

**ANALYSIS AND
RECOMMENDATIONS FOR
REVISION OF STATUTORY
LIEN POLICY IN POLAND**

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ABSTRACT

This report considers the Government of Poland's current policy on statutory liens, in response to a request made by the Ministry of Finance to USAID. In Poland, a statutory law confers certain rights and privileges on the government to facilitate the collection of taxes and other fiscal obligations is the so-called statutory lien or mortgage. This law gives the government an automatic security interest in real property owned by a debtor who has failed to meet financial obligations owed to the state or *gmina*. Bankers in Poland cite the statutory lien as a major impediment to entering or vigorously pursuing the housing finance market. Their experience indicates that mortgage loans cannot be adequately secure as long as there is a possibility of a government statutory lien that will have superseding priority even if it arises later than the bank's lien. Experience to date with execution procedures (all in non-residential mortgages) demonstrates the detrimental effect of the statutory lien. In 70-80 percent of execution cases, the state exercises its right to recover tax obligations; in cases where the state is a claimant, the bank loses 50-80 percent of the balance of its loan. The absence of direct experience with execution on residential property results in substantial uncertainty with regard to the statutory lien and how banks can best protect themselves. Consequently, the risk is shifted to the borrower. The results are more expensive and time-consuming loan application and underwriting procedures, more expensive loans with less attractive terms, and less competition in the banking sector.

ANALYSIS AND RECOMMENDATIONS FOR REVISION OF STATUTORY LIEN POLICY IN POLAND

I. EXECUTIVE SUMMARY AND OVERVIEW

I.1. Introduction

In most countries, substantive or statutory laws confer certain rights and privileges on the government to facilitate the collection of taxes and other fiscal obligations. In Poland, one of these rights is the so-called statutory lien or mortgage, which gives the government an automatic security interest in real property owned by a debtor who has failed to meet financial obligations owed to the state or *gmina*. The lien takes effect upon a default in payment of an obligation without further contractual or judicial action on the part of the state.¹ The state's lien is not only certain and expeditious, it is also privileged in the sense that it is given priority over other creditors' liens in the order of payment from the proceeds of a foreclosure or involuntary sale of property against which there are multiple liens, even if the other liens were registered in the land registry before the debt to the government arose.

Bankers in Poland cite the statutory lien as a major impediment to entering or vigorously pursuing the housing finance market. Their experience indicates that mortgage loans cannot be adequately secure as long as there is a possibility of a government statutory lien that will have superseding priority even if it arises later than the bank's lien.

In considering whether to revise the government's current policy on statutory liens, the Ministry of Finance has sought the assistance of USAID in determining answers to the following questions:

- To what extent does the statutory tax lien impede the development of market-based mortgage finance in Poland?
- How do mature economies handle the institution of the statutory tax lien to protect the public interest in collecting debts owed to the government?
- What other instruments are used in mature economies to protect the public interest instead of the statutory tax lien?

¹That is why it is called a "statutory lien"; it arises solely under authority of a statute rather than by contract with the property owner (as in the case of a bank mortgage), or by order of a court (as in the case of a lien placed against the debtor's property following a court decision).

Research on these issues and resulting conclusions are reflected in this report.²

1.2. Summary of the Impact of the Statutory Lien on Bank Practices

As part of the preparation of this report, a questionnaire was distributed and interviews were conducted with representatives of Polish banks thought to engage in or be interested in mortgage lending. The survey yielded information from 13 banks on their attitudes, practices, and actual experiences with regard to the statutory lien. Principal findings, discussed in Section III, below, include the following:

- Experience to date with execution procedures (all in non-residential mortgages) demonstrates the detrimental effect of the statutory lien. In 70-80 percent of execution cases, the state exercises its right to recover tax obligations; in cases where the state is a claimant, the bank loses 50-80 percent of the balance of its loan. The government tends to disclose its claims only after banks have initiated execution proceedings, so it need not share in the high costs of execution but still maintains its preferred position in payout of the proceeds. The costs of execution ultimately are paid from funds recovered from sale of the debtor's property, but the inefficiency of these activities often means that recovery of costs will not occur for two or three years. This generates further bank losses, over and above the loss of the principal and interest on the loan balance. Additional bank losses frequently result from the unwillingness of the state to participate in any renegotiation or workout process with the debtor (not surprising, given the state's priority position), which among banks is the preferred method of dealing with loan delinquencies.
- The absence of direct experience with execution on residential property results in substantial uncertainty with regard to the statutory lien and how banks can best protect themselves. Consequently, the risk is shifted to the borrower. Virtually all banks require a relatively large safety margin in the ratio of the value of the loan to the value of the real estate. Even where internal regulations allow for higher loans to be provided (up to 75 percent of the real estate value), in the majority of cases loans do not exceed 50 percent of property value. In addition, banks usually demand other forms of security, such as third-party guarantees. The results are more expensive and time-consuming loan

²To prepare this report, a questionnaire was sent to Polish bankers to determine their perspective on the effect of the statutory lien on the practices and feasibility of mortgage lending. After written responses to the questionnaire were received, follow-up telephone discussions were held. In addition to the survey of bankers, conducted by a Polish housing finance specialist, information was provided by a Polish lawyer, an American lawyer with experience in Central and Eastern European housing finance programs, and a German banker/lawyer experienced in banking practices and law in European Union countries and in CEE.



application and underwriting procedures, more expensive loans with less attractive terms, and less competition in the banking sector.

- Banks without experience in the area of housing finance tend to be most concerned with the effects of the statutory lien. Their negative experiences with commercial loans affect their attitudes toward residential loans, even though residential mortgage lending is considered extremely safe and attractive to banks in developed economies. In interviews, such banks report that barriers like the statutory lien make them at least reluctant to enter the housing loan sector; in some cases, they are unwilling even to consider it.

1.3. Summary of the Status of the Law on Statutory Lien in Poland

Recently enacted laws have made substantial changes with respect to the statutory lien in Poland. The 1997 Act on Mortgage Bonds and Mortgage Banks improved the rank of a lender's lien in relation to a statutory lien, but only for loans made by licensed mortgage banks. Loans from licensed mortgage banks serving as collateral for mortgage bonds now take priority over the government's statutory lien, while loans from universal banks continue to rank behind the statutory lien. Apparently, this improvement in the legal framework was made to reflect a legitimate public interest in the security of mortgage bonds. Nevertheless, it creates an uneven playing field in the mortgage lending sector. The security of assets in universal banks should also be of public concern. Furthermore, as mortgage banks are formed, with both domestic and foreign interests, the distinction in the law will have a detrimental, anti-competitive effect on universal banks. Some experts believe that the European Union looks with disfavor on laws that discourage competition or discriminate against one class of competitor in the banking sector.

Previously, the state had no obligation to register its lien or to notify other creditors of the taxpayer that a statutory lien had taken effect. The Law on Registered Liens and Register of Liens, enacted in 1996, requires registration within one month of the lien's effect. While there are some limitations on the obligation to register a statutory lien, amelioration of the problem of "secret" liens represents a major improvement in the applicable legal framework.

