

## Federal Tax Liens—Their Nature and Priority

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THE LAW of federal tax liens is not esoteric, although the nature and priority of these several liens do depart in large degree from the ordinary concepts of creditor security laws. Since the subject is of increasing importance, as one may readily conclude from the surprising abundance of lien cases in current tax reports, this article is written for the purposes of introducing the statutory and case framework of the liens and of attempting to explore the areas of lien law that are either unsettled or of recent origin.

Although other miscellaneous liens may be found in the Internal Revenue Code, the scope of this treatment will be limited to three of the federal liens: the general tax lien, securing all federal taxes capable of assessment, and the two specific liens erected to secure the federal estate and gift taxes. The emphasis of this article will be on the nature and priority of the three liens considered, with only scattered reference to means and methods of their enforcement.

### THE GENERAL TAX LIEN

Since 1866 the United States has possessed a statutory lien for unpaid federal taxes,<sup>1</sup> which attaches to the taxpayer's property after the Collector of Internal Revenue has made specific demand to pay the taxes. The priority of the earlier lien related back to the time that the taxes had become due and payable to the United States.<sup>2</sup> By amendment in 1879,<sup>3</sup> the effective date of priority for this general tax lien was changed to the date upon which the Collector of Internal Revenue received from the Commissioner of Internal Revenue an assessment list carrying the unpaid tax liability of the delinquent taxpayer.

Because the date of receipt of the assessment list remains the test of priority under the current statutes, a word of explanation about assessment procedure is necessary. Normally a tax is assessed by the Commissioner after the available administrative procedures for determining the amount

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<sup>1</sup> 14 STAT. 107 (1866).

<sup>2</sup> *United States v. Pacific R.R.*, 1 Fed. 97 (E.D. Mo. 1880).

<sup>3</sup> 20 STAT. 331 (1879). "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment-list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person."

of the tax unpaid, and for giving the taxpayer an opportunity to present his side of the tax controversy, have been exhausted. At such time, if the tax deficiency remains unpaid, the Commissioner signs an assessment list containing the tax, penalty and interest outstanding against the taxpayer. That list is then delivered to the particular Director of Internal Revenue who has jurisdiction over the taxpayer, and who issues both a notice of the assessment and a demand for payment to the taxpayer. If payment is not made, the Director can then proceed to enforce the lien by appropriate administrative and judicial procedures.<sup>4</sup>

This assessment lien may properly be analogized to a judgment lien, partly because both liens are created without any action by the delinquent debtor and partly because the assessment of a tax has been likened to a judgment procured in a court of law.<sup>5</sup> The analogy is further strengthened by the summary methods of enforcing the assessment lien that are available to the Director. He may seize and sell any tangible property of the taxpayer (execution of judgment) and he may levy upon intangible obligations owed to the taxpayer (garnishment).<sup>6</sup> However, the general tax lien, if compared with a judgment lien, is different in at least two respects: (1) It burdens property, including realty, without any public record of the assessment or of the lien, and (2) it reaches personalty prior to the time that the Director has reduced the chattels to possession. In short, the assessment lien is a secret lien, effective even in the absence of a record entry or of possession; it therefore behooves persons who deal with delinquent taxpayers to move carefully so that their interests may not be jeopardized by the tax lien.

Several attacks, testing its extraordinary features, have been made upon the validity of the assessment lien. The first scrimmage was fought over whether or not the lien statute should be construed "reasonably," that is, in favor of a bona fide purchaser or encumbrancer who took the property of the taxpayer without actual notice of the tax lien. This controversy reached the Supreme Court in *United States v. Snyder*.<sup>7</sup> The Court there held (1) that the lien for taxes was not subject to the recording laws of the states, and (2) that the lien was enforceable against a subsequent bona fide purchaser for value without notice. Since the statutory lien of the sovereign for taxes had no predecessor at common law, the sole source of law was the

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<sup>4</sup> INT. REV. CODE §§ 272 *et seq.*, 3670 *et seq.*

<sup>5</sup> *Bull v. United States*, 295 U.S. 247 (1935). The Court likened an assessment to a judgment because of the imperative need of the government for promptly collecting its taxes.

