THE EFFECTS OF COUNTY PERSONAL PROPERTY TAX LIENS ON THE RIGHTS OF SECURED CREDITORS

KEITH MAUNE*

INTRODUCTION

In most states, counties are allowed to tax personal property and may attach liens to the personal property if the taxes are not paid.[1]

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1. *See* 50 State Statutory Surveys: Taxation: Collections and Remedies, *Collection Procedures*, 0140 Surveys 1 (WestLaw, Oct. 2015) [hereinafter 50 State Survey]; *Property Tax - Chart Builder*, BLOOMBERG LAW, https://www.bloomberglaw.com/bbna/chart/2/1150

However, secured creditors may already have a lien on the same personal property, which they perfected by making the appropriate filing as set forth by the Uniform Commercial Code (the "UCC").[2] The laws that control the relative rights of the counties and the secured creditors vary widely among states.[3] In some states, despite a creditor's apparent priority under the UCC, a county's lien can override a creditor's prior lien, even without any registration or opportunity for the creditor to discover the county's lien.[4] Some states also allow counties to attach liens to property in other counties in the state.[5]

The conflict between the rights of the counties and the rights of the secured creditors comes up most often in the context of repossession by the creditor.[6] When the creditor repossesses and liquidates its collateral, the law often requires that creditor to repay delinquent taxes to the county.[7] However, the creditor may not even be able to discover if any taxes were due until pursued by the county.[8] Furthermore, in some states, a creditor who repossesses and liquidates collateral may be forced to pay the county up to the entire amount to satisfy the taxpayer's outstanding personal property taxes, regardless of whether those taxes reflected amounts due on that creditor's collateral or whether it was based on taxes due on other property.[9]

(last visited Nov. 20, 2016). The WestLaw Survey provides a quick and convenient listing of the tax-related statutes in each state. Note that some statutes refer to taxes levied by the state government, but the listings also include all relevant statutes governing the collection of county property taxes—the subject of this Note. The listings are simply arranged in numerical order as codified and are listed with the section title. The Bloomberg Chart Builder resource is much more helpful but takes a bit more effort to access and interpret. The tool allows the user to select from a list of the fifty states (or allows selection of all fifty states) and from a list of 141 "topics" relating to state property tax laws (each of these "topics" is much more specific than the four broad "dimensions" of state law that will be referred to in this Note). The items selected will become the rows and columns in a table. The tool then generates a chart of the selected topics in the selected states. For example, the available selections for topics include several that are relevant to the subject matter of this Note: "Jurisdiction Imposing Tax," "Situs," "Foreclosures," "Type and Creation of Lien," "Holder/Beneficiary of Lien, Lien Priorities," "Actions for Personal Property," and "Property in Another County/State." Each cell of the chart is populated with a snippet of any applicable state law along with the statute reference. This Chart Builder tool is the best starting point for researching the county tax laws for other states not discussed in this Note. Note that neither resource includes any case law, however.

2. *See* THEODORE EISENBERG ET AL., 2B-24 DEBTOR-CREDITOR LAW § 24.04 (1982). This is an expansive treatise on many areas of debtor-creditor law. Chapter 24, "Secured Transactions," provides an excellent overview of the topic.

3. *See* 50 State Survey, *supra* note 1.

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.*

8. *Id.*

9. *See* 50 State Statutory Surveys: Taxation: Collections and Remedies, *Collection Procedures*, 0140 Surveys 1 (WestLaw, Oct. 2015) [hereinafter 50 State Survey]; *Property*

Because of the unpredictability and financial burden on creditors in states with such laws, this Note argues that some states should reconsider their current laws to more appropriately balance the interests of the creditors with the interests of the counties. This Note argues for objectively balancing the interests of the parties, keeping in mind the counties' legitimate need to collect taxes while incorporating the creditors' need for predictability and fair treatment. In order to understand the perspective and normal expectations of the secured creditors, this Note first examines how their security interests usually work under the UCC absent any government tax liens. Section I starts with explaining UCC Article 9, which governs secured transactions in all fifty states, and the special type of security interest known as a purchase money security interest ("PMSI"). The Section will examine how Article 9 normally dictates priority among secured creditors.

Next, in Section II, the state laws that control the rights of counties and secured creditors are broken down into four dimensions: priority, discoverability, scope, and apportionment. The Section examines each of these four dimensions and explores the variations that exist among the states. Next, in Section III, this Note analyzes the laws in several states that have recently had changes in their laws related to personal property taxes. This brings together the four dimensions to illustrate how they can be combined in ways that are more favorable to counties or more favorable to creditors. Finally, in Section IV, this Note presents the best practice model that states ought to adopt to balance the interests of the counties and the secured creditors fairly and explains why the proposed rules are the fairest and most practical approach.

I. BACKGROUND

Although a full discussion of secured transactions is outside the scope of this Note,[10] a brief summary of basic rules is an important backdrop to the discussion about county tax liens. Since these rules govern the liens of secured creditors absent any government intervention, they help to frame the normal expectations of the creditors. The Uniform Commercial Code has been adopted in all fifty states, and Article 9 of the UCC provides rules for the priority among creditors' liens, known officially as "security interests."[11] A security interest is acquired by private contract between the parties with the debtor signing a security agreement.[12] But, priority over other creditors is based upon "perfection" of the security interest, which is

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Tax - Chart Builder, BLOOMBERG LAW, https://www.bloomberglaw.com/bbna/chart/2/1150 (last visited Nov. 20, 2016).*See* 50 State Survey, *supra* note 1.

10. Numerous resources exist which can provide further information about the Uniform Commercial Code. *See generally* EISENBERG ET AL., *supra* note 2.

11. *Id.* § 24.01.

12. *Id.* § 24.04.

generally accomplished by filing a UCC Financing Statement (a "UCC-1") with the registry that is maintained in each state.[13] Thus, perfection provides notice to other creditors, since the registry is publicly searchable, and the process provides a fair basis for determining priority.[14] Priority among creditors is usually based simply upon first-to-perfect.[15] This is also called first-in-time, but still refers to the first creditor to perfect (not necessarily the first creditor to acquire the security interest via the security agreement), thus providing notice to others.[16] A creditor can file a lien on a specific piece of collateral, a category of collateral (e.g., all vehicles or all inventory), or all property of the debtor (i.e., a "floating lien").[17]

The major exception to the first-to-perfect rule is with purchase money security interests ("PMSIs").[18] A PMSI is a special type of security interest where the creditor provides the funds to purchase a specific piece of property and the creditor takes a security interest in that property as part of the purchase transaction.[19] For example, the lien that a bank acquires when it loans money for the purchase of a vehicle could be filed as a purchase money security interest.[20] The rules require that the money is directly traceable to the purchase of the specific piece of collateral.[21] For example, the bank could pay the dealer directly for the vehicle. The rules also have strict filing deadlines to perfect a PMSI.[22] When a PMSI is timely perfected, it takes priority over pre-existing security interests, even if, for example, the existing security interest covered "all vehicles" or "all property."[23] This priority status makes sense since the preexisting creditor is not in any worse position because of the subordination. After all, the borrower would not have acquired the additional property but for the money provided by the new creditor. The new creditor has used its money to pay specifically for the new piece of collateral, so its security interest in that collateral has priority under the UCC.