On the other hand, the scope of the lien has been considerably expanded by other recent changes in legal framework. The new Tax Code, enacted in 1997, makes obligations to *gminas* as well as to the state the basis for a statutory lien and increases the types of property that are subject to the lien. It also adds to the individuals whose property is subject to the lien beyond the taxpayer himself, and requires all such persons to reveal to the tax authority on demand all their property and proprietary interests that may be subject to the lien.

1.4. Findings from Other Countries

■ **Use of the Statutory Lien.** In general, in developed market economies such as those in Western Europe and the United States, statutory liens are given priority over contractual or private mortgage liens only if they arise out of obligations directly relating to the property involved, such as those for real estate taxes or infrastructure development. Other kinds of taxes or financial obligations to the government, such as income or social security taxes, can provide a basis for a statutory lien on the property of the debtor, but do not take priority over a lender's lien. If there is an involuntary sale or foreclosure to satisfy a lien for those kinds of taxes, the government would be paid after a mortgage lender with a previously filed lien.

Frequently, there is a time limitation on the priority effect of government liens that relate to the property. In Germany, for example, priority is given to debts related to the property only for the previous four years; in Austria, the limit is three years. This helps assure that the debt underlying the privileged lien will not become so large that other lienholders are left with no chance to be paid.

Among the reforming economies of Central and Eastern Europe, Hungary has adopted the most market-oriented legal framework for mortgage lending. The 1997 Law on Mortgage Banks and Mortgage Bonds places all registered mortgage liens (from any bank) ahead of all statutory liens in priority of payment from a foreclosure sale.

In Czech Republic, as in Poland, a recent law on mortgage banks provides mortgage liens only from registered licenced mortgage banks with priority over a subsequently filed statutory lien. Otherwise, statutory liens retain priority over lenders' liens. In Slovakia, the statutory lien remains privileged in all cases.

■ **Alternatives to the Statutory Lien.** In Western Europe, the most common alternative to the statutory lien is an expedited writ of execution issued by an authority other than a court (usually a tax authority). In Germany, for example, tax and customs authorities have their own execution officers who can perform executions, including foreclosure sales, under a writ of execution issued by the relevant authority. Execution on property of the debtor under these procedures does not provide priority for the government's lien over existing private or contractual liens.

In the United States, liens for employment taxes and similar business obligations are rarely in conflict with residential mortgage loans. If the debtor is a business entity, property occupied as a residence by a principal of the business is exempt from foreclosure or bankruptcy procedures. Tax obligations not related to the property are usually enforced through court action for a judgment against the individual debtor rather than through a foreclosure sale of the debtor's real estate.

1.5. Overview of Recommendations for Poland



The privileged position afforded to the statutory lien is a critical impediment to development of competitive, market-based mortgage lending in Poland. If a borrower fails to pay his taxes after obtaining a mortgage, the lender's mortgage yields to the state's statutory lien if there is a foreclosure sale, even if the mortgage is registered first. As a result, banks cannot predict with any certainty at the time a loan is made that their right to payment is reasonably secured by the mortgaged property, and whether they can hope to get paid if the borrower subsequently incurs debts to the state. This uncertainty creates not only higher risk for lenders but in some cases a reluctance to make mortgage loans at all.

The potential effects of this risk have been at least tacitly acknowledged by the Government of Poland in the case of licensed mortgage banks, in the Act on Mortgage Bonds and Mortgage Banks. This law gives registered mortgage loans from mortgage banks priority over statutory liens. The law should be extended to include mortgages from any bank. This will place universal banks in parity with mortgage banks, foster fair competition, and avoid possible concerns on the part of the European Union that the banking regulations of Poland are discriminatory. Liens would take priority based on the order in which they are entered into the land registry. This is the simplest way to solve the problem of statutory lien priority in Poland, and follows the example set in Hungary.

Alternatively, Poland could adopt the policy generally followed in Western Europe and the United States, and limit the priority of statutory liens to those based on payments related to the property itself, such as real estate taxes or infrastructure development fees. A time limitation would also be advisable, to afford priority only to real estate taxes due for the prior two years, for example, so that the size of the debt with priority does not become so great as to compromise unreasonably a lender's security. This also would provide a sufficient amount of time for the government to take action to enforce its rights under the lien, on the basis of an executory document issued by the tax authorities. Retaining such limited priorities should not create an unsurmountable obstacle to the proper functioning of bank lending.

II. THE IMPACT OF THE STATUTORY LIEN ON THE DEVELOPMENT OF HOUSING FINANCE IN POLAND

II.1. Competition in the Housing Finance Banking Sector

Universal banks in Poland have been engaged in market-based real estate lending for over three years, and the sector is emerging as one of the most competitive and dynamic in the region. While four universal banks hold a major share of the outstanding portfolio, new entrants to housing finance have increasingly emerged in the last year. Meanwhile, within the structure dictated by Act on Mortgage Bonds and Mortgage Banks, mortgage banks are being formed, with both domestic and foreign interests involved.

It is quite likely, therefore, that housing finance in Poland, at least in the near future, will be served by two institutional structures: universal banks and mortgage banks. The universal banks will continue to fund themselves through deposits and may also develop various approaches to capital market funding. The mortgage banks will fund themselves through mortgage bonds as specified under the Act and under National Bank of Poland regulations; it may be some time, however, before mortgage bonds become familiar vehicles in the Polish capital market.

Given this structure—potentially highly competitive and thus beneficial to market development—it seems especially important that both types of banks operate under the same legal and administrative framework with regard to the statutory lien or any other elements so relevant to their risk and cost profile. As noted in the Overview of Recommendations (Section I.5), and the Conclusions and Recommendations (Section VIII), this report recommends that universal banks be provided the same privileges as mortgage banks with regard to the statutory lien to remedy the disadvantage under which they are currently operating. Once a level playing field has been reinstated, any additional reforms to the rules should be applicable to both types of banks, to maintain fairness in the highly competitive banking environment.

II.2. Results of Survey of Bankers

To determine the practical effects of the statutory lien on mortgage lending practices, a questionnaire was distributed to all banks in Poland thought to engage in or be interested in mortgage lending. Fourteen banks responded to the questionnaire. Personal interviews were then conducted with representatives of the responding banks; information from 13 banks is included in this report. Given their diversity, these banks provide a reasonably representative sample of the banking community from a research standpoint. Table 1, below, shows the categories of banks responding to the questionnaire.