<sup>6</sup> INT. REV. CODE §§ 3690 *et seq.*, 3700 *et seq.* See *Citizens Nat'l Trust and Savings Bank v. United States*, 135 F.2d 527 (9th Cir. 1943); *United States v. Morris and Essex R.R.*, 135 F.2d 711 (2d Cir. 1943), *cert. denied*, 320 U.S. 754 (1943).

<sup>7</sup> 149 U.S. 210 (1893).

the words of the statute. These words, the Court stated, gave no justification for reading the equitable doctrine of bona fide purchaser into the law.<sup>8</sup>

Defeated in the Supreme Court, the attackers continued their fight in the halls of Congress. The lieutenants for ameliorating the lien law argued that the secret assessment lien upset the certainty of record titles to land. A purchaser of real estate, they argued, bought at his peril. If any predecessor in title had been delinquent in paying his taxes, the purchaser might be compelled to forfeit his property to satisfy that earlier obligation.<sup>9</sup> Yielding to this pressure in 1913, Congress amended the lien statute to provide that the tax lien should not be valid against a mortgagee, purchaser, or judgment creditor until notice of the lien had been made a matter of public record.<sup>10</sup> In passing the amendment, Congress noted that the prior lien was "so comprehensive . . . [that] any person taking title to real estate is subjected to the impossible task of ascertaining whether any person, who has at any time owned the real estate in question, has been delinquent in the payment of taxes referred to while the owner of the real estate in question."<sup>11</sup>

After this amendment, one could purchase, take a mortgage, or secure a judgment with impunity, if he first checked the records. Since one notice of tax lien is filed under the name of the taxpayer to reach all of his property, without reference to specific descriptions, the prospective mortgagee, purchaser, or judgment creditor could protect himself on both personal and real property.

In 1939, Congress added the class of pledgees to those protected from the effects of the assessment lien.<sup>12</sup> Finally, those dealing in securities were exempted from the general rules of the lien statute.<sup>13</sup>

The second battle over the exceptional qualities of the federal tax lien was waged with the weapons of "inchoate" and of "perfected." On all counts the government has succeeded in checking the opposition in this particular battle, with but an occasional skirmish still arising. The argument of the attackers is that the assessment lien, that is, the lien for taxes before being filed for record, is an inchoate lien not entitled to priority over later perfected encumbrances. Thus, in *U. S. v. City of Greenville*,<sup>14</sup> the

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<sup>8</sup> See *MacKenzie v. United States*, 109 F.2d 540 (9th Cir. 1940); *United States v. Beaver Run Coal Co.*, 99 F.2d 610 (3d Cir. 1938); *Ferris v. Chic-Mint Co.*, 14 Del. Ch. 232, 124 Atl. 577 (1924).

<sup>9</sup> See 22 A.B.A. Rep. 48 (1899); *Blacklock v. United States*, 208 U.S. 75 (1908) (holding that the tax lien was valid against a subsequent mortgagee without notice); *United States v. Curry*, 201 Fed. 371 (D.C.Md. 1912); *United States v. Pacific R.R.*, *supra* note 2.

<sup>10</sup> 37 STAT. 1016 (1913).

<sup>11</sup> H.R. Rep. No. 1018, 62nd Cong., 2nd Sess. (1912).

<sup>12</sup> Revenue Act of 1939, § 401, 53 STAT. 882 (1939).

<sup>13</sup> Revenue Act of 1939, § 401, 53 STAT. 883 (1939).

<sup>14</sup> 118 F.2d 963 (4th Cir. 1941).

