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Federal Tax Lien Trap for the Unwary

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The enactment of HB 138, which became effective on September 11, 2008, might have created a trap for the unwary title examiner and for the creditor's attorney in a foreclosure action. The potential trap arises due to the interplay of Ohio and Federal law in the area of federal tax liens. The trap is believing *lis pendens* has arisen when it may not have.

HB 138 amended Ohio Revised Code ("ORC") § 2703.26, Ohio's *lis pendens* statute. Prior to HB 138 the statute read as follows:

"When summons has been served or publication made, the action is pending so as to charge a third person with notice of its pendency. While pending, no interest can be acquired by third persons in the subject of the action, as against the plaintiff's title."

Under this former statute liens recorded in the period between filing of the Complaint and service upon the principal defendants attached to the real estate. The title exam and judicial report or commitment needed to be supplemented or amended to reflect any such liens so that the lien creditor(s) could be joined.

With the enactment of HB 138, ORC§ 2703.26 now reads:

"When a complaint is filed, the action is pending so as to charge a third person with notice of its pendency. While pending, no interest can be acquired by third persons in the subject of the action, as against the plaintiff's title."

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Since the enactment of HB 138 most liens which haven't been recorded prior to the Complaint being filed will not attach as a lien against the real estate; however, there is at least one and perhaps two exceptions to that blanket statement: mechanics and federal tax liens.

Mechanics liens were an exception to the *lis pendens* effect of §2703.26 prior to enactment of HB 138 and remain so under the revised statute. Mechanics liens are an exception due to ORC§ 1311.21(C) which states:

“(C) The rule of *lis pendens* does not apply to a mechanics' lien claimant whose lien rights arose or accrued before an action involving the real property which is the subject of that lien became pending pursuant to section 2703.26 of the Revised Code and whose lien is filed within the statutory period but subsequent to the date the action becomes pending pursuant to section 2703.26 of the Revised Code.”

§ 2703.26, as amended, will not affect the validity of a mechanics lien the right to which arose prior to the Complaint being filed, if the mechanics lien is filed within the statutory period, even if the mechanics lien is filed after the Complaint.

The potential problem with federal tax liens involves a federal statute and a provision of Ohio's Rules of Civil Procedure.

The federal statute involved is 26 USC 7425 entitled “Discharge of Liens.” It states as follows:

“7425(a) JUDICIAL PROCEEDINGS. – If the United States is not joined as a party, a judgment in any civil action or suit described in subsection (a) of section 2410 of title 28 of the United States Code, or a judicial sale pursuant to such a judgment, with respect to property on which the United States has or claims a lien under the provisions of this title –

(1) shall be made subject to and without disturbing the lien of the United States, if notice of such lien has been filed in the place provided by law for such filing at the time such action or suit is commenced, or

(2) shall have the same effect with respect to the discharge or divestment of such lien of the United States as may be provided with respect to such matters by the local law of the place where such property is situated, if no notice of such lien has been filed in the place provided by law for such filing at the time such action or suit is commenced or if the law makes no provision for such filing.”

“Commenced” under the federal statute may not mean “*lis pendens* has arisen” under ORC§ 2703.26. In fact, revised ORC§ 2703.26 doesn't assert that the action is commenced by filing the Complaint only that a *lis pendens* has arisen. Rule 3(A) of the Ohio Rules of Civil Procedure determines when an action is “commenced.” Rule 3(A) states:

“(A) **Commencement.** Civil action is commenced by filing a complaint with the court, if service is obtained within one year from such filing upon a named defendant ...”

Under Civil Rule 3(A) an action is not commenced until both a Complaint is filed and service is obtained (within one year). Since 26 USC 7425(a)(2) requires commencement of the action before a federal tax lien may be disregarded based on *lis pendens*, the recent amendment of ORC§ 2703.26 has not eliminated the need to update the judicial report or commitment after service on the principal defendants. If a federal tax lien has been recorded prior to service on the principal defendants, the USA should be joined as a party defendant.