Table 1.
Types of banks responding to questionnaire

Total	14
Large network banks	6
Medium-sized banks	4
Small banks	4
Banks operating throughout Poland	3
Local banks	11
Banks experienced in financing residential real estate	7
New entrant banks	3
Inexperienced banks	4



Information obtained from the questionnaire responses and personal interviews was compiled, and is presented in Table 2. Analysis of this information leads to the following conclusions:

- Bankers believe that mortgage security is weakened both by the existence of the statutory lien itself and by its priority over bank mortgages in payments from execution procedures. Their perceptions have been borne out by actual experience. In most cases, a borrower experiencing financial difficulty stops paying tax liabilities, including social security contributions from the State Social Security Agency (SSSA), as well as mortgage payments. These liabilities take precedence over the bank mortgage.
- In the context of execution procedures, all practical experience to date with the effect of the statutory lien and its priority ranking derives from non-residential real estate. This experience shows a high frequency of cases where the state exercises its rights to recover tax obligations (70-80 percent of the cases), and a high level of bank losses (50-80 percent of the balance of the loan). In interviews, bankers emphasized that the government tends to disclose its claims only after the banks have launched execution proceedings, thus managing to avoid sharing in the high costs of execution but still maintaining its preferred position in payout of the proceeds. Although costs of execution are covered by funds recovered in the execution process, the inefficiency of these activities often means that costs will not be recovered for several years after execution begins. This generates further bank losses, over and above the loss of the principal and interest on the loan balance. Additional bank losses frequently result from the unwillingness of the state to participate in any renegotiation process with the debtor (not surprising, given the state's position).
- The absence of direct experience related to execution on residential property results in diverse attitudes with regard to the effect of the statutory lien. Virtually all banks require a relatively large safety margin in the ratio of the value of the loan to the value of the real estate. Even where internal regulations allow for higher loans to be provided (up to 75 percent of the real estate value), in the majority of cases loans do not exceed 50 percent of property value. In addition, banks usually demand other forms of security, such as third-party guarantees, when granting residential loans.
- Because the actual amount of any statutory lien that may affect the property is usually unknown at the time the loan is made, banks find it difficult to assess the actual level of the threat to their security. In general, two approaches result, both detrimental to development of a vigorous and competitive housing finance market:

- ◆ To the extent that banks perceive that the statutory lien presents a threat to their security, the additional risk is shifted onto the customer through lower loan to value ratios, additional security (such as third-party guarantees), and less favorable loan terms. The result is a more individualized underwriting process and more expensive and time-consuming loan application analysis, with higher commissions and longer time for loan application assessment. Despite the fact that housing loans are believed to be highly secure at least in a theoretical sense, a comparison of housing loan prices and commercial loan prices discloses no substantial difference, which suggests that risks for the two types of loans are not calculated separately.
- ◆ Banks with less experience in the area of housing finance tend to be more concerned with the effects of the statutory lien. In interviews, such banks state that the lien is a barrier that makes them at least reluctant to enter the residential mortgage lending sector; sometimes it results in their complete unwillingness to enter the sector.
- According to available bank statistics, mortgage-based housing loans that become delinquent at some point during their term are eventually paid. More detailed discussion on this issue with PAMBank, Inc., with its extensive experience and portfolio, revealed that in cases where execution proceedings were initiated against mortgage borrowers, the borrowers paid their liabilities. Banks avoid eviction-based execution for political reasons, preferring to renegotiate the terms of the loan with the borrower, usually by extending the repayment period.³ Political aspects aside, the high costs of execution and the uncertainty resulting from state claims are recognized as important factors.⁴

³ None of the banks participating in the questionnaire had recorded a case of eviction followed by the sale of the real estate used to secure the loan.

⁴ In interviews, bankers pointed to additional mortgage loan risk factors, such as the inefficiency of the registration process, the lack of effective eviction procedures, and the shortage of rental accommodations.



Table 2
Results of Survey of Banks of Statutory Lien and Mortgage Lending

Name of Bank	Does Bank offer residential mortgage loans?	Incidence of application of government security in loan recovery procedures	Portion of loan balance recovered by Bank	Other costs incurred by Bank	Other comments on related issues	LTV Ratio	Additional types of security required
Gospod. Bank Ph-Zachodni, Wrocław	No	In the majority of cases (non-residential mortgage loans)	Minor	Execution costs		Real estate value: 150 percent of loan	
Górnśl. Bank Gosp. Rybnik	Yes	None in case of residential loans				Housing loan: 70 percent; other: 50 percent	
Bank Rozwoju i Ekspertu, Warszawa	No	90 percent of cases (non-residential mortgage loans)	100 percent of cases (non-residential mortgage loans)	Court and execution costs (occasionally reimbursed)			Yes
Bank Depozytowy-Kredytowy, Lublin	No	In all cases of execution proceedings		Execution costs; unwillingness of tax office to negotiate settlement	Lack of available substitute accommodation in cases of eviction		
Wielkop. Bank Kredytowy	No	In 80 - 90 percent of cases of execution proceedings for commercial loans		Court and bailiff costs; interest		50 - 60 percent	
PAM Bank S.A	Yes	None on record	30 - 50 percent			Maximum 65 percent	Promissory note; other mortgage

Table 2
Results of Survey of Banks on Statutory Lien and Mortgage Lending

Name of Bank	Does Bank offer residential loans?	Incidence of application of government security in loan recovery procedures	Portion of loan balance recovered by Bank	Other costs incurred by Bank	Other comments on related issues	LTV Ratio	Additional types of security required
BISE, Warsaw	Yes	4 cases by statutory lien, 3 cases by State Treasury pre-emption		Costs of execution		Maximum 65 percent	
PBK SA, Warsaw	Yes	In 80 percent of execution cases	Below actual amount of liability	Execution costs (reimbursed)			Promissory note; reappropriation
PKO SA, Warsaw	Yes	None in case of housing loans	20 - 30 percent			Maximum 75 percent	
GBW, Poznań	Yes	None in case of housing loans	Tax arrears in majority of			50-70 percent	
BPH, Cracow	Yes	Frequent, but none in case of housing loans					Additional security applied case by case
PBG, Łódź	Yes	None in case of real estate mortgages					Additional security applied case by case
Lubelski Bank Regionalny	No, but plans to	Approximately 70 percent of cases			Slow judicial procedures	75 percent	The Bank intends to apply additional security, including an LTV below 50 percent. In cases of a well-backed mortgage, they may accept 50 percent.
BudBank SA	Yes, has recently started to offer loans.	Approximately 80 percent of cases	Approximately 70 percent		Lengthy execution procedures; lack of real estate liquidity		The Bank intends to apply 70 percent of LTV for the housing sector. Should mortgage security prove sufficient, the Bank would provide loans for up to 50 percent of commercial investments.



III. THE CURRENT STATUS OF POLISH LAW ON STATUTORY LIENS

III.1. Overview

Like most other countries, Poland has a long-established legal framework to enable the state to collect financial obligations owed to it. The government has the power to bring a lawsuit against a debtor, seeking a court judgment that a debt is owed. With such a judgment, execution procedures can begin and property of the debtor can be sequestered and sold to satisfy the debt. In addition, the state has the right to a lien on the real or personal property of the debtor; the lien takes effect upon a default in payment of an obligation without further contractual or judicial action on the part of the state. The state's lien is not only expeditious, it is also privileged in the sense that it is given priority over liens of other creditors in the order of payment from the proceeds of a foreclosure or involuntary sale of property against which there are multiple liens.