State of South Carolina, the County of Greenville and the City of Greenville each claimed that its lien on the property of the tax debtor was superior to the assessment lien of the United States for taxes, because each designated a specific piece of property, whereas the federal lien described no particular property but purported to attach to *all* of the taxpayer's property. The Fourth Circuit rejected the contention and granted priority to the United States. The fact that the general tax lien is extremely broad in scope and purpose cannot be employed to sabotage its validity. In other words, the assessment lien is a "specific" and "perfected" lien upon the property of the taxpayer.<sup>15</sup>

A similar raid has been made by isolated commandoes who claim that the assessment lien is "inchoate" on personal property until the Director seizes the chattels. Since record titles are unimportant to personalty, the argument runs, and since changes in title to personalty are usually accompanied by changes in possession, the tax lien is unperfected until the Collector takes possession.<sup>16</sup> This argument, too, has been repudiated.<sup>17</sup>

<sup>15</sup> *Accord*, Metropolitan Life Ins. Co. v. United States, 107 F.2d 311 (6th Cir. 1939), *cert. denied*, 310 U.S. 630 (1940); United States v. Reese, 131 F.2d 466 (7th Cir. 1942); Cobb v. United States, 172 F.2d 277 (D.C. Cir. 1949); United States v. Record Pub. Co., 60 F. Supp. 194 (N.D. Cal. 1945). *Contra*, on the theory that a lien naming specific property of the debtor is more "specific" and "perfected" than a lien against all of the property of the debtor: City of Winston-Salem v. Powell Paving Co., 7 F. Supp. 424 (M.D.N.C. 1934); Gerson, Beesley & Hampton Inc. v. Shubert Theater Corp., 7 F. Supp. 399 (S.D.N.Y. 1934); Berrymont Land Co. v. Davis Creek Land & Coal Co., 119 W. Va. 186, 192 S.E. 577 (1937). And note *In re Ann Arbor Brewing Co.*, 2 CCH 1952 FED. TAX REP. ¶ 9509 (E.D. Mich. 1952), where the court applied the marshalling of assets doctrine to pay subordinate liens first out of lien property because the federal lien reached other property of the taxpayer.

<sup>16</sup> *Roberts & McInnis v. Emery's Motor Coach Lines*, 2 P-H 1950 FED. TAX SERV. ¶72,737 (1950); 2 CCH 1950 FED. TAX REP. ¶ 9455.

<sup>17</sup> *Ibid.* The following cases indicate that the federal tax lien constitutes an interest against personal property of the taxpayer from a date earlier than the time that the Director seizes the property: *Glass City Bank v. United States*, 326 U.S. 265 (1945) (holding the tax lien valid against an after-acquired intangible prior to service of notice of levy, the process of making seizure of an obligation owing to the taxpayer by a third party); *Adams v. O'Malley*, 182 F.2d 925 (8th Cir. 1950) (tax lien valid in bankruptcy on personal property in possession of trustee in bankruptcy); *In re Burch*, 89 F. Supp. 249 (D.C. Kan. 1948) (same); *United States v. Graham*, 96 F. Supp. 318 (S.D. Cal. 1951), *aff'd*, P-H 1952 FED. TAX SERV. ¶72,581 (1952), *cert. denied* October 13, 1952 (rentals owing taxpayer subject to lien without service of notice of levy); *United States v. Record Publishing Co.*, *supra* note 17 (lien on personal property enforceable without prior seizure). Furthermore, this lien on personal property has been enforced against third parties who had secured an interest in the personal property of the taxpayer between the time the federal tax lien arose and the time the Director took action to reduce the property to possession: *Nelson v. United States*, 139 F.2d 162 (9th Cir. 1943), *cert. denied*, 322 U.S. 764 (1944) (lien valid against intangible of taxpayer assigned by him to a third party before the Collector served notice of levy); *MacKenzie v. United States*, *supra* note 8 (lien enforced against bank deposit of taxpayer on which another creditor of taxpayer had secured an attachment prior to service of notice of levy by Director); *Investment & Securities Co. v. United States*, 140 F.2d 894 (9th Cir. 1944) (intangible assigned by taxpayer to third party after assessment held subject to lien although Director did not make levy until

Seizure of personal property by the Director is not a method of perfecting the tax lien but rather is a means of enforcing an existing lien.<sup>18</sup>

A further attack on the assessment lien has been based on the recording requirement added by the amendment of 1913. Because Congress has provided that notice of the tax lien *may* be filed for record, these challengers have argued that the tax lien is inchoate and subject to attack by subsequent creditors or by other parties not specifically named in the amendment. The courts, having taken a quick look at the express language of the amendment, have defeated this sortie summarily.<sup>19</sup>

These results are no more than a logical application of the rule of *United States v. Snyder*. The fact that Congress enacted a legislative exception to that case in favor of mortgages, pledgees, purchasers and judgment creditors does *not* affect the validity and priority of the assessment lien toward other classes of interested parties. Those other parties are in no better position today than they were before the mitigating amendment was passed. One must view the assessment lien as a completely perfected, specific and valid lien against all the world except the four classes named in the protecting amendment.