II. THE FOUR PRIMARY DIMENSIONS OF STATE LAWS

Although the UCC Article 9 governs secured transactions among private parties, state laws regarding county personal property tax liens can and do override the UCC rules. In an attempt to make sense of the varying state laws, this section analyzes these laws along four dimensions: priority,

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13. *Id.*
14. *Id.*
15. *Id.*
16. THEODORE EISENBERG ET AL., 2B-24 DEBTOR-CREDITOR LAW § 24.04 (1982).
17. *Id.* § 24.01.
18. *Id.* § 24.06.
19. *Id.*
20. *Id.*
21. *Id.*
22. THEODORE EISENBERG ET AL., 2B-24 DEBTOR-CREDITOR LAW § 24.06 (1982).
23. *Id.* § 24.01.

discoverability, scope, and apportionment. These dimensions represent the four major ways in which the laws affect the rights of secured creditors. While the UCC laws that control the creditors are substantially identical among the states, the state laws relating to county tax liens vary widely.[24] First, the laws vary in how they handle priority between the statutory county tax liens and security interests controlled under the UCC, as discussed in Section I. Second, the laws vary in terms of discoverability, that is, how easily creditors are able to discover the existence of a county tax lien. The third variation relates to scope: are counties able to attach liens to the property assessed, or to all property in the county, or to property outside their jurisdiction as well? Finally, the fourth variation is with how apportionment is handled. In other words, can a county take the entire amount due out of a single creditor's collateral, even when that amount exceeds the amount due on the repossessed property?

A. Priority Variations

While all private creditors play by the rules of the UCC, the government has the option to override the normal priority rules for tax liens but does not always choose to do so. The federal government, for example, voluntarily conformed to the UCC priority rules with the passage of the Federal Tax Lien Act of 1966, whereby federal tax liens are subordinated to pre-existing perfected security interests.[25] Furthermore, the federal government even sometimes recognizes the priority of subsequent PMSIs. For example, the IRS permits subsequent PMSIs to take priority over an existing IRS tax lien.[26]

Although the federal government is sensitive to the interests of secured creditors, including subsequent purchase money lenders, state governments are usually less lenient. Many states do abide by first-in-time rules but fail to recognize priority of subsequent purchase money creditors.[27] This results in circular priorities since a subsequent PMSI has priority over a preexisting security interest, and a preexisting security interest has priority over the state's tax lien. Yet, the subsequent PMSI does not have priority over the state's tax lien.[28] This is the case, for example, in Tennessee, where the state may attach a lien to all property in the state as a

24. *See* 50 State Survey, *supra* note 1.

25. *See* I.R.C. § 6322 (1966) (showing IRS treatment of liens in conformity with Federal Tax Lien Act).

26. I.R.S. Pub. No. 785 (2005).

27. *See* 50 State Survey, *supra* note 1.

28. To put this in mathematical terms, this is like saying $A > B$ and $B > C$, yet $A < C$. For a further discussion of this priority paradox in the context of Kentucky's state tax lien priority laws, which follows the majority rule as mentioned, *see* Richard H. Nowka, Whayne Supply Co., Inc., v. Commonwealth of Kentucky Revenue Cabinet: *Does Policy Prevail Over the Plain Meaning of a Statute?*, 24 N. KY. L. REV. 273, 280 (1997).

result of delinquent taxes, but the lien is subordinate to security interests that were perfected prior to the state's filing of its lien.[29]

The focus of this Note, however, is with the tax liens of counties, where the priority rules of the UCC are respected least of all. In the majority of states, the state legislatures allow counties priority over all other creditors.[30] The exact language varies ("first lien," "superior to all other liens," "priority over the claim of any creditor"), but the policy is clear: a preexisting creditor who has a valid, perfected security interest can be trumped by a county tax lien.[31] However, there are a couple of exceptions, for example, Virginia and Wisconsin.

In Virginia, the statute provides that:

> [a] security interest perfected prior to any distraint[32] for taxes shall have priority over all taxes, except those specifically assessed either per item or in bulk against the goods and chattels so assessed. Taxes specifically assessed either per item or in bulk against goods and chattels shall constitute a lien against the property so assessed and shall have priority over all security interests.[33]

In one way, this is particularly generous to creditors because priority is recognized not only for security interests perfected prior to the assessment of the tax, but also for any security interest perfected prior to distraint for taxes. However, the exception takes away most of the benefit; since personal property taxes are assessed "in bulk against the goods and chattels," such taxes still have priority.[34] There is limited benefit, however, in that taxes assessed on a specific class of property (e.g., motor vehicles) do not constitute a lien against *all* of the debtor's property.[35]

Additionally, despite a clarification in the statutory language in 2001, courts continue to treat the lien as arising at the time of distraint. This is an important distinction for creditors, who therefore retain the ability to

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29. TENN. CODE ANN. § 67-1-1403(a), (c)(3)-(4) (2016).

30. This can be seen in the 50 State Survey or Chart Builder tool. *See* 50 State Survey, *supra* note 1.

31. *See, e.g.,* TENN. CODE. ANN. § 67-5-2101(a) (2016) ("first lien"); KY. REV. STAT. ANN. § 134.420(3) (West Supp. 2015) ("priority over any other"); TEX. TAX CODE ANN. § 32.05(b)(1) (West 2015) ("priority over . . . the claim of any creditor"); NEV. REV. STAT. ANN. § 361.450(1) (2015) ("superior to all other liens"); MISS. CODE. ANN. § 27-35-1(1) (West 2012) ("preference over all . . . liens").

32. To "distrain" means to seize personal property. BLACK'S LAW DICTIONARY (10th ed. 2014).

33. VA. CODE ANN. § 58.1-3942(C) (West 2009 & Supp. 2016).

34. *Id.*

35. *In re* Ricketts Constr. Co., Inc., 441 B.R. 512, 516 (Bankr. W.D. Va. 2010) (holding that an unpaid assessment on a motor vehicle constituted a lien only on the debtor's motor vehicles, and noting, "[i]f the General Assembly had intended to create such a universal lien, it would not have limited scope of the lien to 'the property so assessed.'").

repossess the equipment before a county exercises its right of distraint. The original language of the statute used the word "distrained" where it has now been replaced with "so assessed": "[t]axes specifically assessed either per item or in bulk against the goods and chattels *distrained* shall have priority over all security interests[.]"[36] In 2000, a federal bankruptcy court in Virginia interpreted this language to mean that no lien attaches until the goods are actually distrained.[37] In 2010, another division in the same district revisited this statute, now revised as quoted above. The court acknowledged that the statute was changed as a result of the interpretation in the 2000 case,[38] yet still noted that "[t]he Code of Virginia does not address specifically when the lien arises. By implication, however, the lien arises after the property has been seized through distraint."[39]

Another exception to the majority rule is found in Wisconsin. In Wisconsin, the code is unusual in that it does not contain any provisions regarding tax liens or distraint of personal property. Rather, the law simply provides that "[d]elinquent personal property taxes . . . may be recovered by the taxation district in a civil action[.]"[40] The law in Wisconsin seems to give no special treatment to counties. There is no assertion of any lien, much less a lien that takes priority over existing liens. The law even provides for special approval by the county board before legal action is commenced, as well as notice to the taxpayer about when and where the meeting will be held to consider the legal action.[41]

B. Discoverability Variations

In the majority of states, the lien on the personal property comes into existence upon the assessment of taxes without any additional filing or notice to other existing or future creditors.[42] Furthermore, there are usually no laws requiring that counties respond to creditors even if they were to query them directly.[43] The lack of discoverability of liens presents major problems for creditors. First, the creditors are unable to fully assess the creditworthiness of the borrower if they are not able to discover existing liens as they make their decision about whether to extend credit. Creditors

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36. *In re* Tultex Corp., 250 B.R. 560, 563 (Bankr. W.D. Va. 2000) (emphasis added and removed).

37. *Id.*

38. *Ricketts*, 441 B.R. at 516 n.3.

39. *Id.* at 515 n.2.

40. WIS. STAT. ANN. § 74.55(1) (West 2011).

41. *Id.* § 74.53(5).

42. For example, in Mississippi, "[t]axes (state, county and municipal) assessed upon lands or personal property . . . shall be a lien upon and bind the property assessed." MISS. CODE ANN. § 27-35-1(1) (West 2012). Similarly, in Alabama, "when property becomes assessable the state shall have a lien upon each and every piece or parcel of property[.]" ALA. CODE § 40-1-3 (2011). For laws in other states, refer to the 50 State Survey, *supra* note 1.

43. *See* 50 State Survey, *supra* note 1.

can easily run queries against databases to discover federal tax liens, state tax liens, and tax liens against real property.[44] However, they often are unable to discover these personal property tax liens.