Prior to 1997, the state had no obligation to register its lien or to notify other creditors of the taxpayer that an obligation to the government had not been paid, that the state's lien had taken effect, or what amount the taxpayer owed. This right of nondisclosure, coupled with the high priority afforded the statutory lien regardless of other previously filed liens on a given property, made it difficult for banks to predict the level of security afforded by a mortgage registered against a borrower's property, not only at the time the loan was made but at any time during the term of the loan.⁵

In the past two years, significant changes have been made in the legal framework applicable to the statutory tax lien in Poland, primarily as the result of adoption of a new Tax Code (enacted August 29, 1997, effective January 1, 1998), the Law on Registered Liens and the Register of Liens (enacted December 6, 1996), and the Law on Mortgage Bonds and Mortgage Banks (enacted August 29, 1997). In some respects, the new Tax Code has considerably extended the scope of application of the statutory lien. For the first time, a *GMINA* as well as the State Treasury can establish a statutory lien on the property of the taxpayer (Article 34), and all of the property of the debtor is subject to the lien (Article 24). A statutory lien can be set up on a fractional part of property, perpetual usufruct rights, co-operative ownership rights to a housing unit, co-operative ownership rights to a commercial unit, rights to a single family house in a housing co-operative, and to any monetary debt secured by a mortgage. Thus, the range is the same as that of a contractual or private mortgage.

⁵ For these reasons, the statutory lien was cited by bankers and lawyers as the "key legal impediment to development of market-based mortgage lending" in Poland in a comprehensive assessment of housing finance. *Building on Progress: The Future of Housing Finance in Poland*, by Urban Institute Consortium for USAID/Warsaw, May 1997.

Changes in the law have improved the legal environment in connection with statutory liens in the sense that regulations have become more precise and some gaps and inconsistencies have been removed. Ironically, it is primarily the tax authorities who benefit from increased clarity in the regulations, while from the standpoint of mortgage lenders the current legal status is less advantageous than it was before. The concessions for contractual or private creditors have been relatively insignificant since their rights are still overcome by privileges afforded the state and *gminas*. The one exception is the improved priority for mortgage loans from licensed mortgage banks, granted under the Act on Mortgage Bonds and Mortgage Banks, as discussed below in Section III.3. Universal banks do not benefit from this provision, however, so the overall effect of the change is detrimental to the development of fair competition in the mortgage lending sector.

III.2. Scope of Tax Liabilities That May Be Secured by a Statutory Lien

Previously, tax liabilities subject to the statutory lien covered debts that could be secured “in the interest of the State Treasury,” and “due to tax liability in an amount determined by way of a decision taken by the tax authority.” Article 24, 1980 Act on Tax Liabilities. This excluded *gminas* as entities whose tax entitlements could be secured by a statutory lien, so statutory liens could not be applied to obligations such as infrastructure service rates, real estate taxes, or taxes on means of transport.

In 1995, the Supreme Court interpreted the 1980 Act on Tax Liabilities to apply the statutory lien to inheritance and gift taxes, agricultural taxes, forest taxes, real estate taxes, income taxes collected in the form of the tax chart (applicable to a small portion of small businesses), taxes on special types of agricultural production, and value added taxes (VAT) but only when the VAT tax base is determined by an estimated assessment. Payment of all other taxes, including personal income taxes, corporate income taxes, ordinary VAT and excise taxes, and stamp duty could not be secured by a statutory lien.

In cases where the statutory lien could not be used, the tax authorities could use the method of compulsory mortgage, described in Articles 109-112 of the 1982 Act on Title Registry and Mortgage. The right to establish a compulsory mortgage can be vested in any creditor (private or public), and can be established without the debtor's consent. The difference, as compared to the government's statutory lien, is that a compulsory mortgage must be disclosed in the Title Registry, hence, it could not be “hidden” from other creditors. In addition, a compulsory mortgage could be registered only on the basis of an executory document issued by the tax authorities along with a writ of execution, a formal document obtained through judicial action that confirms the amount of secured debt.

The compulsory mortgage also was used by the SSSA to collect unpaid social security obligations. This was possible because SSSA is not an entity separate from the State Treasury. However the Supreme Court in 1996 decided that despite the financial links between the State Treasury and SSSA, accounts receivable of the latter could not



be a base for setting up a statutory lien.

These inconsistencies with regard to the types of debt which may be secured by a statutory lien were resolved by the 1997 Tax Code. Article 35 of the Tax Code states that a statutory lien can be used to secure tax liabilities arising in accordance with Article 21, paragraph 1 of the Code, which include the following:

- Liabilities resulting from a decision determining the amount of tax liability.
- Liabilities resulting from a decision issued by a tax authority, specifying the amount of overdue tax.
- Liabilities resulting from a decision confirming liability of an entity collecting tax from taxpayers and transferring it to tax authority.

For taxpayers, this means that any tax liability may be a base for establishing a compulsory mortgage. It is worthwhile to note that a statutory mortgage can be used not only directly against a taxpayer, i.e., the individual obliged to pay the tax. According to Article 35 paragraph 3 of the Tax Code, the statutory mortgage also can be used to encumber the property of an individual or legal entity which, based on provisions of tax law, is obliged to calculate tax amount, collect it from the taxpayer and transfer it in a specified period of time to the tax authority (Articles 8 and 9 of the Tax Code).

In accordance with these regulations, a statutory lien right may be vested in the State Treasury or *gmina* against such persons as an employer who is obliged to calculate and deduct from the remuneration of all employees advance payments of personal income tax and transfer them to tax authority; a Notary Public, who collects stamp duty from people involved in legal transactions such as buying and selling real estate or setting up a contractual mortgage; or a village administrator who collects farm taxes.

The scope of application of the statutory lien was also strengthened by Article 39 of the Tax Code, which obliges the taxpayer, tax collector, or tax transferor to reveal on demand of the tax authority made during tax proceedings all property and proprietary interests upon which a statutory lien can be established, if there is evidence deduced from data gathered during the proceedings that a tax due might not be paid.

III.3. Priority of the Statutory Lien

The most crucial problem for lenders arising out of the statutory lien on real property lies in the lien's priority as compared with those of other creditors. According to the Code of Civil Procedure, Article 1025, paragraph 1, which sets forth the sequence of satisfaction of different creditors after an involuntary sale, the government's statutory lien (whether or not it has been registered) is in third position, a higher priority than any other mortgage,

including a contractual mortgage with a lender, which would be in sixth position. A private mortgage lender may be surprised to discover that there is a statutory lien against property securing a mortgage loan that takes precedence over the mortgage loan security if there is a foreclosure sale, even if the lender's lien was registered first.

As noted below, the Act on Registered Liens and Registry of Liens requires the registration of liens on movable property for such liens to take effect. Even more importantly, it eliminated the priority of statutory liens on movables in relation to previously registered liens. This change in priority was not applied to liens on real estate. From the viewpoint of a bank which has financed construction or purchase of a residential building, it may not matter if the government first satisfies its claims due to unpaid VAT charges, where the statutory lien must be disclosed, or due to unpaid income taxes, where a statutory lien need not be disclosed. In either case, the bank would be satisfied after the government.