### *Property Subject to the Lien*

Section 3670, Internal Revenue Code, "Property Subject to Lien," provides that the amount of the taxes unpaid "shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." Clearly, all tangible property, either real or personal, of the taxpayer is burdened by the tax lien.<sup>20</sup>

Intangible property has presented more of a problem for the courts. That intangible property, per se, is not exempt from the federal tax lien is easily demonstrated.<sup>21</sup> In addition to the cases that hold the lien reaches

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after assignment); *Citizens State Bank of Barstow, Texas v. Vidal*, 114 F.2d 380 (10th Cir. 1940) (same); *United States v. Caldwell*, 74 F. Supp. 114 (M. D. Tenn. 1947) (personal property transferred after lien arose but prior to execution by United States held subject to lien); *Filipowicz v. Rothensies*, 43 F. Supp. 619 (E.D. Pa. 1942) (levy made after assignment of claim; claim still burdened by earlier tax lien); *In re Gee*, 1 CCH 1953 FED. TAX REP. ¶9223 (S.D. Cal. 1952) (lien on personal property valid in bankruptcy despite possession by another adverse lienor).

<sup>18</sup> INT. REV. CODE § 3692, which permits the Collector to levy upon "all property and rights to property . . . on which the lien provided in section 3670 exists . . ." This distinction is clearly brought out in G.C.M. 5432, VIII-1 CUM. BULL. 134 (1929).

<sup>19</sup> *In re Baltimore Pearl Hominy Co.*, 5 F.2d 553 (4th Cir. 1925).

<sup>20</sup> Even the property of a non-resident taxpayer is subject to the lien. *United States v. Dallas Nat'l Bank*, 152 F.2d 582 (5th Cir. 1945), *aff'd*, 164 F.2d 489 (5th Cir. 1947).

<sup>21</sup> Thus, the indebtedness of a third party to the taxpayer is subject to the federal tax lien: *Nelson v. United States*, *supra* note 17; *Glass City Bank v. United States*, *supra* note 17. Taxpayer's rights as cestui que trust: *In re Rosenberg's Will*, 269 N.Y. 247, 199 N.E. 206, *cert. denied*, 298 U.S. 669 (1935); *United States v. Dallas Nat'l Bank*, *supra* note 20; *United States v. Canfield*, 29 F. Supp. 734 (S.D. Cal. 1939). Taxpayer's interest as insured: *Kyle v. McGuirk*,

intangibles, the statutes providing for the enforcement of the lien specify various types of choses in action that can be seized by the Collector. Thus, Section 3691, Internal Revenue Code, defines the property of the taxpayer available for distraint by the Collector to include "goods, chattels, or effects, including stocks, securities, bank accounts, and evidences of debts . . . ." <sup>22</sup> Furthermore, Section 3672, in setting up special requirements of notice for securities of the taxpayer, indicates definitely that securities are subject to the lien. <sup>23</sup>

These rules are sometimes generalized in the statement that the federal tax lien attaches to all of the property of the taxpayer, including rights of property in the hands of third parties that a private creditor could seize to satisfy his debt. <sup>24</sup> However, this general rule is inaccurate to the extent that