More commonly, a borrower may not have had any tax liens initially, but the borrower later encounters liquidity problems. A borrower that defaults on the loan to the creditor may often have unpaid personal property taxes as well. In this scenario, if the creditor repossesses property from that borrower, the creditor may not be able to discover whether or not these priority liens exist. This leaves open the possibility that a county may later demand that the creditor repay the proceeds from its repossessed collateral. This unknown liability can be a critical issue to creditors since the taxes due could wipe out their entire proceeds from repossession. In such a case, a creditor would want to know ahead of time, since it could save itself the trouble of pursuing the repossession.

Some states have addressed this problem either by mandating that counties respond to queries from creditors or by establishing a statewide registry. The statewide registry is the most helpful solution, allowing creditors to check the registry both on the front end before extending credit and upon repossession to determine whether delinquent taxes need to be paid. Other states have implemented a statute mandating timely responses from counties upon receipt of an inquiry from a creditor. A mandatory response solution is far easier to implement but is only useful to query a limited number of counties. Thus, it is not helpful for making a credit decision on the front end and only provides a solution for repaying taxes after repossession. Three examples of states that have attempted to address the discoverability problem in one of these ways are Tennessee, Georgia, and Maryland.

In Tennessee, legislation that was passed in 2010 implemented a mandatory response system. The legislation required counties to respond to queries from creditors within fifteen days.[45] If the counties do not respond as to whether or not any taxes are owed, then the county waives its lien, and the creditor may consider the lack of response notice that nothing is owed.[46] As will be discussed in Section III, creditors in Tennessee only need to check with one or two counties, so this system of querying individual

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44. A web search for the type of lien being sought is usually the easiest way to find the appropriate site where any private party can execute a search. For example, Tennessee's UCC filings database is available to search online at https://tnbear.tn.gov/UCC/Ecommerce/UCCSearch.aspx, and Tennessee real property tax liens can be searched at http://www.assessment.cot.tn.gov/RE_Assessment/. Federal tax liens must be registered in the state databases, making them easy to discover as well. 26 U.S.C. § 6323(f)(1)(A)(ii). Additionally, private parties provide services to allow for quick nationwide lien searches rather than having to search many different state and county databases. *E.g.*, CT LIEN SOLUTIONS, https://www.ctliensolutions.com/.

45. TENN. CODE ANN. § 67-5-1805(c)(4)(B)(iii) (2016).

46. *Id.*

counties is workable in Tennessee. However, it would be little help in other states where creditors might have to check with every county in the state.

Georgia has implemented a statewide registry for personal property tax liens. In Georgia, legislation first enacted in 1995 granted authority to the Georgia Superior Court Clerks' Cooperative Authority to establish a "state-wide uniform automated information system for real and personal property records[.]"[47] The system was mandated to be operational as of January 1, 2004 and is now available on the web for public access.[48]

Maryland has somewhat of a hybrid system. Under legislation passed in 2013, the State Department of Assessments keeps a record of "certified assessments" from counties, and creditors must contact each county that has a certified assessment "in an amount equal to or greater than the cost basis of the personal property subject to repossession by the secured party" to determine whether any taxes are due.[49] The counties have forty-five days to respond to the creditors or to dispute the valuation of the repossessed collateral.[50]

Discoverability is an essential dimension in determining the fairness to secured creditors. Notably, however, this is the only dimension that cannot be entirely controlled merely with the stroke of a legislative pen. Although the intermediate solution of mandating responses from counties can be accomplished simply by statute, the broader solution of implementing a registry is far more involved. A statewide registry would require the coordination and cooperation of potentially hundreds of counties within a state. Therefore, the best and most practical solution to the discoverability problem must be determined in the context of the other dimensions. This will be explored further in the case studies in Section III, as well as in the best practice model in Section IV.

C. Scope Variations

There is much variation among states regarding where personal property liens attach. The messiness of this question stems from the nature of personal property taxes. A comparison to real property taxes best illustrates the issue: unlike personal property, there is a fixed, manageable number of real property parcels in each county. Each real property parcel is taxed for a specific amount associated with that individual piece of property. If the tax is unpaid, the lien attaches to that particular parcel of land. A registry of real property parcels is already maintained in each

47. 1995 Ga. Laws 260 (codified as GA. CODE ANN. § 15-6-97 (West 1995)).

48. *Lien Index | Lien Searches | GSCCCA*, THE CLERKS AUTHORITY, http://search.gsccca.org/Lien/lienindex.asp (last visited Apr. 2, 2017).

49. 2013 Md. Laws 370 (codified as MD. CODE ANN., TAX-PROP. § 14-805(c)(2)(i) (West 2002 & Supp. 2013)).

50. MD. CODE ANN., TAX-PROP. § 14-805(c)(3)(ii)(1).

county, so liens for unpaid taxes can easily be noted within the same registry, providing notice to any potential buyers.

Personal property requires different treatment for several reasons: (1) there are too many pieces of personal property to give them individual treatment; (2) personal property is more frequently bought and sold, so it would be a hassle to take into account taxes with each sale, as is done with real property; and (3) personal property does not remain in a particular county but can be moved outside of the county or even outside of the state. For these reasons, personal property is usually taxed by total value or value by category. For example, businesses may have to report and pay taxes on the value of all vehicles or the value of all office equipment. The taxes are not necessarily associated with any specific items of property, and the business is free to sell these items or move them across county or state lines. Because of these challenges, in some ways, personal property tax is treated as a tax on the particular business or individual, rather than being a tax associated solely with the property.

In other words, there is close nexus between pieces of real property and the taxes assessed on that property. When a payment is made, it is applied against a specific parcel of real property. There is less of a nexus between pieces of personal property and the taxes assessed on those pieces of property. When a payment is made, it is applied against the overall account for the taxpayer. There is no tracking as to whether or not taxes have been paid on any particular piece of personal property.

Both real property taxes and personal property taxes are secured by the underlying property of the taxpayer. However, real property taxes are secured against a *particular* piece of real property. If the taxes on a particular piece of property are unpaid, then, naturally, the lien attaches to that particular piece of property. However, with personal property taxes, the scope of what property the lien attaches to is more complicated. This "scope" dimension, like all the other dimensions, varies among the states. Because of the fact that personal property can be bought and sold, and moved into or out of the county, some states choose to provide counties additional scope in their liens.

The states that provide the least rights to counties grant liens only on the actual property assessed. For example, the language in South Carolina provides, "All taxes . . . shall be considered . . . a first lien in all cases whatsoever *upon the property taxed*[.]"[51] One small expansion of this limited scope for South Carolina counties is an automatic lien on subsequently acquired property of a delinquent taxpayer.[52]

In Florida, counties have slightly more scope in their liens. Similar to South Carolina, the scope is initially "any property against which the taxes have been assessed[.]"[53] However, if the property cannot be located in

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51. S.C. CODE ANN. § 12-49-10 (2014) (emphasis added).
52. *Id.* § 12-49-30.
53. FLA. STAT. ANN. § 197.122(1) (West 2014).

the county or the sale of the property is insufficient to pay the debt, the scope expands to "all other personal property of the taxpayer in the county."[54] But, in the case of the expanded scope, Florida does not assert priority against a lienholder and does not claim any liens against property that has been sold.[55]

Kentucky also provides liens "on the property assessed."[56] However, this lien stays with the property even after a subsequent sale to a bona fide purchaser.[57] Nevada counties have still more scope to their liens. Counties start with a larger scope, receiving a lien "upon all property then within the county."[58] Furthermore, once the lien attaches, the lien stays with the property, regardless of subsequent movement or even a subsequent sale to a bona fide purchaser.[59]

Other states allow for counties to attach liens in other counties within the state. For example, North Carolina provides a procedure for counties to file a "tax receipt" in another county, which effectively operates as a lien,[60] and Alabama allows counties to file a lien in any other county where property is located.[61] Broadest of all, in Mississippi, county tax liens automatically attach "upon any personal property so situated or brought into this state."[62] This automatic attachment has a much greater effect on creditors that may repossess property in other counties without notice of any delinquencies.

