



DEPARTMENT OF TAXATION

STATE OF HAWAII
P.O. Box 259
Honolulu, Hawaii 96809

December 23, 1996

TAX INFORMATION RELEASE NO. 96-6

RE: Priority of State Tax Lien Under HRS §231-33; Use of Form D-37 (Notice of Mortgage, Pledge or Purchase)

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I. Section 231-33, Hawaii Revised Statutes (“HRS”)

A. Background and Scope of TIR

This Tax Information Release (this “TIR”) sets forth the Department’s position with respect to the operation of section 231-33, HRS, in general and subsection (e) of section 231-33, HRS in particular. The procedures set forth in this TIR offer guidance for private lienors limited to the operation of section 231-33, HRS; they do not address lien priority issues or collection remedies that operate independently or in contravention of that section.

B. The State Tax Lien, Generally

Section 231-33(b), HRS, provides that any State tax which is due and unpaid, including applicable penalties and interest, is a debt due the State. From the time the State tax lien arises, it is a paramount lien against all private lienors upon all property and rights to property belonging to any person liable for the tax, whether the lien of the private lienor arises before or after the State tax lien, except as specified in section 231-33, HRS, and federal or State laws which provide special priority rules or a different recording mechanism.

The State tax lien extends to all real, personal, tangible, intangible, and rights to property, that the person owns at the time the State tax lien arises, or that the person later acquires, irrespective of whether the State tax lien is recorded.

C. When the State Tax Lien Arises

The State tax lien arises at the earliest of the following events:

- When a return showing the tax due is filed with the Department of Taxation (Department);
- When the tax is assessed by the Department; or
- When a certificate of State tax lien is recorded by the Department.

D. When the Interest of a Private Lienor Arises

As used in section 231-33, HRS, the interest of a private party, such as a mortgagee, pledgee, purchaser, or judgment creditor (hereinafter collectively referred to as “private lienor”) arises when all of the following are established:

- The identity of the private lienor;
- The property subject to the private lienor’s interest; and
- The amount of the private lienor’s interest.

If a private lienor’s interest must be recorded in order to be valid against subsequent purchasers, the private lienor’s interest does not arise before the interest is recorded (section 231-33(a)(3), HRS).

II. State Tax Lien Priority Rules

The State tax lien is paramount over a private lienor’s interest irrespective of when the private lienor’s interest arises, except in the following instances:

- **Real property.** The interest of a private lienor (such as a mortgagee, purchaser, or judgment creditor) in real property has priority over the State tax lien if the interest arises and is recorded before a certificate of State tax lien is recorded at the Bureau of Conveyances (Bureau) (sections 231-33(c)(1) and 231-33(f), HRS).

“Real property” includes leasehold, other interests in real property, and any personal property sold or mortgaged with real property if it is affixed to the real property and described in the instrument of sale or mortgage (section 231-33(a)(5), HRS). It does not matter if the real property is registered with the Land Court or is dual system property because the recordation of a certificate of State tax lien in the Bureau alone is effective against Land Court property or dual system property (section 231-33(f), HRS).

Note: Under certain circumstances, the State tax lien may prime that of a private lienor as to after-acquired property under the “choateness” rule notwithstanding that the private lienor’s interest is recorded first in time. See United States v. Vermont, 377 U.S. 351 (1964); United States v. McDermott, 507 U.S. 447 (1993). This is an example of a situation where the State tax lien will have priority notwithstanding the private lienor’s compliance with the procedures under section 231-33, HRS and this TIR.

- **Motor vehicle.** The interest of a private lienor in a motor vehicle has priority over the State tax lien if the interest arises and the notice required by section 286-46, HRS, is filed in the tax lien and encumbrance record with the appropriate county director of finance before a certificate of State tax lien is filed in the tax lien and encumbrance record (section 231-33(c)(2), HRS).
- **Inventory.** The State tax lien is extinguished as to tangible personal property sold by the taxpayer in the ordinary course of business for valuable consideration (section 231-33(d), HRS).
- **Securities, negotiable instruments, and money.** A person who pays adequate and full consideration for title to securities, negotiable instruments, or money and has no notice or knowledge of the State tax lien, takes the property or money free of the State tax lien (section 231-33(d)(1), HRS).
- **Special classes of property.** There are classes of property, such as patents, waterborne vessels and aircraft, for which federal or State law provides special priority rules or different recording mechanisms. For those classes of property, the relevant federal or State law shall determine the priority between the State tax lien and the private lien.
- **Other property.** As to other property or rights to property not described above (“other property”), the private lienor’s interest will have priority over the State tax lien only under the circumstances described below (section 231-33(e), HRS). The priority scheme relating to secured creditors under Article 9 of the Uniform

Commercial Code is not applicable to statutory liens, such as the State tax lien. Section 490:9-102(2), HRS; Bank of Honolulu v. Davids, 6 Haw. App. 25 (1985).

III. Use of Form D-37 by a Private Lienor to Gain Priority Over a State tax lien with Respect to Other Property

A private lienor (mortgagee, pledgee, or purchaser) is not required to give notice on Form D-37 in order to gain priority over a State tax lien for real property; motor vehicles; inventory; securities, negotiable instruments, and money; and special classes of property for which federal or State law provides special priority rules or a different recording mechanism.

As to other property to which section 231-33(e), HRS, is applicable, a private lienor qualifies for priority over a State tax lien if the following two conditions are satisfied:

- (1) The private lienor gives notice of the mortgage, pledge, or purchase made or about to be made by filing a **completed Form D-37** with the Department, and
- (2) The private lienor's interest arises before the certificate of State tax lien is recorded or within ten days after the certificate of State tax lien is recorded.