82 F.2d 212 (3rd Cir. 1936); *Smith v. Donnelly*, 65 F. Supp. 415 (E.D. La. 1946); *United States v. Ison*, 67 F. Supp. 40 (S.D. N.Y. 1946); *United States v. Trout*, 46 F. Supp. 484 (S.D. Cal. 1942); *United States v. Prudential Ins. Co.*, 54 F. Supp. 664 (E.D. Pa. 1944); see *United States v. Aetna Life Ins. Co.*, 46 F. Supp. 30 (D.C. Conn. 1942) and, on fire insurance, see *Hill v. Firemen's Ins. Co.*, 25 F.2d 1007 (W.D. Ark. 1928). Bank account of taxpayer: *MacKenzie v. United States*, *supra* note 7; *United States v. First Capital Nat'l Bank*, 89 F.2d 116 (8th Cir. 1937); *United States v. National City Bank of N.Y.*, 32 F. Supp. 890 (S.D. N.Y. 1940); *United States v. City State Bank*, 19 F. Supp. 775 (W.D. Tenn. 1937); *United States v. Marine Midland Trust Co.*, 46 F. Supp. 38 (S.D. N.Y. 1942); *Westheimer v. Collector of Int. Rev.*, 12 F. Supp. 20 (S.D. N.Y. 1935); *United States v. Larson Jr. Co.*, 27 A.F.T.R. 953 (S.D. N.Y. 1940); *Roberts & McInnis v. Emery's Motor Coach Lines*, *supra* note 16; G.C.M. 5432, VIII-1 CUM. BULL. 134 (1929). Taxpayer's interest as annuitant: *Cannon v. Nicholas*, 80 F.2d 934 (10th Cir. 1935); *Schwarz v. United States*, 191 F.2d 618 (4th Cir. 1951). Rental obligation owing to taxpayer: *United States v. Warren R.R.*, 127 F.2d 134 (2d Cir. 1942); *United States v. Grahani*, *supra* note 17. Taxpayer's wages: *United States v. Long Island Drug Co.*, 115 F.2d 983 (2d Cir. 1940); *Neidich v. Maloney*, 27 A.F.T.R. 1042 (D.C. N.J. 1940). Claim of taxpayer against estate of bankrupt: *Filipowicz v. Rothensies*, *supra* note 17. Claim of taxpayer for labor and materials furnished: *Citizens State Bank of Barstow v. Vidal*, *supra* note 17. Workmen's compensation award payable to taxpayer: *United States v. Ocean Accident & Guarantee Corp.*, 76 F. Supp. 277 (S.D. N.Y. 1948). Taxpayer's money: *Railway Express Agency v. Jones*, 29 A.F.T.R. 1340 (N.D. Ill. 1940); *United States v. Willmann*, 63 F. Supp. 535 (E.D. Mo. 1945). Taxpayer's rights as shareholder in bank being liquidated: *Investment & Security Co. v. United States*, *supra* note 17. Postal Savings Certificates held by taxpayer: *United States v. Lewis*, 29 A.F.T.R. 1427 (D.C. Colo. 1941). Liberty Bonds owned by taxpayer: see *Jacobson v. Hahn*, 88 F.2d 433 (2d Cir. 1937).

<sup>22</sup> The maxim "Expressio unius est exclusio alterius" does not apply to this listing of properties subject to distraint. Property *not* listed in § 3691 is not, for that reason, exempt from the federal tax lien. *Cannon v. Nicholas*, *supra* note 21; *In re Rosenberg's Will*, *supra* note 21.

<sup>23</sup> Section 3672 defines securities to include "any bond, debenture, note, or certificate, or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase any of the foregoing; negotiable instrument; or money." The federal tax lien reaches not only stock held by the taxpayer, but also dividends paid thereon. *United States v. Worley*, 64 F. Supp. 271 (D.C. Ind. 1940).

