lien so satisfied is entitled to priority over the lien imposed by section 6321.

[45] *See* 1966 U.S. CODE CONG. & AD. NEWS, *supra* note 2, at 3731; House Technical Explanation, *quoted* in 5 P-H 1975 FED. TAXES ¶35,783 at 35,790, which states that §6323(e)(6) "permits the amount of a lien or security interest, which has priority over the Federal tax lien to be increased by the amount paid . . . to satisfy any lien on the property to which the lien or security interest relates . . . ." *See also* Proposed Treas. Reg. §301.6323(e)-1(d), 38 Fed. Reg. 790 (1973).

[46] *See* note 41 *supra.*

[47] INT. REV. CODE OF 1954, §6323(i)(2) gives effect to subrogation if permitted under local law.

[48] Subrogation arises when one who is not obligated to pay the debt must pay it

uity had paid the entire sum owed to Mutual, it would have been subrogated to the rights and priorities held by Mutual under its first deed of trust.[49] In the example from the regulations proposed for §6323(i)(2),[50] a first mortgagee is senior to the federal tax lien which, in turn, is senior to a second mortgagee. When the first mortgagee begins foreclosure proceedings, the second mortgagee pays off the first mortgage in order to protect his own lien. If, under local law, the second mortgagee is subrogated to the first mortgagee's rights to the extent of the payments, then under §6323(i)(2), the federal tax lien is invalid as to those rights even though it is valid as to the second mortgagee's rights under his mortgage.[51] If the second mortgagee had been senior to the federal tax lien, as in *Equity Mortgage,* he still would be protected under the doctrine of subrogation.[52]

A more complex situation arising under circumstances not consid-

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to protect his own interest. L. JONES, MORTGAGES §1113 (8th ed. 1928)[hereinafter cited as JONES]. Thus, the second mortgagee, although not required to do so, must make payments on the first mortgage in order to prevent his own lien from being extinguished by the first mortgagee's foreclosure. He therefore is subrogated to all the rights held by the first mortgagee under that mortgage. *See also* CASNER, *supra* note 4, §§16.145, .147; JONES, *supra,* §1111; OSBORNE, *supra* note 4, §279. As to the amount of payment, the general rule is that the entire obligation must be satisfied for subrogation to be enforced. JONES, *supra,* §1122 at 577, §1132 at 589. *See* Medigroup, Inc. v. Schildknecht, 463 F.2d 525 (7th Cir. 1972); Lumberman's Mutual Ins. Co. v. Massachusetts Bonding & Ins. Co., 310 F.2d 627 (4th Cir. 1962); Corn Constr. Co. v. Aetna Cas. & Sur. Co., 295 F.2d 685 (10th Cir. 1961); John B. White, Inc. v. Providence Washington Ins. Co., 329 F. Supp. 300 (E.D. Pa. 1971). Virginia also follows the general rule. *See* Obici v. Furcron, 160 Va. 351, 168 S.E. 340 (1933); Combs v. Agee, 148 Va. 471, 139 S.E. 265 (1927); Hinman v. Mason, 149 Va. 267, 136 S.E. 573 (1927), *aff'd on reh.* 149 Va. 267, 141 S.E. 144 (1928); Baugh & Sons Co. v. Black, 120 Va. 12, 90 S.E. 607 (1916). This rule of full payment would appear to preclude Equity Mortgage Corporation from being entitled to relief under the doctrine of subrogation because it did not fully satisfy Loftus' obligation to Mutual. However, the doctrine arises in equity. As such, it may be invoked when an injustice might otherwise result and when the creditor's security interest is still fully protected. *See, e.g.,* Baugh & Sons Co. v. Black, 120 Va. 12, 90 S.E. 607, 610 (1916).

[49] If Mutual had not foreclosed, the federal government would still have had a tax lien on the land to the extent that it could have redeemed from any foreclosure by Mutual or its subrogee.

[50] Proposed Treas. Reg. §301.6323(i)-1(b)(2), 38 Fed. Reg. 795 (1973).

[51] If Equity had paid off the principal and interest in default on Mutual's deed of trust, it would have been subrogated under Virginia law to Mutual's rights under the first mortgage. *See* cases cited note 48 *supra.* Although the Government redeemed the property, the tax lien under which it purported to redeem would be invalid as to Equity's rights acquired through subrogation. Section 6323(i)(2). Therefore, Equity would have been able to foreclose on the first mortgage and acquire the property, but again subject to the federal government's right of redemption under §7425(d).

[52] *See* text accompanying note 49 *supra.*

ered by the Fourth Circuit in *Equity Mortgage* involves three mortgages senior to a federal tax lien. If the third mortgagee makes complete payments to the first mortgagee to prevent his foreclosure, the third mortgagee is entitled to be subrogated to the rights under the first mortgage.[53] This right of subrogation becomes crucial if the second mortgagee subsequently forecloses, extinguishing both the third mortgagee's lien and the federal tax lien, and the Government redeems. Under §6323(i)(2), the third mortgagee's payments to the first mortgagee will not have been in vain because the third mortgagee will be subrogated to the rights held under the first mortgage, which is still valid as against the Government's exercise of its redemption right.[54] The doctrine of subrogation, given effect by §6323(i)(2) and its accompanying regulations, offers protection against the Government's right of redemption to junior mortgagees who pay off senior mortgagees prior to the junior's own foreclosure.

The Internal Revenue Code and the proposed Treasury regulations are silent as to payments made subsequent to a purported redemption by the federal government.[55] The Fourth Circuit based its holding regarding Equity's post-redemption payments on the principle against unjust enrichment.[56] An alternative analysis, based on a suspension of the running of a statute of limitations, is more consistent with §7425(d). Under §7425(d)(1), the 120-day period in which the Government may redeem the property[57] is essentially a statutory limitation on that right. By the terms of the Code, redemption is incomplete until the redemption price has been paid.[58] Since payment was never completed because of the litigation arising out of Equity's rejection of the Government's tender, the running of the 120-

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[53] *See* text accompanying note 48 *supra.*

[54] *See* text accompanying notes 49-51 *supra.*

[55] The statement in §301.7425-4(b)(4)(i) that only payments made between foreclosure and redemption will be reimbursed is not applicable because redemption has never been fully effected. *See* text accompanying note 57 *infra.*

[56] 504 F.2d at 1078.

[57] INT. REV. CODE OF 1954, §7425(d)(1) provides that the Government "may redeem such property within the period of 120 days from the date of such sale. . . ."

[58] INT. REV. CODE OF 1954, §7425(d)(2) provides that "[i]n *any* case in which the United States redeems real property . . . the amount paid for such property *shall* be" the amount prescribed in §2410(d). [Emphasis added.] Notwithstanding §7425(d)(3)(c), which provides that the execution of a certificate of redemption "shall constitute prima facie evidence of the regularity of such redemption," payment of the amount prescribed in §2410(d) must be made to effect redemption. Because the amount tendered by the Government to redeem was the central issue in Equity's quiet title action, payment of the redemption price had not been completed. Therefore, redemption, itself, had not been completed.