The only recent improvement in the law on ranking of contractual vs. statutory mortgages was given to mortgage banks only, in the Act on Mortgage Bonds and Mortgage Banks of August 29, 1997. Article 40 of that law amended Article 1025 of the Code of Civil Procedure, by adding the following clause in position 2a) in order of satisfaction of debts:

- Liabilities secured by a mortgage resulting from mortgage bank debt recorded in the register of security for mortgage bonds, maintained in conformity with the Act of August 29, 1997, on Mortgage Bonds and Mortgage Banks (Journal of Law No. 140, item 940).⁶

⁶ Article 1025, Section 1 of the Polish Code of Civil Procedure currently states in its entirety the following sequence of satisfaction of creditors with the proceeds of an involuntary sale:

§1 Debts of the debtor shall be satisfied in the following order:

- ◆ Costs of the execution proceedings
- ◆ Alimony
- ◆ Financial obligations to the employees and pensions due to damages for causing a disease, disability causing loss of work, crippling injury or death, as well as the costs of the last disease and usual expenses for the funeral of the debtor
- ◆ Liabilities secured by a mortgage, resulting from mortgage bank debt, recorded in the register of security for mortgage bonds, maintained in conformity with the Act of August 29, 1997 on Mortgage Bonds and Mortgage Banks
- ◆ Taxes and other fees to which the provisions on tax obligations are applied, together with late charges and the costs of execution
- ◆ Fees for the perpetual usufruct and fees for usufruct of buildings owned by the State together with late charges and the costs of execution
- ◆ Financial obligations resulting from bank credits
- ◆ Financial obligations secured by mortgage, by pledge, or debts granted priority by the force of law, as well as rights arising against real estate before a notice of *lis pendens* was filed in the land and mortgage book or before a motion to make such entry was filed in the appropriate documents
- ◆ Financial obligations of creditors who have started an execution procedure
- ◆ Other obligations and debts



This provision, which places mortgage liens from mortgage banks ahead of the government's statutory lien, which remains in position number 3, is enormously important. It means that some private debts claimed under provisions of the Code of Civil Procedure can be satisfied before the government's tax related debt. Therefore, an exception has been made to the principle of absolute priority of the government's public interest in collecting debts owed to it over other creditors' interests in real estate.⁷ There seems to be no rational policy basis for making this exception available to mortgage banks but not other banks, so-called universal banks, when their debts are of the same nature. In any case, even the exception for mortgage banks remains theoretical at the present time, as there are as yet no licensed mortgage banks in Poland.⁸

III.4. "Secrecy" of the Statutory Lien

A statutory lien has been called a "secret" or "hidden" lien, since the right comes into existence and may exist at least for some period of time without disclosure in the Title Registry maintained for a particular property against which it takes effect. To some extent, provisions of the new Tax Code restrict the secrecy, but unfortunately do not eliminate it entirely.

⁷ The exception is narrow. It applies only when:

- ◆ The loan is issued by a mortgage bank, a bank specialized in originating mortgage backed loans. Forming a mortgage bank requires fulfilling numerous formal and capital conditions
- ◆ The debt is secured by a mortgage established only on a property owned by the borrower or on a perpetual usufruct right; the mortgage can not be established on other rights, mortgageable under the Act on Title Registry and Mortgage
- ◆ The mortgage in the interest of a mortgage bank is recorded as the first entry in the Title Registry
- ◆ The secured debt is recorded at the same time in the register of security for mortgage bonds maintained by the mortgage bank in accordance with regulations of the Act on Mortgage Bonds and Mortgage Banks

⁸ It can be argued that when preparing the 1997 Tax Code, the legislature was aware of that resolution of problems relating to the statutory lien was a prerequisite to development of long-term residential lending. This is evidenced by two essential provisions: Sections 5 and 6 of Article 34 of the 1997 Tax Code, which read:

- A statutory lien is effective for any owner of the mortgaged property and it has higher rank than any other mortgage, even though the tax related debt might have not been disclosed in the Title Registry.
- Provisions of Section 5 are not applicable if the mortgaged property is at the same time encumbered with a mortgage established to secure a long-term bank residential loan; in such case the rank is determined by the sequence of submission of applications to make an entry in the Title Registry.
- While these provisions appear to say that a statutory lien does not take priority over a previously registered bank mortgage, knowledgeable commentators agree that the Tax Code should not be read to reach this result, the priority of a statutory lien over a *universal* bank loan remains in effect, and the language in Sections 5 and 6 should be interpreted to apply only to mortgage loans from licensed mortgage banks. In practice, as long as these ambiguities and uncertainties exist, the provisions in question do not provide an effective solution to the problem.

By contrast, secrecy of the state's lien recently was abrogated in the case of another very similar tool for collecting debts to the government, the statutory lien on moveable property. Under the 1980 Act on Tax Liabilities, the statutory tax lien took effect simply upon the arising of tax liability (Article 23). Such a lien could be established even on movables not owned by the taxpayer if he used them in his job and if they were seized by a tax execution officer in the taxpayer's place of work (Article 49). As a result, the statutory lien at the end of 1997 was a double secret: not only was it not disclosed to third parties, such as other creditors of the taxpayer, but even the taxpayer himself might not be aware of it. When the lien secured a liability determined by way of a formal decision, the taxpayer learned of it when the decision was served. However, if the liability arose other than in connection with a decision, the taxpayer would not know about the statutory lien encumbering his property.

Secrecy of the statutory lien on movable property was abrogated by the Act on Registered Liens and Register of Liens passed on December 6, 1996. Article 20, paragraph 2 of the Act provides that the statutory right to establish a lien did not vest in the State Treasury unless the statutory lien was disclosed in an appropriate register.⁹ The general rule is simple: no entry equals no effective statutory lien.

In the area of real or immovable property, the Tax Code continues to provide that the statutory lien is effective upon issuing or serving the tax decision upon the taxpayer, but it now requires the tax authorities to file an application to record a statutory lien against real property within one month of when the lien arises; otherwise, the lien loses its effectiveness or expires.¹⁰ In practice, the one-month time limit is tolled when the government has submitted an entry application for registration, not when the lien is actually registered. Given the inefficiencies of the registration process, it may be many weeks or even months before there is actual legal notice of a statutory tax lien against a particular piece of property. This time lag is mitigated by the fact that when the entry application form is submitted, a notice is placed on the affected property's registration file to show that a registration is in process. If the notice is detailed enough, this should be sufficient to put persons interested in the file, such a prospective mortgage lender, on notice that there are claims against the property that have not yet been officially registered.

Before the lien is registered, a prospective buyer of the real property has the

⁹ The "appropriate register" is a register maintained by tax authorities in accordance with Article 45, paragraph 1 of the Tax Code, and paragraphs 4-6 of the Ordinance of the Minister of Finance of December 31, 1997 on enforcement of some provisions of the Tax Code.

¹⁰ For liens established before the new Tax Code took effect (before January 1, 1998) or for those that come into effect during the first year under the new Tax Code (between January 1 and December 31, 1998), the government has 12 months (not one month) to file for registration in the title registry.



privilege of obtaining information from the tax authorities not only about the existence but also the amount of any not yet disclosed statutory lien on the property, so long as the buyer has the consent of the owner or other persons with rights in the property that may be affected by the lien (Article 40, Tax Code). This right is of limited usefulness. First, it applies only to a buyer, not to a bank which has already made or is intending to make a loan to the buyer for purchase of the property. Second, there are ambiguities about when an individual or entity becomes a “buyer.” If it is after completion of the sales contract, then the right to know about an undisclosed statutory lien is useless, as the buyer is not in a position to change his position. If it is when a person intends to buy a property, how can this intention be verified? It is useful to remember that under Polish law (Article 157, paragraph 1 of the Civil Code), ownership title cannot be transferred conditionally or with a term clause. A notary public will refuse to draw a contract in which the parties agree that the title is transferred to the buyer only on the condition that the property is not encumbered by a statutory lien.