<sup>24</sup> *Citizens State Bank of Barstow, Texas v. Vidal*, *supra* note 17; *Investment & Securities Co. v. Robbins*, 49 F. Supp. 620 (E.D. Wash. 1943), *aff'd*, 140 F.2d 894 (9th Cir. 1944); *Federal Tax Liens and Their Enforcement*, 33 VA. L. REV. 13, 15 (1947).

the federal government is not bound by state immunities and exemptions, whereas the private creditor cannot levy execution upon properties of the debtor expressly declared exempt from judicial process by state law or policy.<sup>25</sup>

An interesting variation from this rule is provided by *United States v. Warren RR Co.*<sup>26</sup> There the taxpayer, a corporation, had leased property to another corporation under a rental arrangement whereby the tenant was to pay rent directly to the shareholders of the taxpayer corporation. At a later date the lessor corporation incurred tax liability to the United States upon the rents. The United States brought an action to collect these taxes by attaching the rental payments being made to the shareholders under the lease. The Second Circuit Court of Appeals held that the rental payments to the shareholders were subject to the federal lien for the corporation's taxes. The reasoning of the court was pragmatic; these payments were the only source from which the taxes could be satisfied. Since the rights of the shareholders to the rentals were derived from the taxpayer corporation, the court thought that, in equity, those derived rights should be burdened with the tax liability of the corporation.<sup>27</sup>

Despite this last decision, the lien for taxes is normally limited to the interests of the taxpayer in the property. If the taxpayer has hitherto validly conveyed his interests in a parcel of property to another party, the tax lien will not attach to that parcel.<sup>28</sup> However, this result can be modified if the transfer was in fraud of taxes. The United States may then proceed

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<sup>25</sup> See text *infra* at note 54.

<sup>26</sup> *Supra* note 21.

<sup>27</sup> *Accord*, *United States v. Morris & Essex R.R.*, *supra* note 6; *United States v. Utica R.R.*, 135 F.2d 922 (2d Cir. 1943). *Contra*, *Johnson v. Western Union Tel. Co.*, 293 N.Y. 379, 57 N.E. 2d 721 (1944). In *Commissioner v. Western Union Telegraph Co.*, 141 F.2d 774 (2d Cir. 1944) the reasoning of the *Warren* case was rejected by the Second Circuit Court of Appeals. The court found that the prior assignment of rights to the shareholders was valid; since the rentals were no longer the property of the taxpayer-corporation, the tax lien could not attach to them. However, the taxpayer had transferred the rentals from year to year to its shareholders by way of constructive dividends. Hence the court held that the shareholders were liable for the tax as transferees under INT. REV. CODE § 311.

<sup>28</sup> *United States v. Burgo*, 175 F.2d 196 (3rd Cir. 1949); *Schweinler v. Manning*, 88 F. Supp. 964 (D.C.N.J. 1949); *United States v. Safe Deposit Co. of N.Y.*, 15 F. Supp. 1080 (S.D.N.Y. 1936); *United States v. Bank of Rockville Centre Trust Co.*, 19 F. Supp. 124 (E.D. N.Y. 1937); *Driver v. Hooper*, 30 A.F.T.R. 1709 (N.D. Cal. 1942). Thus, in *Cannon v. Nicholas*, *supra* note 21, the court held that the interest of the beneficiary in a life insurance policy upon the life of the taxpayer could not be sold to pay the insured's taxes. Nor can property held by the taxpayer for the benefit of third parties be sold under the federal tax lien: *Schwarz v. United States*, *supra* note 21; *Tower Production Co. v. Jones*, 45 F. Supp. 593 (W.D. Okla. 1942), *rev'd on other grounds*, 138 F.2d 675 (10th Cir. 1943). Similarly, bonds held by a taxpayer only for the limited purpose of providing bail are not subject to distraint: *Jacobson v. Hahn*, *supra* note 21.

to set aside the conveyance to realize the amount of the taxes out of the property conveyed.<sup>29</sup>

The more difficult question has been to measure the extent to which the intangible is burdened by the lien. At first the courts apparently adopted the rule that the federal tax lien reached an intangible only to the extent that the taxpayer had present, accrued rights thereunder. Thus, if the taxpayer had conveyed all of his present interests in an intangible to others, the tax lien was held to be ineffectual.<sup>30</sup>

Also, the lien was limited to amounts presently owing or accrued on obligations at the time the lien was foreclosed.<sup>31</sup> Logically, it would follow that an intangible not in existence at the time the federal tax lien arose would not be reached by the lien. In other words, many courts did not treat the federal tax lien as a continuing lien.