The Department nevertheless primes the private lienor notwithstanding satisfaction of conditions (1) and (2) if the Department records a certificate of State tax lien covering the unpaid taxes within 15 days after the filing of the Form D-37. To accommodate private lienors, the Department may waive all or part of the 15-day period.

These principles are illustrated in the following examples involving other property. In each example, assume that the private lienor's interest arises with respect to a debtor with delinquent State tax liabilities.

Example 1: A private lienor's interest arises on April 1, 1996. The private lienor does not file a Form D-37. The Department never records a certificate of State tax lien. The State tax lien has priority because the private lienor did not satisfy condition (1). If proper notice on Form D-37 is not given, the State tax lien always has priority over the private lienor's interest irrespective of whether the certificate of State tax lien is ever recorded.

Example 2: A private lienor files a completed Form D-37 on March 1, 1996. The private lienor's interest arises on March 13, 1996. The Department records a certificate of State tax lien on March 15, 1996. The State tax lien has priority even if the private lienor satisfied conditions (1) and (2). If a Form D-37 is filed, the Department has 15 days after the filing to record a certificate of State tax lien. If the Department records within this period, the State tax lien always has priority over the private lienor's interest.

Example 3: A private lienor files a completed Form D-37 on March 1, 1996. The Department does not record a certificate of State tax lien until March 19, 1996, after the expiration of the 15-day period. The private lienor's interest arises on March 25, 1996 (within ten days after the filing of the State tax lien). The private lienor's interest has priority. Conditions (1) and (2) were satisfied and the Department failed to record a certificate of State tax lien within the 15-day period.

Example 4: A private lienor files a completed Form D-37 on March 1, 1996. The Department records a certificate of State tax lien on March 19, 1996, after the expiration of the 15-day period. The private lienor's interest does not arise until April 1, 1996. The State tax lien has priority. Although the Department did not record a certificate of State tax lien within the 15-day period, condition (2) was not satisfied.

IV. Form D-37 Filing Requirements When a Loan is Modified with Respect to Other Property

As stated above, a Form D-37 is required to be filed by a private lienor with respect to the private lienor's interest in other property in order to be eligible for priority over the State tax lien as to that property. Generally, a private lienor is not required to file a new Form D-37 each time a loan is modified as long as the other property ("collateral") and security agreement remain unchanged and no new money is advanced, subject to certain exceptions contained in the examples below.

Example 5: A loan is made and the original security agreement is executed with the loan. The private lienor is required to file a Form D-37.

Example 6: Without more, a loan's maturity date is extended and the interest and principal repayment provisions are adjusted. The private lienor files a UCC Statement of Amendment to reflect this change in loan terms. The private lienor is **not** required to file a new Form D-37 because the collateral and security agreement remain unchanged.

Example 7: Assume the same facts as in Example 6, except that additional collateral is delivered by way of another security agreement and the filing of a new financing statement. The private lienor is required to file a new Form D-37 only with respect to the additional collateral received and not for the collateral covered by the original Form D-37 filing. If, however, the original financing statement is released in conjunction with the new security agreement and financing statement, a new Form D-37 is required to be filed with respect to the original and additional collateral.

Example 8: Assume the same facts as in Example 6, except that additional collateral is delivered by way of an amendment to the existing security agreement and the filing of a new

financing statement with respect to the original and additional collateral. A new Form D-37 **is** required to be filed but only with respect to the additional collateral received since the original financing statement is not released.

Example 9: A loan is refinanced, the old loan is paid off with money from the new loan, no additional money is advanced, and the collateral and security agreement are not changed. The private lienor modifies the loan agreement or debt instrument to document the refinancing. The private lienor **is not** required to file a new Form D-37 because the collateral and security agreement remain unchanged and no new money is advanced.

Example 10: Assume the same facts as in Example 9, above, except that additional or new collateral is received. A new Form D-37 **is** required to be filed but only as to the additional or new collateral. However, if a new loan agreement or debt instrument is executed and the original security agreement is released and a new Security Agreement and Financing Statement executed, then a new Form D-37 is required to be filed as to all of the collateral.

Example 11: A UCC Continuation Statement is filed without the addition or substitution of collateral. The private lienor **is not** required to file a new Form D-37.

Example 12: A UCC Statement of Amendment is filed to change a debtor's address. The private lienor **is not** required to file a new Form D-37.

Example 13: A UCC Statement of Amendment is filed to perfect the security agreement with respect to additional collateral received at additional locations. A new Form D-37 **is** required to be filed but only as to the additional collateral.

Example 14: A UCC Statement of Amendment is filed to correct the serial number of a specific item of collateral. The private lienor **is not** required to file a new Form D-37.

Example 15: A UCC Statement of Amendment is filed to reflect a change in legal entity (e.g., sole proprietorship to corporation). The private lienor **is not** required to file a new Form D-37.

Example 16: A UCC Statement of Amendment is filed to document that a third party has assumed the loan and acquired the collateral. The private lienor **is not** required to file a new Form D-37.

Example 17: A private lienor secures a loan with a security agreement that does not contemplate future advances, files a Form D-37, and files a UCC-1. The mortgagee makes a

second loan secured by the same collateral. A new Form D-37 **is** required to be filed at the time the second loan is made.

Example 18: A private lienor secures a loan with a security agreement that provides for future advances under a line of credit where there is a stated credit limit and files a UCC-1. At the time the credit is established, a Form D-37 **is** required to be filed, but new Forms D-37 **need not** be filed for future advances made within the original stated credit limit. However, a new Form D-37 **is** required to be filed whenever the credit limit is increased or each time an advance is made in excess of the stated credit limit if the private lienor also files a UCC-1 financing statement or other document with the Bureau or other public officer or agency as to that credit increase or excess advance, in which event a new Form D-37 is required to be filed only as to that increase or advance.



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HRS Section Explained: HRS §231-33