It may be possible to conclude two separate contracts: one creating an obligation to transfer title if certain conditions are met such as the absence of undisclosed liens, and the other for actual transfer of title. The potential buyer, having signed the first contract, would file an application for a report on the existence and amount of any statutory lien, and then, if the property is not encumbered, would sign the second contract purchasing the property. In such a case, a buyer would have to act quickly, because under Article 40, paragraph 2, a statutory lien established after issuance of the report but before conveyance of title would be valid and effective against the subject property.

III.5. Bankruptcy

In cases where the debtor is bankrupt, the law provides that taxes, public tributes, and social security debt accrued within two years prior to the bankruptcy are satisfied from the estate in bankruptcy in category three, i.e., immediately after costs of bankruptcy proceedings and fees for the trustee in bankruptcy, before secured bank loans. Ordinance of the President of Poland of October 24, 1934, Article 204 (full body of the document in Journal of Law of 1991, No.118, item 512, with subsequent changes).

IV. THE STATUTORY LIEN IN SELECTED CENTRAL AND EASTERN EUROPEAN COUNTRIES

IV.1. Hungary

Recent changes to the Civil Code of Hungary (Law XXXVI/1996) and the Law on Mortgage Banks and Mortgage Bonds (Law XXX/1997) have strengthened the position of liens of mortgage lenders vis-à-vis other liens, including the government’s statutory lien. The Law on Mortgage Banks and Mortgage Bonds moved the position of contractual

mortgage liens from sixth (last) place to fourth place, ahead of taxes, social security, and other public debt. Most notably, in contrast to Poland, the law makes this provision applicable to mortgage loans from all banks, not just mortgage banks.

Prior to the passage of the Law on Mortgage Banks and Mortgage Bonds, the basic order of satisfaction of claims following a foreclosure, provided in §165 of the Law on Court Procedure (Law LIII/1994), was as follows:

- ◆ Child maintenance
- ◆ Other maintenance
- ◆ Employees' wages and other income coming from the same consideration
- ◆ The amount determined against the debtor in a criminal, penal, or minor offense proceeding, in a claim arising from the confiscation of wealth (with the exception of a civil claim) for the benefit of the State
- ◆ Tax, social security, and other public debt
- ◆ Other debt

Article 29 of the Mortgage Banks and Mortgage Bonds Law amended the Law on Court Procedure by adding the following section:

- ◆ Article 170(1). When a claim secured by a mortgage lien is to be satisfied from the sales proceeds of real property, or water or air vehicle, such claim should be satisfied prior to claims specified in paragraph d) - f) of Article 165.

Under the Law on Court Procedure, mortgage liens are satisfied in the order in which they are registered. Law LIII/1994, Article 170(2). With regard to claims of the government for taxes, social security, and other public debt, Article 170(1) has been interpreted to mean that when such debts are registered as liens, they are included in the category of mortgage liens described in that article; in other words, they are satisfied in fourth place, after categories a), b), and c). The Law on Court Procedure provides that within a category, debt is satisfied in the order in which it is filed. Therefore, any previously registered contractual mortgage, such as a bank loan, would be satisfied before a government lien.

There is an obligation under Hungarian law for the government to register its liens for taxes or other public obligations, after the issuance of a decision establishing this right. The Law on Court Procedure provides that such liens are to be registered expeditiously. In any case, notice that an application for filing a tax lien must be included



among the registration documents for the affected property immediately after submission, so during the period between submission and actual registration, there is public notice that a lien will be registered (Article 138).

Some commentators believe that tax liens are now in an excessively disfavored position in Hungary, at least in the case of real estate taxes on the property for which the unpaid tax debt has accrued. Even if an effort is made in the future to fine-tune these new provisions with regard to real estate taxes, the Hungarian legal framework will continue to afford a strongly market-oriented model on the approach to the priority of private mortgage liens.

IV.2. Czech Republic

Under Article 337 of the Code of Civil Procedure (ZPO), tax liens (which need not be registered) have an absolute priority over contractual mortgages, without regard to date of registration of the contractual mortgage. As in Poland, a recent law on mortgage banks provides an exception to this rule; previously registered mortgages from licensed mortgage banks serving as collateral for mortgage bonds do not lose their priority.

Liens for customs assessments (import duties) require entry into the land register and do not affect the priority of mortgages previously registered. There are no other types of statutory liens that have an effect on mortgage priority.

IV.3. Slovakia

Statutory liens for ordinary tax assessments (income tax or corporate tax) and for customs assessments have priority over contractual liens. Upon request, tax authorities will confirm whether there are existing unpaid claims for ordinary tax assessments existing at the time of the request. Customs authorities are not required to provide information about existing claims.

Priorities in payment to creditors depend on the legal basis under which an execution against the debtor's property is carried out. In the case of a mortgage established under the Civil Code (ZPO), the execution must be carried out as a public auction, in which case claims of work contracts and social security claims of the previous one month have priority over a contractual mortgage. If the execution is carried out under Law 233/95, Section 157, which allows foreclosure sales without a court proceeding, the following priorities exist:

- ◆ Court expenses and costs of execution
- ◆ Taxes, charges, and duties if the lien is of a preferential nature by law and for amounts due within the three years prior to the auction, and if duly lodged

- ◆ Claims of the enforcing lender, claims collateralized by a lien of execution or lien of covenant or by restricted transfer of immovable property reimbursement of material encumbrances assumed by the successful bidder at auction, according to their order of preference.

There are no government statutory liens for charges related to energy, infrastructure, transportation or the like.

V. THE USE OF THE STATUTORY LIEN IN SELECTED WESTERN EUROPEAN COUNTRIES AND THE UNITED STATES

V.1. *Western Europe*

Following the universal practice, expenses and costs of execution have priority in payment from the proceeds of foreclosure sales throughout Western Europe.

In general, statutory liens are more restricted in Denmark, Germany, Sweden, and the United Kingdom than in countries following the Napoleonic Code.

- **Denmark.** In Denmark, there is priority for only two categories of statutory liens: taxes and duties in favor of the central or local government which are directly related to the property, including real estate taxes, fire insurance licensed by the government (§ 4 (1) tinglysningslov), and claims related to water, energy, and other public services (§ 4 (2) tinglysningslov).

- **Sweden.** Privileges for statutory liens in Sweden are even more restricted; only unpaid real estate taxes or council rates for the most recent two years, and certain public encumbrances are entitled to priorities.

- **United Kingdom.** In the United Kingdom, liens based on stamp duties (fees for change of ownership, or transfer taxes) and public infrastructure charges related to the development of the property itself have priority. In practice, lenders require a statement that infrastructure charges have been paid prior to granting a loan.

