

PUBLICATION

Perfection of Security Interests in United States Federal Income Tax Refunds

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From time to time, businesses anticipate receiving a large federal income tax refund. When such a situation arises, there may be a desire to borrow against the proposed refund in order to access the anticipated funds more quickly than they would otherwise be available. Secured lenders may also wish to perfect a security interest in future federal income tax refunds to further collateralize existing loans secured by all assets of a borrower. Both sides to a loan transaction may therefore be interested in the method to create and perfect a security interest in a federal income tax refund.

1. Execution of Security Agreement Describing the Collateral

Article 9 of the Uniform Commercial Code governs security interests in most types of personal property. Because Article 9 does not expressly exclude federal income tax refunds from its scope, the grant of a security interest in a federal income tax refund is subject to the provisions of Article 9. Del. Code Ann. tit. 6, § 9-109(a). Because no section of Article 9 expressly discusses federal income tax refunds, such refunds are deemed to be “general intangibles.” See Del. Code Ann. tit. 6, § 9-102(a)(42).

To create a security interest in a general intangible such as a federal income tax refund, a borrower must grant a lender a security interest through a security agreement or similar instrument. Under Del. Code Ann. tit. 6, § 9-203, a security interest is enforceable with respect to specific collateral against the borrower and third parties when (a) value has been given (i.e., a loan has been made), (b) the borrower has rights in the collateral or the power to transfer the collateral, and (c) the borrower has executed a security agreement or similar instrument that describes the collateral.

The security agreement (and the UCC-1 financing statement to be filed in connection with it) must describe the collateral in reasonable detail. Del. Code Ann., tit. 6, §9-108(a). Though a description such as “all general intangibles” is likely sufficient, a reference to the specific federal income tax refund in question, or at least a reference to “all federal income tax refunds” might be preferable for both the borrower and the lender.

2. Execution of IRS and DOT Forms

The execution and delivery of a security agreement coupled with the filing of a financing statement creates and perfects a lender’s security interest in many types of personal property. In the case of a federal income tax refund, however, additional steps are necessary to allow the lender to obtain payment of the federal income tax refund directly from the IRS.

In addition to the security agreement discussed above and the UCC-1 financing statement described below, a lender should also prepare and have the borrower execute the following IRS forms: (a) Form 2848 Power of Attorney (“Form 2848”) and (b) Form 8302 Electronic Deposit of Tax Refund of \$1 Million or More (“Form 8302”). Form 2848 allows an individual, other than the borrower, to obtain the federal income tax refund on behalf of the Borrower.

Part I, Section 6 of Form 2848 requires the name of an “authorized representative” who will receive the federal income tax refund instead of the borrower. Form 2848 does not, by itself, authorize the “authorized representative” to endorse or cash the federal income tax refund. That requires an additional DOT form described below. For purposes of preparing Form 2848, the person named as the “authorized representative” must either be: (a) an attorney, (b) a certified public accountant, or (c) an “enrolled agent” as defined in Treasury Department Circular No. 230. In order for the IRS to process Form 2848 quickly, the person listed as the “authorized representative” should be an individual that has already received what is known as a “centralized authorization file” or “CAF” number from the IRS. If there is no such person, the IRS will assign a CAF number to the individual listed as the “authorized representative.” Form 2848 should be faxed to the appropriate CAF service center.

In cases where the lender expects that the federal income tax refund will equal \$1 million or more, the lender should require the borrower to execute a Form 8302 authorizing the IRS to wire the proceeds of the federal income tax refund to an account maintained by the lender for the benefit of the borrower (i.e. an account for the borrower that is located at the lender's financial institution). Form 8302 should be filed with the borrower's tax return, if possible. Otherwise, Form 8302 should be mailed to the same IRS address where the borrower files its annual tax return.

In addition to the IRS forms referenced above, the borrower must also execute the following DOT forms: (a) Form 235 Resolution By Corporation Conferring Authority Upon An Officer To Execute A Power Of Attorney For The Collection of Checks Drawn On The United States Treasury (“Form 235”) and (b) Form 234 General Power Of Attorney For The Collection of Checks Drawn On The United States Treasury (“Form 234”). The DOT forms authorize the lender to endorse the checks, or in the case of a wire transfer, to ultimately deposit the funds in an account for the benefit of the lender.

3. Filing a UCC-1 Financing Statement

To perfect a validly created security interest in a federal income tax return, a lender must file a UCC-1 financing statement using the description of the collateral contained in the security agreement in the appropriate filing office under the UCC. Del. Code Ann. tit. 6, § 9-310(a). In most cases where a lender is filing against an entity borrower, that financing statement should be filed in the Office of the Secretary of State of the borrower's state of incorporation. Del. Code Ann. tit. 6, § 9-307(e).

Lenders should be aware that following the IRS and DOT procedures outlined in Section 2, above, will not absolutely guarantee that the lender will receive the borrower's federal income tax refund directly from the IRS. First, lenders should be aware that the IRS has not always honored Form 8302 and has in some instances mailed checks despite receiving a Form 8302.

Second, a lender must keep in mind that a taxpayer has the right to revoke any of the above referenced IRS and DOT forms. While not a perfect solution to the problem, the loan documents related to the loan secured by the federal income tax refund should prohibit the borrower from revoking any of the IRS or DOT forms and should make any such revocation an event of default. The loan documents should also grant the lender a power of attorney to prepare and submit such forms if and to the extent needed as a result of such revocation (though it is not entirely clear that the IRS or DOT would accept a form executed on behalf of a taxpayer by a power of attorney).

Third, a lender should keep in mind that the IRS has the right to use all or part of a taxpayer's federal income tax refund to offset a prior outstanding balance. Therefore, before making a loan secured by a federal income tax refund, a lender should obtain some familiarity with its borrower's prior tax filings and situation to confirm

that no outstanding amounts are owed to the IRS at the time of the loan and that its borrower is not under an active audit at the time of making the loan.

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