D. Apportionment Variations

Apportionment refers to what portion of the delinquent tax a repossessing creditor may have to repay to the county. As discussed in the previous section, the differences between personal property as opposed to real property also create difficulties regarding apportionment. Since personal property taxes are often associated with a pool of property and individual items are being bought and sold continuously, there is no direct link between the tax lien and any particular item. A potential problem therefore arises when a secured creditor repossesses its collateral and the county demands repayment of the delinquent taxes from the proceeds.

Texas resolves the issue squarely in favor of the counties, declaring that the tax liens are a "lien in solido," meaning that each creditor is liable

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54. *Id.*
55. *Id.* ("However, a lien against other personal property does not apply against property that has been sold and is subordinate to any valid prior or subsequent liens against such other property.").
56. KY. REV. STAT. ANN. § 134.420(1) (West 2015).
57. *Id.* § 134.420(2).
58. NEV. REV. STAT. § 361.450(2) (2015).
59. 158 Nev. Op. Att'y Gen. No. 96-28 (Sept. 27, 1996).
60. N.C. GEN. STAT. § 105-364(b) (2008).
61. ALA. CODE §§ 40-5-17, 40-5-31 (2011).
62. MISS. CODE ANN. § 27-35-1(1) (West 2012).

for up to the entire amount.[63] This may mean that a creditor repays to the county the entire amount it receives from the sale of repossessed collateral, even when that amount represents taxes assessed on other property that was not the creditor's. Many other states try to avoid this scenario. In Alabama, a creditor typically only has to repay to a county the amount of taxes due on the creditor's collateral, provided that the debtor has sufficient other property to cover the tax lien.[64]

Georgia apparently has an apportionment rule as well, although awkwardly phrased. The statute creates the apportionment through carefully crafted priority rules. The initial rule in the statute is that "liens for taxes are superior to all other liens[.]"[65] However, the statute gives an exception: "The lien for any ad valorem tax shall not be superior to the title and operation of a security deed when the tax represents an assessment upon property of the taxpayer other than property specifically covered by the title and operation of the security deed."[66] Therefore, it appears that a prior lienholder would have to pay only the taxes due which represent the assessment upon its own collateral but not taxes due on other property.

North Carolina takes a similar approach to Georgia, solving the apportionment problem through priority rules. Tax liens are superior to other liens when they represent taxes imposed on that property.[67] However, "[t]he tax lien, when it attaches to personal property, shall, insofar as it represents taxes imposed upon property *other than that to which the lien attaches*, be *inferior* to prior valid liens and perfected security interests and superior to all subsequent liens and security interests."[68] Again here, because the creditor is only subordinate to the taxes imposed on its own property, the statute effectively accomplishes apportionment.

Maryland's tax code simply uses the term "pro rata," making for a much simpler statute that gives the same result.[69] The wording is probably still sufficiently clear, given the common meaning of the term. The law succinctly states that a creditor can satisfy a tax lien by "paying the required pro rata portion of the personal property taxes due[.]"[70]

Tennessee's laws go even a step further. The apportionment is described with the language: "The personal property taxes to be withheld and paid . . . shall be determined by the valuation of *only such personal property that the secured party has sold*[.]"[71] This is probably the clearest language yet, since it avoids any potential argument about what "pro rata" means, and it directly addresses what taxes are to be paid instead of

63. TEX. TAX CODE ANN. § 32.01(b) (West 2015).
64. ALA. CODE § 40-5-12 (2011).
65. GA. CODE ANN. § 48-2-56(b) (West 2011).
66. *Id.* § 48-2-56(d)(2).
67. N.C. GEN. STAT. § 105-356(b)(1) (West 2008).
68. *Id.* § 105-356(b)(2) (emphasis added).
69. MD. TAX CODE, TAX-PROP. § 14-805(c)(1)(i) (West 2002 & Supp. 2013).
70. *Id.*
71. TENN. CODE ANN. § 67-5-1805(c)(1) (2016) (emphasis added).

defining it indirectly through priority rules. Furthermore, the statute also limits the secured creditor's tax liability to only four years' worth of taxes.[72]

III. CASE STUDIES

Having explored the four major aspects of state laws and some of the variations that exist within each dimension, this Section now examines the laws of specific states. This state-by-state look will better illustrate how the variations in the four dimensions interact in combination with each other. Priority is usually the most straightforward aspect. If the county doesn't have priority, then the creditor does not need to worry; however, that is the minority rule.[73] Also, as discussed above, states sometimes use priority rules to establish the idea of apportionment in a very non-obvious way.[74] Potential issues with discoverability are closely linked to scope and apportionment. Having a statewide registry is more important if liens can attach statewide, whereas mandatory responses from counties can suffice in states where liens stay within the county. Apportionment is a critical issue as well, since creditor-friendly apportionment rules can significantly temper other rules that are friendlier to the counties.

This Section looks at three states with three very different sets of laws. Additionally, these three states are particularly interesting because they have all had recent changes in their laws. Looking at these states and their changes provides excellent insight into how laws can be designed to more fairly balance the interests of counties and the interests of secured creditors and how sometimes the results fall short of that objective.

First, this Section looks at recent events in Texas, where a 2012 court case interpreted the law controlling the scope of liens to be more favorable for the creditors, and there is now pending legislation to change the scope back to be more favorable to counties. Then, this Section looks at Tennessee, where a 2009 court case interpreted the priority law to be more favorable to the counties, and, in response, the legislature in 2010 completely revamped the laws regarding the other three dimensions of discoverability, scope, and apportionment to be very favorable to creditors. Finally, this Section examines Maryland, where the laws were also recently revamped completely through legislation passed in 2013.

A. Texas

In Texas, as is the majority rule for the priority dimension, county tax liens have "priority . . . over the claim of any creditor[.]"[75] The Texas laws do not address discoverability, so creditors have no easy way to

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72. *Id.* § 67-5-1805(c)(3).
73. *See* 50 State Survey, *supra* note 1.
74. *See supra* Section II-D.
75. TEX. TAX CODE ANN. § 32.05(b)(1) (West 2015).

discover potential county tax liens. As is typical in many states, the lien automatically attaches on January 1 of each year, and the lien is declared to be perfected on attachment with no further action, notice, or registration by the taxing unit.[76] The Texas state government website indicates that "[c]ounty tax assessor-collector offices can answer questions about" taxes due and provides a directory of the 254 different county tax assessors in Texas.[77] In other words, a creditor that wanted a definitive answer about potential tax liens would have to contact all 254 counties and even then would not be guaranteed a response. Regarding apportionment, the Texas Tax Code states that a tax lien is a "lien in solido," meaning that a secured creditor can be held liable to pay up to the entire amount.[78] The law does not provide much clarification regarding the scope of the lien, but it does provide an exception whereby "a tax lien may not be enforced against personal property transferred to a buyer in ordinary course of business[.]"[79]

In 1995, a secured creditor who repossessed its collateral attempted to claim an exception under this "buyer in the ordinary course of business" exception. The Texas Court of Appeals held that the exception did not apply to a secured creditor and clarified the laws firmly in favor of the county.[80] The Court held that the county's personal property tax lien was superior to the security interest of the secured creditor, regardless of whether the security interest preexisted the tax lien, and even though the county had not given notice to the secured creditor nor taken any action to file the lien, foreclose the lien, or take possession of the property.[81] The secured creditor was ordered to distribute its proceeds to the county.[82]

A more recent development that clarified the scope of the liens stemmed from the bankruptcy of Conquest Airlines, originally filed in 1996.[83] The debtor had personal property located in Travis County and in Jefferson County.[84] The Travis County assessor filed claims for delinquent taxes exceeding $500,000.[85] The dispute arose because the claims exceeded the value of the personal property located in Travis County.[86] The Travis County assessor claimed that the liens attached to all of the debtor's property, including that which was located in Jefferson County.[87] The

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76. *Id.* § 32.01(a), (d).