- **Germany.** In Germany, the situation is slightly more complex, although basically favorable from a private lender's point of view. Distribution of proceeds from a foreclosure is as follows:

- ◆ Costs of the foreclosure (§109 (1) ZVG)
- ◆ Expenditures by the mortgagee on maintenance and repair (§10 (1) ZVG)



- ◆ In case of agricultural or forestry properties, claims of related work contracts of the current and the previous year
- ◆ Public liens from the prior four years which are directly related with the property (§10 (3) ZVG)

Liens in category 4 may be based on federal or state law or statutes established by the central (federal), regional (Länder), or local governments, but are not subject to registration (see §54 GBO). The most significant examples are: stamp duties (§12 GrdstG), even if owed by the seller; public planning costs, and infrastructure costs owed to local governments (§134 (2) BauGesB); certain duties for services owed to local governments and established by state law, including gas, energy, water, and other amenities such street-cleaning; insurance premiums based on state law (e.g., fire insurance); duties for land consolidation, contributions for certain local government services (water, sewage, etc.) based on federal or state law; chimney-sweeping (federal law).

■ **Austria.** The situation in Austria is comparable to Germany. Distribution of proceeds of a foreclosure follows this order:

- ◆ Costs of the foreclosure
- ◆ Expenses for maintenance, repairs, and improvement
- ◆ Taxes and duties which are directly related to the property (for the previous three years)
- ◆ Taxes and duties for agricultural and forestry properties (for the previous six months)

Tax claims basically benefit from a right of registration only, but preference regarding ranking does not exist. However, unregistered statutory liens for stamp duty or with regard to land improvement or infrastructure measures would have priority.

One important exception to the rule provides a priority for claims based on urgently needed repairs to rented residential property, if performed on the basis of a court order.

■ **France.** In France, a contractual mortgage is overridden by the following so-called *privilèges généraux*, which need not be registered in the land register:

- ◆ Court expenses
- ◆ Copyrights

- ◆ Unpaid claims of work contracts resulting from the past six months, with an absolute priority for claims of the past 60 days (CC 2101 No. 4; 2104 No. 2)

Claims in category 3 are considered to be the riskiest. In practice, for loans secured by property owned by a commercial firm or company, at least two months' wages are deducted from the qualifying loan amount. Another way the related risk can be avoided is by lending to a single-purpose company.

The so-called *privilèges spéciaux immobiliers* which are exclusively defined by Art. 2103 CC require entry into the land register with certain deadlines; otherwise, they would fail to override contractual mortgages registered previously. The most common case is the *privilège du prêteur deniers* (Art. 2103 No. 3 CC) granted in favor of a lender who makes a loan to enable purchase of the property. This privilege would be subject to a deadline of two months following the closing of the purchase contract before a notary, and would come into existence only in case the loan amount was determined on the basis of the cost to purchase the property and the seller confirms that the purchase has been paid out of the loan amount.

Another statutory lien subject to registration exists in favor of the seller of a property for the purchase price (Art. 2103 No. 1 CC). However, a mortgage registered earlier would not be affected. In practice, lenders require the borrower to present a receipt of payment, confirmed by a notary, or the loan amount would be forwarded directly to the seller through a notary.

In addition, a statutory lien subject to registration may be established in favor of architects or other persons or companies employed by the owner of a property for their fees plus interest. This lien can override a mortgage registered previously; however, it is restricted to the value added to the property by the service. This related value has to be confirmed by a valuation before the beginning of the project and a second valuation within six months following completion. This lien must be registered within 15 days following approval of the performance by the owner of the property.

■ **Belgium.** The legal situation in Belgium is similar to that of France, with one significant exception: claims of work contracts cannot override the priority of a contractual mortgage.

Statutory liens not subject to registration exist exclusively in favor of the government (Art. 15, 17 *Loi hypothécaire*), for the following:

- ◆ Stamp duty plus registration fees
- ◆ Income tax, including corporate tax
- ◆ Value added tax



◆ Inheritance tax

Because of these liens, the practice is for a notary to require a so-called *certificat de non-opposition* from the tax authority prior to the establishment of a mortgage contract. The *certificat de non-opposition* confirms that there are no unpaid tax claims and the tax authorities will not later assert claims that might take priority over the contractual mortgage.

Privileges related with the purchase of a property and privileges in favor of companies and persons employed by the owner of the property (restricted to the value added to the property) are equivalent to those in France.

V.2. United States

■ **State Tax Liens.** Ordinarily, as a matter of state statutory law, real estate taxes and other fiscal obligations to a state that relate to the property itself are interests *in rem*, and constitute a lien against the property immediately upon becoming delinquent. Statutory liens for state real property taxes usually take precedence over contractual liens regardless of when the other liens arose or when they were registered; where public and private claims compete for the proceeds of a tax or foreclosure sale, payment of unpaid real estate taxes takes priority over satisfaction of any other private or contractual liens. See, e.g., D.C. Code §47-1312.

Delinquent state income and employer taxes become personal debts of the person (natural or legal) liable for payment. A lien arises at the time the tax becomes overdue, whether or not a certificate of delinquency is filed or registered. Such a lien does not take priority over a previously registered contractual mortgage or other secured debts, but would take priority over other unsecured debts, even if they arose before the tax delinquency.

■ **Federal Income Tax Liens.** Liens for unpaid federal taxes can be assessed and registered against real estate owned by the taxpayer. The lien does not take priority over a previously registered contractual lien such as that of a mortgage lender.

The federal government is entitled to a lien “upon all property and rights to property, whether real or personal, belonging to [a delinquent taxpayer].” IRC §6321, 26 USCA §6321 (1989). The lien comes into existence at the time the IRS district director assesses the lien or takes administrative action to note its existence; “the lien imposed by section 6321 shall arise at the time the assessment is made.” IRC§6322. However, the lien “shall not be valid as against any purchaser, holder of a security interest, mechanic’s lienor, or judgment lien creditor until notice thereof . . . has been filed.” IRC §6323.

What happens if a lien is “assessed” prior to the time a valid mortgage on the taxpayer’s property is recorded, but the lien is not registered until after the mortgage? Courts have ruled that the federal tax lien attaches upon assessment, *except* as to creditors protected under §6323 (including holders of a security interest such as a mortgage lender), against whom notice is necessary for the federal tax lien to achieve priority. See *Streule v. Gulf Fin. Corp.*, 265 A.2d 298 (D.C. App. 1970).

There is a six-year statute of limitations for enforcing federal tax liens. If the government brings an action to foreclose, all parties having liens upon the property or claiming an interest in the property must be made parties to the action. The distribution of proceeds is determined as part of the court order authorizing the sale. IRC §7403.

VI. ALTERNATIVE MECHANISMS TO THE STATUTORY LIEN

VI.1. *Western Europe*

In Western Europe, two basic alternative mechanisms to the statutory lien are commonly used: preferences regarding the distribution of proceeds of a foreclosure sale or in a bankruptcy procedure, and procedures replacing an enforced judgment to pay by a writ of execution issued by an authority other than a court. Neither mechanism provides priority over contractual liens already existing other than the priorities in favor of the government described in Section V.