In *Glass City Bank v. United States*,<sup>32</sup> the Supreme Court seized an opportunity to pass upon this question. The controversy was hatched by an attempt of the United States to foreclose its tax lien upon payments owed to the taxpayer for services as a receiver that were rendered five years after the lien had been perfected. The Court held that the tax lien caught the obligation owed to the taxpayer because the lien was a "continuing" lien. Basis for this conclusion was found in Section 3670 of the Internal Revenue Code where Congress had provided that the lien should "continue until the liability [for taxes] . . . is satisfied." Additional confirmation was presented by Section 3768, which stated that the lien might be foreclosed against property "owned by the delinquent, or in which he has any right, title, or interest." Both verbs indicated, to the Court, that property reached by the lien included property owned at foreclosure, even if acquired by the taxpayer after the effective date of the lien.

In effect, the Court held that the federal tax lien burdened after-acquired property or rights of the taxpayer. With this principle in mind, one can reconcile or explain the discrepancies in the decided cases. If the federal tax lien is capable of reaching property regardless of the date of acquisition, the courts could no longer be realistic in limiting foreclosure to rights that were present and vested at the time of foreclosure. To adopt such a rule would merely compel the United States to bring a series of suits in order to reach the rights of the taxpayer as they accrue.

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<sup>29</sup> See *United States v. Bank of Rockville Centre Trust Co.*, *supra* note 28; *United States v. Bleser*, 34 F. Supp. 653 (E.D. Wis. 1940); *United States v. DeMartini*, 53 F. Supp. 162 (N.D. Cal. 1943); *United States v. Phillips*, 59 F. Supp. 1006 (S.D. Ga. 1945); *Petrashich v. Credit Bureau of San Diego*, 27 A.F.T.R. 987 (S.D. Cal. 1940).

<sup>30</sup> *United States v. Western Union Telegraph*, 50 F.2d 102 (2d Cir. 1931), overruled by *United States v. Warren R.R.*, *supra* note 21, and see note 27.

<sup>31</sup> *United States v. Long Island Drug Co.*, *supra* note 21; *United States v. Dallas Nat'l Bank*, *supra* note 20.

<sup>32</sup> *Supra* note 17.



Thus, until recently the courts were reluctant to allow the federal government to foreclose its tax lien against a life insurance policy owned by the taxpayer.<sup>33</sup> However, an increasing number have reached the opposite result and permit the tax lien to be foreclosed upon life insurance policies to the extent of their cash surrender value. These courts pay but little heed to the question of whether or not the taxpayer's right to the cash surrender value is fully matured by proper surrender of the policy by him and by proper notice to the beneficiaries.<sup>34</sup> The earlier cases to the contrary emphasized the necessity of complying with the formal condition that the insured, not the Government, surrender the policy; until surrender, the insured has no property interest in the policy to which the tax lien can attach.<sup>35</sup>

Upon foreclosure on a policy, the Government is paid the cash surrender value of the policy if it has not matured. If, however, the insured is receiving benefits under the policy, the problem is more difficult. If the benefits are payable as a long-term annuity, the court may order the insurer to turn over the periodic payments on the policy to the Director until the tax liability is wiped out. More conveniently, the court may attempt to fix the present value of the annuity by agreement among the parties or by a forced sale of the policy and order that amount paid over to the Government.<sup>36</sup>

The rule that the tax lien is a continuing lien attaching to after-acquired property of the taxpayer applies to tangible real and personal property as well as to intangibles.<sup>37</sup>

To what extent does the tax lien burden property held in partnership? Apparently the answer to this query depends upon the type of tax involved.

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<sup>33</sup> *United States v. Massachusetts Mut. Life Ins. Co.*, 127 F.2d 880 (1st Cir. 1942); *United States v. Metropolitan Life Ins. Co.*, 130 F.2d 149 (2d Cir. 1942); *United States v. Pennsylvania Mut. Life Ins. Co.*, 130 F.2d 495 (3d Cir. 1942); *United States v. Aetna Life Ins. Co.*, *supra* note 21.