77. *Local Property Appraisal and Tax Information*, COMPTROLLER.TEXAS.GOV, http://comptroller.texas.gov/propertytax/references/directory/tac/ (last visited Apr. 2, 2017).

78. TEX. TAX CODE ANN. § 32.01(b).

79. *Id.* § 32.03(a).

80. Cent. Appraisal Dist. of Taylor County v. Dixie-Rose Jewels, Inc., 894 S.W.2d 841, 843 (Tex. Ct. App. 1995).

81. *Id.*

82. *Id.*

83. *In re* Conquest Airlines Corp., No. 96-10215-CAG, 2012 WL 2236717, at *1 (Bankr. W.D. Tex. June 15, 2012).

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.*

bankruptcy trustee contended that the Travis County claims could be satisfied only from the property located in Travis County.[88]

The court examined the language of the statute and initially remarked that either interpretation was plausible.[89] The relevant language provides:

> On January 1 of each year, a tax lien attaches to *property* to secure the payment of all taxes, penalties, and interest ultimately imposed for the year on *the property*, whether or not the taxes are imposed in the year the lien attaches. The lien exists in favor of each taxing unit having power to tax the property.[90]

The court then looked at past wording of the statute and the legislative history to try to determine the legislative intent behind the vague wording.[91] The court found that prior to 1982, the statute was much clearer: "All taxes shall be a lien upon *the property upon which they are assessed*[.]"[92] That language clearly supported a scope limited to the county.[93] In 1982, the language was changed to be very similar to the present language: "On January 1 of each year, a tax lien attaches to *property* to secure the payment of all taxes, penalties, and interest ultimately imposed for the year on *that property*[.]"[94] In 1993, the language was modified again, changing "that property" to "the property" as it now reads.[95]

For each successive change, the court found the legislative records indicating either that there would be no fiscal implications of the change or that the change was considered nonsubstantive.[96] From these records, the court concluded that the meaning behind the words "property" and "the property" in the current statute referred to the property being taxed by the county.[97] Curiously, the court did not focus its attention on the following sentence in the statute: "The lien exists in favor of each taxing unit having power to tax the property."[98] This seems to imply more clearly the scope of

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88. *Id.*

89. *Conquest Airlines*, 2012 WL 2236717 at *2.

90. *Id.* (quoting TEX. TAX CODE ANN. § 32.01(a) (West 2015) (emphasis added)).

91. *Id.* at *3.

92. *Id.* at *4 (quoting TEX. REV. CIV. STAT. ANN. art. 1060 (1963) (repealed 1982) (emphasis added).

93. *See id.*

94. *Id.* (quoting TEX. TAX CODE ANN. § 32.01(a) (1982), (current version at TEX. TAX CODE ANN. § 32.01(a)) (emphasis added).

95. *In re* Conquest Airlines Corp., No. 96-10215-CAG, 2012 WL 2236717, at *5 (Bankr. W.D. Tex. June 15, 2012) (quoting TEX. TAX CODE ANN. § 32.01(a)).

96. *Id.*

97. *Id.*

98. TEX. TAX CODE ANN. § 32.01(a).

"the property," limiting it to the property that was taxed by the particular county.[99]

Regardless, the court ultimately reached the conclusion that the scope of the liens for Travis County was limited to the property within that county.[100] This opinion was published by the court in 2012. In response to this decision, in 2013, a bill was introduced to add the language "irrespective of whether the personal property is located within the boundaries of the taxing unit in whose favor the lien attaches" to the statute.[101] The bill passed both houses of the legislature but was vetoed by the governor in 2013; it was introduced again in 2015 but did not make it out of the Senate Finance Committee.[102]

In summary, Texas grants priority to counties over all secured creditors. Counties only give up their lien on property that is transferred to a buyer in the ordinary course of business. There is no discoverability provision other than contacting each of the 254 counties in Texas. There is no apportionment of taxes, so a creditor may have to repay to a county taxes due on other property. Fortunately for creditors, the Bankruptcy Court did interpret the statute as limiting the scope of a county's lien to the property located within that county. However, since that was the interpretation of a federal bankruptcy court, there is still a risk that a Texas court could interpret the existing statute differently. Furthermore, the bill to amend the statute could eventually pass, explicitly expanding the counties' scope to property statewide. Given the lack of discoverability and lack of apportionment, an expansion of the scope would have a particularly detrimental impact to secured creditors in Texas.

B. Tennessee

Tennessee's priority statute appears to be another typical example of the majority rule, which grants priority to counties. The law specifies that tax assessments shall "become and remain a first lien upon such property[.]"[103] In the event a secured party repossesses and sells its collateral, "the party possessing the security interest shall withhold and pay from the proceeds of the sale an amount sufficient to satisfy the personal property taxes assessed[.]"[104] However, this seemingly straightforward provision has been the subject of significant litigation over the years.

In 1980, a dispute arose between Commerce Union Bank and the Commissioner of the Department of Revenue over proceeds from the

99. *Id.*
100. *Conquest Airlines*, 2012 WL 2236717 at *5.
101. S.B. 1606, 83d Leg., Reg. Sess. (Tex. 2013).
102. S.B. 50, 84th Leg., Reg. Sess. (Tex. 2015).
103. TENN. CODE ANN. § 67-5-2101(a) (2016).
104. TENN. CODE ANN. § 67-5-2003(h) (2016).

bank's repossession and sale of an automobile.[105] Each party claimed its lien had priority: the bank had a prior purchase money security interest, and the Commissioner had a subsequent tax lien against the same property.[106] Although a different statute controlled at the time, the holding of the court was not specific to the particular statutory language.[107] The court held that in the case of a purchase money security interest, there is no period of time during which the debtor acquires rights to the collateral.[108] Instead, the debtor only ever has an "equitable interest" in the property.[109] Therefore, the debtor never has an interest in the property to which a tax lien can attach[110] and, consequently, purchase money security interests have priority over tax liens.[111] In the end, Commerce Union Bank was allowed to keep the proceeds from the sale of the repossessed automobile.[112]

Even after the statute was changed to its current form, the holding of that case regarding the attachment of liens continued to apply. So, although the counties' tax liens had priority over all general liens, regardless of which was first-in-time, purchase money security interests were treated differently. Since the taxpayer never had rights to property secured by a purchase money security interest, counties did not have priority over those secured creditors.

In 2007, another dispute arose, this time between Williamson County and two secured creditors.[113] The secured creditors had loaned money for the purchase of two tractors and had properly perfected their purchase money security interests.[114] When the borrower defaulted, the creditors repossessed and sold the tractors.[115] Williamson County asserted that its "first lien" granted by the current statute had priority over the creditors.[116] The chancery court, relying on the Commerce Union Bank case, held that the purchase money security interests had priority over the County's tax lien and granted summary judgment to the creditors.[117]

Williamson County appealed, and the Tennessee Court of Appeals reviewed the issue of law de novo.[118] The court reexamined the current

105. Commerce Union Bank v. Possum Holler, Inc., 620 S.W.2d 487, 489 (Tenn. 1981).
106. *Id.* at 490.
107. *Id.* at 493.
108. *Id.*
109. *Id.*
110. *Id.*
111. Commerce Union Bank v. Possum Holler, Inc., 620 S.W.2d 487, 493 (Tenn. 1981).
112. *Id.*
113. State v. A & F Constr., No. M200800360COAR3CV, 2009 WL 499421, at *1 (Tenn. Ct. App. Feb. 26, 2009).
114. *Id.*
115. *Id.*
116. *Id.* at *2.
117. *Id.*
118. *Id.*

statute, and was apparently the first court to pay attention to a subsequent section of the new statute.[119] In the section following the declaration of the "first lien" was further clarification:

> Such taxes shall be a lien upon the fee in the property, and *not merely upon the interest of the person to whom the property is or ought to be assessed*, but to any and all other interests in the property, whether in reversion or remainder, *or of lienors, or of any nature whatever.*[120]