■ **United Kingdom.** In the United Kingdom, tax authorities must go through the court system and apply for a judgment to pay. Tax claims, claims of the social security system, claims of alimony and maintenance, and claims based on work contracts are part of the system of preferences regarding the distribution of proceeds of a foreclosure or in a bankruptcy procedure, and do not affect the priorities of liens already existing.

■ **Germany.** In Germany, tax claims, claims of social security authorities, claims of alimony and maintenance, and claims based on work contracts are also part of the system of priorities in the distribution of proceeds of a foreclosure or in a bankruptcy procedure. Related claims based on civil law such as claims of alimony and for maintenance or claims of work contracts require an enforced judgment to pay or a writ of execution on the basis of a contractual title issued by a notary.

An ordinary notice of tax assessment or customs assessment or a notice of a social security claim issued by a competent authority can serve as a writ of execution. Tax and customs authorities are staffed with separate execution officers who are authorized to perform executions and foreclosures (including public auctions) on movables or claims directly. Regarding real estate, the above-mentioned documents may be used to apply for the entry of a compulsory mortgage in the land register or for forced sale via public



auction performed by a competent court, or for sequestration of the property. Social security authorities are not equipped with execution offices; they must use an ordinary executor. In all these cases, priorities of liens already existing would not be affected. However, the above-mentioned instruments would enable speedy execution.

VI.2. United States

■ **Child Support Obligations.** In the United States, imposition of the obligation of a noncustodial parent to pay child support is controlled by state law. In general, a valid order to pay child support is an enforceable court judgment that can be registered and executed upon like any other money judgment. Its priority among other enforceable judgments for monetary obligations would be determined by date of registration. It would not take priority over a contractual mortgage unless it was registered before the mortgage.

While child support obligations are imposed under state law, federal law has created a comprehensive, uniform system to help assure that such obligations are met. In 1975, the federal government began the Child Support Enforcement (CSE) program under the federal Social Security Act as a unified program to enforce child support obligations through cooperative efforts among federal, state, and local authorities. The CSE program is administered by the Office of Child Support Enforcement of the US Department of Health and Human Services. Each state has a CSE support agency that works directly with family or domestic relations courts, uses administrative processes to establish support orders, and collects and distributes child support payments.

There is a strong public interest in enforcement of a parent's obligation to pay for child support. In 1991 (the last census year), there were 6.2 million child support orders in place in the US, accounting for \$17.7 billion dollars in annual payments due. In that year, \$11.9 billion were collected, leaving \$5.8 billion due and unpaid. The magnitude of the child support system has profound fiscal implications because of the relationship between nonpayment of support by parents and the nonsupported child's need for federal and state funded assistance or welfare programs. HHS estimates that more effective collection of child support would result in savings in welfare payments of \$4.2 billion over the next 10 years.

Enforcement of child support orders often is carried out under the Uniform Interstate Family Support Act, which allows enforcement proceedings across state lines. Most child support income collected through administrative or legal means uses direct wage withholding provisions of the federal or state laws (56.9 percent). Other collections methods include interception of state and federal tax refunds (7.7 percent), and interception of unemployment benefits (1.9 percent). Other remedies are available that do not directly result in collection of funds, such as suspension or revocation of business or professional licenses issued to the nonpaying parent, and criminal prosecution of

nonpayers. There are no statistics kept by the federal office of Child Support Enforcement of collections through lien and foreclosure of real estate owned by the defaulting parent.

■ **Employment Taxes and Other Obligations of an Employer.** In the United States, employers usually must withhold a share of each employee's social security and other employment taxes and pay them directly to the government. While unpaid employer obligations provide a basis for a lien against the property of the debtor, this situation would not be likely to create a conflict with the rights of a mortgage lender. In most cases, the debtor would be a business entity, and property occupied as a residence by the owner or other principals of the business would be exempt from foreclosure or forced bankruptcy sale against the taxpayer entity. Ordinarily, the lien for unpaid employment taxes would be used to support a money judgment against the debtor and for seizure (and sale in appropriate cases) of property of the business, such as inventory, accounts receivable, or other assets.

Even in cases where the employer/taxpayer is an individual (for example, in a case of household employees), a lien for unpaid social security or other employment-related taxes would not take priority over a contractual mortgage lien.

VII. CONCLUSIONS AND RECOMMENDATIONS FOR CHANGES TO STATUTORY LIEN POLICY IN POLAND

According to Polish bankers and lawyers, the key legal impediment to development of market-based mortgage lending is the privileged position afforded to statutory liens for unpaid financial obligations to the government. If a borrower fails to pay his taxes after obtaining a mortgage, the state's statutory lien takes priority over the lender's lien if there is a foreclosure sale. As a result, banks cannot predict with any certainty that their right to payment is reasonably secured by the mortgaged property, and whether they can hope to get paid if the borrower defaults. Uncertainty creates higher risk for lenders and in some cases a reluctance to make mortgage loans at all. This opinion is confirmed by the survey of banks conducted as a part of this study.

Experience in market-oriented economies shows that insufficient security of bank collateral is broadly related to risks concerning the safety and soundness of banks. This problem is particularly severe when these institutions have not yet built up sufficient reserves. Clear security of title is a pre-condition to establishment of capital markets funded by issuance of mortgage-backed securities; related risks would affect the safety and soundness of such bonds unless they are guaranteed by the government. However, any solution based on a government guarantee could compromise the financial status of the government, unadvisable from the standpoint of the public interest, and could also deter the formation of private, market-based operations of the capital market.



Poland already has taken steps to limit the detrimental effects of the statutory lien on the development of market-based mortgage lending. The problem of the “secret” lien has been ameliorated by requiring the registration of statutory liens. However, notice of such liens is not sufficient to resolve the problem as long as they continue to take priority over previously filed contractual liens.

The new Pledge Law removes the statutory tax lien priority unless it is disclosed and registered prior to the pledge, but this only applies to enforcement of liens on movable property. Moreover, the Mortgage Banking and Mortgage Bond Law eliminates the priority of the statutory lien over contractual mortgages on real property, but only for mortgage loans issued by licensed mortgage banks. From a policy standpoint, there is little reason for this limitation—the security of mortgage loans made by all banks should be of equal concern.

Therefore, Article 1025, §2a, of the Code of Civil Procedure, as amended by the Act on Mortgage Bonds and Mortgage Banks, should be extended to include any mortgage registered as security for a bank loan. This will place universal banks in parity with mortgage banks, foster fair competition, and avoid possible concerns on the part of the European Union that the banking regulations of Poland are discriminatory. Liens would take priority based on the order in which they are entered into the land registry. This is the simplest way to solve the problem of the statutory lien priority and follows the example set in Hungary.

Alternatively, Poland could adopt the policy followed in many countries in Western Europe and the United States, and limit the priority of statutory liens to those based on payments related to the property itself, such as real estate taxes or infrastructure development fees. A time limitation would also be advisable, for example, to afford priority only to real estate taxes due for the prior two years, so that the size of the debt with priority does not become so great as to unreasonably compromise a lender’s security. This also provides a reasonable length of time within which the government can take action to enforce its rights under the lien, on the basis of an executory document issued by the tax authorities. Retaining these limited priorities should not create an insurmountable obstacle to the proper functioning of bank lending.