

170.0083**Memorandum**

To: S. Shoblom
Eureka Branch Office

Date: March 18, 1997

From : Thomas J. Cooke
Tax Counsel

Telephone: (916) 445-6496
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Subject: Security Interest In Deposit Account
REDACTED TEXT

Your memorandum dated February 27, 1997 and concerning the above taxpayer has been forwarded to me for response.

In your memorandum, you state that you have received two levy responses from the same bank REDACTED TEXT claiming a security interest in all deposit accounts of the taxpayer when the taxpayer has a loan with the bank. You further state that the security interest indicates that the bank can assemble the collateral when the debtor is in default. You state that the taxpayer was not in default when the levy was served. The serving of the levy made the account go into default. You also state that the bank simply applies the funds which were in the accounts to the loan and gives the taxpayer credit for a payment.

You ask:

1. Can the bank apply the funds which the levy attached when the loan was not in default at the time the levy was served?
2. Does the Board have a right to the funds in the account because some of those funds consist of sales tax reimbursement?

On May 1, 1995, partners of the taxpayer signed a "Commercial Security Agreement" in which the taxpayer granted to the bank a security interest in the taxpayer's "Deposit Accounts." The security interest provided that:

"Grantor shall not pledge, mortgage, encumber or otherwise permit the Collateral to be subject to any lien, security interest, encumbrance, or charge, other than the security interest provided for in this Agreement, without the prior written consent of Lender."

The security agreement defined "Events Of Default" to include:

"Commencement of foreclosure or forfeiture proceedings, whether by judicial proceeding, self-help, repossession or any other method, by any creditor of Grantor or by any governmental agency against the Collateral or any other collateral securing the Indebtedness. This includes a garnishment of any of Grantor's deposit accounts with Lender."

The security agreement further provided that:

"[i]f an Event of Default occurs under this Agreement . . . , Lender may declare the entire Indebtedness . . . immediately due and payable, without notice . . . Lender shall have full power to sell, lease, transfer, or otherwise deal with the Collateral or proceeds thereof in its own name or that of the Grantor."

This security agreement was effective on the date that it was executed. Commercial Code section 9302 (1)(g) provides an exception to the usual requirement that there be a filing of a financing statement with the Secretary of State to perfect a security interest when a security interest is sought in a "deposit account." If the deposit account is maintained by the secured party, the security interest is perfected in the deposit account when the security agreement is executed.

Government Code section 7170(a) provides that a state tax lien attaches to all property belonging to a taxpayer. However, Government Code section 7170(c) provides that a state tax lien is not valid as to:

"(4) any person (other than the taxpayer) who, notwithstanding the prior filing of the notice of the state tax lien:

"(G) acquires a security interest in a deposit account"

Code of Civil Procedure section 700.140(a) provides that a levy on a deposit account reaches amounts in the account at the time of service on the financial institution. However, Code of Civil Procedure Section 701.040 provides:

"(a) Except as otherwise ordered by the court upon a determination that the judgment creditor's lien has priority over the security interest, if property levied upon is subject to a security interest that attached prior to levy, the property or obligation is subject to enforcement of the security interest without regard to the levy unless the property is in the custody of the levying officer; but, if the execution lien has priority over the security interest, the secured party is liable to the judgment creditor for any proceeds received by the secured party from the property to the extent of the execution lien."

The taxpayer violated the security agreement and caused an "Event of Default" when it permitted the Board's levy to be served on the deposit account. The bank was permitted by the security agreement to declare the taxpayer's loan balance immediately "due and payable." It is our opinion that the Bank was legally permitted to apply all amounts in the deposit account to the taxpayer's outstanding loan balance rather than to pay those amounts to the Board in response to the Board's levy.

In California, a seller has no legal responsibility to collect sales tax reimbursement from its customers. The seller may pay sales tax from its profits alone. Sales tax reimbursement is a contractual obligation between the seller and purchaser when those parties agree that the purchaser will pay sales tax reimbursement to the seller. Under these circumstances, the presence of sales tax reimbursement in a deposit account is similar to other funds which have been placed in deposit accounts from the contractual relationship between seller and purchaser.

TJC/cmm

cc: Santa Rosa District Administrator (JH)
Mr. Rick A. Slater (MIC:55)