Based upon this language, the court of appeals found that lien attaches to and has priority over the interest of the creditor as well.[121] The court held that the chancery court had erred and that the County's tax lien is superior to all other liens, including purchase money security interests.[122]

Interestingly, on appeal, one of the creditors tried to make an argument in the alternative that again illustrates the interrelatedness of the dimensions. The creditor argued that even if it lost the priority argument and was liable to Williamson County, "any liability should be limited to the pro rata amount specifically assessable against these particular tractors."[123] The court declined to address this apportionment argument because it was not decided in the court below.[124]

Following this outcome, Tennessee's legislature passed a bill significantly revamping the personal property tax laws relating to secured creditors.[125] Interestingly, the bill left untouched the newly enforced priority rules. Counties in Tennessee still have absolute priority over all prior and subsequent liens, including purchase money security interests. Instead, the bill balanced out the new priority rule by addressing the other three dimensions of discoverability, scope, and apportionment. Under the new laws, a secured creditor can satisfy all potential tax liability by following certain procedures.[126] First, the creditor must query the county of the borrower's domicile and the county where the equipment was repossessed.[127] Then, any of three scenarios operates to satisfy all potential

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119. State v. A & F Constr., No. M200800360COAR3CV, 2009 WL 499421, at *4 (Tenn. Ct. App. Feb. 26, 2009).

120. *Id.* at *4 (citing TENN. CODE ANN. § 67-5-2102(b) (2016)) (emphasis added).

121. *Id.*

122. *Id.* at *5. The secured creditors alternatively argued that Tenn. Code. Ann. § 67-1-1403(c) established priority for preexisting liens. *Id.* The court, however, found that this provision only applied to Tennessee state tax liens and not county tax liens. *Id.* at *6. As noted earlier, states are more likely to respect first-in-time rules of the UCC (albeit not subsequent purchase money security interests) themselves, although most states simultaneously permit their county governments to disregard first-in-time rules entirely.

123. *Id.* at *7.

124. *Id.*

125. H.B. 3259, 106th Gen. Assemb., Reg. Sess. (Tenn. 2010).

126. TENN. CODE ANN. § 67-5-1805(c)(4)(A) (2016).

127. *Id.*

liability: (1) payment of taxes to the domicile county *or* the repossession county; (2) receipt of a writing from the domicile county *or* the repossession county indicating that the borrower appears on the tax rolls and does not owe any tax; or (3) receipt of a writing from the domicile county *and* the repossession county indicating that the borrower does not appear on the tax rolls.[128]

In all cases, payment of taxes consists of paying up to four years' worth of taxes due based upon the value of the creditor's collateral.[129] So now taxes are not only apportioned, but limited to four years, which is much more favorable to creditors than in most states. Also, failure of a county to respond within fifteen days operates to satisfy option (2) or option (3).[130] Therefore, discoverability is immensely improved for creditors as well. Creditors now only need to check with one or two counties (depending on whether the repossession county is different from the domicile county) and are guaranteed a definitive answer within fifteen days.[131]

Regarding option (1), the law makes sense in requiring the creditor to pay only the domicile county *or* the repossession county in order to avoid making the creditor pay twice. However, it is interesting that apparently the creditor has the choice as to which county it pays. Option (2) is even more curious: according to the way the law is written, a creditor could receive a response from one county indicating that the borrower appears on the tax roll and does not owe any taxes and receive a response from the other county indicating that the borrower *does* owe taxes. In this scenario, the creditor is apparently absolved of paying any taxes because of the use of the word "or" in the statute. It is not clear why this provision was not written with an "and" instead.

In summary, the law in Tennessee was significantly changed in 2009 and 2010, even if there may be some minor corrections still needed. The overall outcome is that counties now have a favorable ruling from the courts regarding priority of their liens, but the creditors have new legislation that provides significantly more rights to them regarding discoverability of liens, the scope of the liens, and the apportionment of taxes due.

C. Maryland

Maryland even more recently overhauled its personal property tax laws through legislation passed in 2013.[132] Prior to the reform, the state of affairs in Maryland was similar to Tennessee before the 2010 legislation.

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128. *Id.* § 67-5-1805(c)(4)(A)(i)-(iii).
129. *Id.* § 67-5-1805(c)(1)-(3).
130. *Id.* § 67-5-1805(c)(4)(B)(iii).
131. *Id.*
132. H.B. 419, Gen. Assemb., 433rd Sess. (Md. 2013).

The tax liens were granted priority as a "1st lien" above all other liens, including purchase money security interests.[133] There were no specific provisions addressing discoverability, scope, or apportionment. Repossessing creditors were expected to pay up to the entire amount of tax liability of their borrower.[134]

The original draft of the bill included language making county tax liens subordinate to prior purchase money security interests.[135] The bill's sponsor noted, unsurprisingly, that counties responded negatively to this proposition and expressed concern about their ability to collect their taxes.[136] This provision was deleted from later drafts of the bill and did not become law.[137]

The bill that did pass contained many provisions similar to Tennessee, along with a few improvements. The basic premise of the bill is the same: give secured creditors a way to be released of all potential liability by checking with certain counties and, at most, pay an apportioned amount of taxes based upon the value of their collateral. The biggest difference is that in Maryland, the creditor must inquire with every county "that has a certified assessment by the State Department of Assessments and Taxation for the business in an amount equal to or greater than the cost basis of the personal property subject to repossession[.]"[138] Note that the assessment amount refers to the value of the property, not the amount of tax due.[139] In other words, the creditor must check with every county that has taxed property worth at least as much as the creditor's collateral. This system addresses the issue of only checking with one or two counties, which allows a creditor in Tennessee to potentially escape liability even when taxes are due in another county.

Additionally, creditors in Maryland must send the inquiries to the counties within sixty days of repossession, [140] whereas Tennessee has no such requirement.[141] Perhaps creditors are still motivated to resolve any

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133. MD. CODE ANN., TAX-PROP. § 14-805(b) (West 2002 & Supp. 2013).

134. *Fiscal and Policy Note*, DEP'T OF LEGAL SERVS, MD. GEN. ASSEMB. (Feb. 13, 2013), http://mgaleg.maryland.gov/2013RS/fnotes/bil_0009/hb0419.pdf.

135. H.B. 419, Gen. Assemb., 433rd Sess. (Md. 2013), http://mgaleg.maryland.gov/2013RS/bills/hb/hb0419f.pdf (first revision, dated Jan. 28, 2013).

136. *Fiscal and Policy Note*, *supra* note 134.

137. H.B. 419, Gen. Assemb., 433rd Sess. (Md. 2013), http://mgaleg.maryland.gov/2013RS/bills/hb/hb0419E.pdf (with markup showing amendments, including striking the subordination language on page 3, lines 13-17).

138. MD. CODE ANN., TAX-PROP. § 14-805(c)(2)(i).

139. *State Department of Assessments & Taxation (SDAT)*, MARYLAND.GOV, http://www.dat.state.md.us/about/Pages/default.aspx (last visited June 1, 2016) ("Assessments are certified by the Department to local governments where they are converted into property tax bills by applying the appropriate property tax rates. An assessment is based on an appraisal of the fair market value of the property.").

140. MD. CODE ANN., TAX-PROP. § 14-805(c)(2)(i).

141. *See* TENN. CODE ANN. § 67-5-1805 (2016).

potential liability as soon as possible, but it seems possible that creditors might sometimes delay in hopes that the borrower is able to pay the taxes. Another timing difference is that Maryland counties have forty-five days to respond,[142] whereas Tennessee counties are only given fifteen days.[143] Although fifteen days seems like a short period of time, counties should have these numbers readily available. One possible issue is that counties may want to dispute the value of the property as asserted by the creditor, so they may need additional time for an appraiser to review the matter before responding.

Maryland also addresses the issue of which county should be paid when taxes are due to more than one county. In Tennessee, the creditor apparently gets to pick,[144] but in Maryland a hierarchy is specified in the statute: first priority is the county of the principal office of the business, and second is the county of repossession.[145] If taxes are not due to either of those counties, then they may be paid to any other county to which taxes are owed.[146] If more than one other county is owed taxes, then the amount due is prorated among those counties, based on the total amount due to each county.[147] But, in any case, the amount the creditor must pay to any county or combination of counties is limited to the amount due based upon the value of that creditor's collateral. Unlike Tennessee, there is no limitation to four years' worth of taxes.[148]

A key feature of the Maryland statute is that if a creditor does *not* follow the procedures to proactively pay the appropriate counties, then the creditor can still be held liable for the entire amount of taxes due.[149] In other words, the benefit of apportionment is conditioned on the proactive and timely payment to the appropriate counties. This is unlike Tennessee, where the penalty for noncompliance is simply that "[a] secured party selling the property who fails to withhold and pay such amount shall be held to be personally liable for such amount[.]"[150] This seems to create a temptation for creditors not to contact the counties and hope to go undetected since there is no additional penalty for getting caught later. The worst case scenario is having to pay that which was due anyway. Maryland cleverly addresses this issue by conditioning the apportionment benefit on the creditors' proactive inquiry and payment of taxes.

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142. MD. CODE ANN., TAX-PROP. § 14-805(c)(3)(ii)(1).
143. TENN. CODE ANN. § 67-5-1805(c)(4)(B)(iii).
144. *Id.* § 67-5-1805(c)(4)(A)(ii).
145. MD. CODE ANN., TAX-PROP. § 14-805(c)(4)(ii)(1)-(2).
146. *Id.* § 14-805(c)(4)(ii)(3).
147. *Id.* § 14-805(c)(4)(ii)(4).
148. *Id.*; TENN. CODE ANN. § 67-5-1805(c)(3).
149. MD. CODE ANN., TAX-PROP. § 14-805(c)(5).
150. TENN. CODE ANN. § 67-5-2003(h) (2016).

IV. THE BEST PRACTICE MODEL

Having examined the four main dimensions of the law and the laws that exist in a few states, the question remains as to what states *should* do. What is the proper balance between the rights of the counties and the rights of the secured creditors? This Section begins by setting forth the model rules in Subsection (A), which is the combination of laws that most fairly strikes this balance. Then, Subsections (B) through (E) contain discussion about each of the four dimensions as implemented in the model rules and explanations for why those rules were selected.

A. The Model Rules

(a) Priority. From the date property tax on personal property is due, any unpaid amount shall constitute a first lien on the property of the taxpayer in the amount due. This lien has priority over all other liens, including pre-existing liens and purchase money security interests.

(b) Scope. The lien as provided in Section (a) shall attach to all property of the taxpayer located in this state. The lien shall automatically attach to any additional property the taxpayer may acquire after the date that the lien initially attached. The lien shall not attach to property sold to a bona fide purchaser.

(c) Discoverability. A secured party may obtain an official notice of tax due from a county by sending a request in writing to the county trustee that includes the name, address, and taxpayer identification number of the taxpayer. In the event the secured party sends such a request via U.S. certified mail and does not receive a response within [thirty] ([30]) calendar days, the signed return receipt shall constitute a notice that no tax is due.

(d) Apportionment. In the event a secured party repossesses property of a taxpayer with delinquent personal property taxes, the maximum liability of the secured party shall be determined based solely on the value of the personal property that the secured party repossessed and the tax rate applicable to the owner of such personal property. This amount shall be referred to as the "apportioned share of taxes." Notwithstanding this section, a secured party may be liable for the entire amount due,

> without apportionment, if the secured party fails to comply with Section (e).
>
> **(e) Secured Party's Duty to Inquire and Pay Taxes.**
>
> **(1)** Within [thirty] ([30]) calendar days after a secured party repossesses personal property of a taxpayer, the secured party shall send inquiries as described in Section (c) to the county of the taxpayer's domicile (the "domicile county") and, if the personal property was not repossessed in the domicile county, to the county in which the personal property was repossessed (the "repossession county").
>
> **(2)** If the secured party receives a notice from the domicile county that the taxpayer owes taxes to that county, then within [thirty] ([30]) days of receiving such notice, the secured creditor shall pay to the domicile county up to its apportioned share of taxes.
>
> **(3)** If the secured creditor receives a notice from the repossession county that the taxpayer owes taxes to that county and the secured creditor's liability under the preceding paragraph (2) is less than the full amount of its apportioned share of taxes to the domicile county, then within [sixty] ([60]) days of receiving such notice, the secured creditor shall pay to the repossession county any taxes due, up to a total amount of its apportioned share of taxes when combined with any amount already paid to the domicile county.
>
> **(4)** A secured party that complies with this provision shall not be liable to any other county in the state and the repossessed property shall be free of all liens as provided in Section (a).
>
> **(5)** In the event the secured party fails to send the inquiries or to pay the taxes due as required under this section, then the amount the secured party owes shall not be apportioned as provided in Section (d), and instead the secured party shall be liable for the full amount of taxes due.

B. Priority

The first and most critical issue is priority, and the model rules unequivocally adopt the majority rule of priority for counties' liens. As discussed in Section I, the federal government and most state governments at least respect first-in-time rights but counties rarely do. A possible reason for this difference is that counties have fewer resources and tools to go after delinquent taxpayers, so they need blunter tools with which to collect their revenue.

Additionally, state and federal taxes are often based on *income* of a particular person or business, whereas the county property taxes are ad valorem, meaning they are based upon the value of *property*. When a tax is based upon income, there is less of a basis for a tax lien to have priority over secured creditors. This is because the secured creditors had no direct connection to the income of the taxpayer and there is no particular reason why an income tax lien should be collected from them. An income tax debt is completely personal to the taxpayer, and thus the expectation is for the state or federal government to let the secured creditor maintain its lien priority and not have to repay such a debt.

On the other hand, when a tax is associated with a piece of property rather than a particular owner, there is a basis for the tax liability to remain with the property upon repossession. With real property taxes, when the debt is clearly associated with a particular piece of property, there is a reasonable basis for requiring a repossessing creditor to pay taxes that were due on that property. The tax was related to that property, and it is fair to let the tax remain with the property. This is particularly true since discoverability is not an issue with real property, so the purchaser has notice and can account for this liability when determining the purchase price.

However, examining the way personal property taxes operate, they are a hybrid between being a tax on a particular entity and a tax on specific pieces of property. Because the tax is applied to entire categories of property and not specific items, the liability is more personal to the taxpayer and only loosely associated with particular pieces of property. This creates the dilemma on whether to create priority rules more similar to real property taxes or more similar to income taxes.

Ultimately, because personal property taxes are in fact ad valorem taxes just like real property taxes, even though the association with the property is looser, allowing the lien to stay with the property and have priority over all other liens is more practical. This is because counties do not have the resources to pursue delinquent taxpayers through other means and rules that take away lien priority of counties would be met with significant pushback, as was the case in Maryland. Furthermore, the detriment to creditors from this rule can be mitigated with complementary rules regarding apportionment and discoverability that are favorable to creditors, as seen in the model rules. However, if priority was taken away from counties, that detriment could not be counterbalanced through other rules. Therefore, the practical and most fair solution is to allow counties to have a favorable priority rule.

C. Discoverability

Regarding discoverability, if cost were not an issue, clearly the ideal scenario is to setup a statewide registry as Georgia has done. Or, as in Maryland, at least have some centralized place to query for initial finding of a delinquency, even if further inquiry has to be made at the county level. With a proper way for creditors to determine on the front end if the borrower is already behind in taxes and to stay alert to problems as they might develop, imposing priority of county liens is more justifiable. What is most fair often times is simply a matter of having proper notice. If creditors had an easy way to discover these liens, they can adjust their practices accordingly.

However, Tennessee's solution of limiting the scope of the liens to one or two counties and then requiring prompt responses from those counties is a quick and easy way to solve the discoverability problem as well. However, the system is only designed to solve the problem on the back-end, when a creditor is repossessing collateral and needs to find out what is due to counties. It does not address the problem on the front end when assessing the borrower's credit. Additionally, for large businesses that operate across several counties, a secured creditor could escape liability if the business owes taxes to a county other than its domicile county or the repossessing county. This could be a scenario that would occur seldom enough that it would not be worth the cost of implementing the more comprehensive solution of a statewide registry. In the majority of cases, borrowers will owe taxes in their domicile county or to the county of repossession, if they owe taxes anywhere.

Because of these reasons, the model rules adopt the Tennessee approach of implementing only mandatory responses from counties. The model rules suggest a timeframe of thirty calendar days for creditors to send their inquiries to the counties after repossession, and they provide thirty days for the counties to respond to the creditors before a non-response constitutes a waiver. The rules also require a secured creditor to pay the domicile county within thirty days of receiving a response indicating that taxes are due. The rules provide a total of sixty days for a creditor to pay the repossession county, since the secured creditor will need to wait for thirty days to elapse to know whether it will have any liability to the domicile county first since payment to the domicile county takes priority. The sixty day timeframe provides the secured creditor thirty days to make the payment to the repossession county after the maximum time it could take to have a definitive answer (either a response or a waiver) from the domicile county.

The thirty-day timeframes are bracketed, since the exact number is somewhat arbitrary and states may choose to adjust this number within reason. The timeframes should be long enough that they do not create a burden on creditors or counties, while being as short as possible to provide certainty for creditors and prompt payment to counties. The thirty-day timeframes are comfortably within the reasonable range, but states may decide to make the timeframes shorter (as Tennessee did using fifteen days) or longer (as Maryland did using forty-five days). Additionally, states could perform a study to try to determine how much revenue is lost by implementing this system versus a statewide registry and could consider implementing the registry if cost justified.

D. Scope

Ultimately, the extent of discoverability limits what is fair to impose regarding scope of the liens. If there is easy statewide discoverability, then it is reasonable to let the lien stay with the property statewide. If, however, discoverability is limited to querying individual counties, then it must be paired with a law limiting scope to particular counties. But, with a proper apportionment system, the scope of the liability can be even simpler: impose statewide liability whenever any taxes are due anywhere without attempting to track individual pieces of property. Under such a system, it would be possible that at times taxes would be assessed on property and paid to a county where that property was never physically located. This system, however, has the practical advantage of simplicity.

The model rules adopt a system where the scope is initially statewide. However, a secured creditor can effectively limit the scope to the taxpayer's domicile county and the repossession county by following the procedures specified to query those counties and pay any taxes due. The scope becomes limited to those counties without regard to whether the collateral property was ever actually assessed in that county. For example, even if the property was moved into the county the day before repossession, the secured creditor would still have to pay taxes due to that county, if any. In this case, the delinquent taxes would represent amounts due on other property. However, the county would still have a valid lien since its lien automatically attached to the property regardless of its location. Despite this possible anomaly, this system is very straightforward and predictable for counties and secured creditors.

Discoverability also impacts the fairness of whether the lien should stay with the property upon transfer to a bona fide purchaser. Although outside the scope of this Note, some states have specific rules or registries for valuable pieces of personal property such as mobile homes, vehicles, and other heavy machinery. Proper notice to a purchaser is essential to imposing liability fairly. Secured creditors can be expected to be aware of personal property tax laws and the liability they may be exposed to. Individual purchasers, however, will rarely consider this possible liability.

The model rules simply include a rule that the lien does not attach to property sold to a bona fide purchaser. States could fairly create exceptions to this rule when an appropriate registry exists, and the rule is sufficiently well-known so as to provide reasonable notice to purchasers.

E. Apportionment

The model rules adopt the rule of apportionment, where a secured creditor only has to repay the taxes due on the collateral it repossessed. However, limiting the taxes due to four years, as done in Tennessee, is unnecessarily lenient on the creditors. The limitation of four years is even more lenient than seen with real estate tax liens, where a creditor would owe all taxes due on that parcel of property. The model rules require a creditor to pay the taxes due based upon the value of the creditor's collateral, calculated from the earliest point in time at which the borrower became delinquent on taxes and was in possession of the property up to the full amount due.

This system benefits the counties by applying any partial payments from the taxpayer to other property and maximizing the amount to be recovered from the secured creditor. To illustrate what this means, imagine that a taxpayer owned $10,000 worth of property outright and free of lien and owned another $10,000 worth of property that was subject to a lien. Now, say that this taxpayer owed $200 in property taxes on its $20,000 of property (based upon a one percent rate across all property), but the taxpayer only made a payment of $100. If the creditor repossessed its property, the creditor could argue that the $100 that was paid represented the $100 due on its $10,000 of collateral, leaving nothing for the creditor to repay. Or perhaps, the creditor could argue that the $100 should be applied evenly across all the property, so that only $50 is still due on its $10,000 of collateral, and $50 is still due on other property.

Although there is an argument for such a system, it would become unduly complicated to calculate and would be unnecessarily generous to the creditors at the expense of the counties. Again here, fairness to creditors is based upon notice and predictability of the result. With a proper apportionment system, discovery of preexisting delinquencies becomes less important because a creditor would not be held liable for those amounts due on other property (and the creditor has plenty of other ways to determine creditworthiness). Additionally, the creditor knows the maximum liability it would ever incur due to a failure of its borrower to pay any taxes. In the example above, based on the model rules, the creditor would still owe $100, representing the amount of tax due on its collateral. This is regardless of any partial payments from the taxpayer, with the exception that the secured creditor would never have to pay more than its apportioned amount.

The model rules also address the allocation of payments to the domicile county and the repossessing county to preclude the anomalous scenarios possible under the Tennessee statute. The model rules give priority to the domicile county with payment to the repossession county only if the domicile county is paid in full and the secured creditor has not yet paid up to the apportioned amount due. There is no particular reason why the domicile county should have priority over the repossession county but having some definite priority makes the process simpler to implement. A state could choose to swap the priorities and the result would be fair as well.

The model statute only provides for payments to the domicile county and repossession county and not any prorated allocation among other various counties as included in the Maryland statute since the model statute does not include a statewide registry system. If a state chooses to implement a statewide registry, payments to other counties should of course be required. In that scenario, perhaps a payment priority system based upon largest amount due would be simpler than requiring prorated payments to potentially many different counties.

Finally, the model rules adopt Maryland's system of conditioning apportionment on creditors making timely inquiries and payments as required under the rules. This compromise is a great option for states without apportionment laws already. However, in states that do already have apportionment laws, placing such a condition upon an existing benefit would undoubtedly be met with significant pushback from creditors.

F. Summary

In summary, the model system grants counties priority over all other liens. Liability would be imposed based on broad authority for counties to claim statewide liens. Because a statewide registry of liens may be expensive to implement, the model rules implement mandatory responses from counties to provide for discoverability. Although the scope of the liens is initially statewide, secured creditors would have the ability to limit liability to the domicile county and repossession county by proactively querying those counties and paying any taxes due. If the creditor complies with those requirements, the amounts due would be apportioned based upon the amount of taxes due on the creditor's collateral.

CONCLUSION

States have widely varying laws that define the relative rights of the counties that impose tax liens on personal property and the rights of the secured creditors that loaned money for the purchase of that personal property. Each state's laws are unique but can be analyzed along four primary dimensions: priority, discoverability, scope, and apportionment. These laws are an area where counties and creditors continue to have conflicts, sometimes leading to changes via court decisions and sometimes prompting legislative reform.

States should be careful not to unfairly balance the rights of counties and creditors, and legislative reform should comprehensively consider all four of the dimensions. An ideal system can give priority to counties but will also provide a way for creditors to discover tax liens. Additionally, the scope of the liability can fairly be imposed statewide, provided that the liability is apportioned based upon the value of the creditor's collateral. Such a system benefits counties in many ways but provides notice and predictability to creditors.