<sup>34</sup> *Kyle v. McGuirk*, *supra* note 21; *Cannon v. Nicholas*, *supra* note 21; *Smith v. Donnelly*, *supra* note 21; *United States v. Ison*, *supra* note 21; *United States v. Prudential Ins. Co.*, *supra* note 21; *United States v. Trout*, *supra* note 21; *Travelers Ins. Co. v. Hess*, 36 A.F.T.R. 1637 (E.D.Mo. 1946). See *United States v. Steele*, 26 A.F.T.R. 1186 (N.D.N.Y. 1939); *United States v. Bleser*, *supra* note 29; *Knox v. Great West Life Assurance Co.*, 109 F. Supp. 207 (E.D.Mich. 1952).

<sup>35</sup> See cases cited note 33, *supra*. An additional distinction between the two sets of opposing cases may be drawn from the type of foreclosure employed by the government. Where distraint is the procedure, only the taxpayer, the Director and the insurance company are concerned; however, where suit is brought, any beneficiary or other interested person may be made a party to prevent possible injustice.

<sup>36</sup> *Schwarz v. United States*, *supra* note 21.

<sup>37</sup> *Glass City Bank v. United States*, *supra* note 17. See G.C.M. 4715, VII-2 CUM. BULL. 94 (1928) and T.D. 4275, VIII-2 CUM. BULL. 167 (1929), prior administrative rulings, that were followed in the *Glass City Bank* case. See *Nelson v. United States*, *supra* note 17 (rule applied to tangible property).

If the tax is an individual liability of one of the partners, as is true for the federal income tax, the lien reaches only his interest in the partnership.<sup>38</sup> The rules of marshalling partnership assets require that the federal tax lien for individual taxes be subordinated to partnership debts, whether secured or unsecured. But, on the other hand, if the tax is a liability of the business, such as social security or withholding tax, the partnership itself would be primarily liable for the amount of the taxes. Consequently, a lien asserted for these taxes ought to be enforceable directly against the partnership assets and ought to take priority over partnership creditors who do not hold any security.<sup>39</sup>

Equitable interests in the hands of a taxpayer are subject to the federal tax lien. Thus, the presence of a valid prior mortgage on the taxpayer's property will not prevent the federal lien from attaching. Under these circumstances, the lien reaches only the equity of the taxpayer in the property.<sup>40</sup> Similarly, the lien will catch the interest of the vendor under a land-purchase contract.<sup>41</sup> The same rule applies to the rights of a taxpayer as vendee under a conditional sales contract.<sup>42</sup> Under the common-law view of conditional sales, a vendee in default possesses no enforceable rights under the contract to which the tax lien could attach.<sup>43</sup> However, in states that have adopted the Uniform Conditional Sales Act, the rights of the vendee are not fully forfeitable by the seller;<sup>44</sup> these rights would presumably be held to be subject to the tax lien.

The rules developed above the often stated in general terms: The rights of the Government to the taxpayer's property under a tax lien are no greater than the rights of the taxpayer. Or, to put it more simply, the tax collector stands in the shoes of the taxpayer when reaching the taxpayer's property.<sup>45</sup>

Pursuant to this general principle, the Government's lien upon obliga-

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<sup>38</sup> *United States v. Kaufman*, 267 U.S. 408 (1925) (income taxes); *Adler v. Nicholas*, 166 F.2d 674 (10th Cir. 1948) (permitting sale of partner's interest to satisfy taxes); I.T. 3356, 1940-1 CUM. BULL. 72 (1940) (income taxes). See A. H. Graves, 12 B.T.A. 124 (1928) for discussion of resulting priority of federal tax lien against partnership creditors.

<sup>39</sup> *Adler v. Nicholas*, *supra* note 38.

<sup>40</sup> *Metropolitan Life Ins. Co. v. United States*, *supra* note 15; *United States v. Sampsell*, 153 F.2d 731 (9th Cir. 1946); *Bank of America v. United States*, 84 F. Supp. 387 (S.D. Cal. 1949); *Sherwood v. United States*, 5 F.2d 991 (E.D.N.Y. 1925); *Oden v. United States*, 33 F.2d 553 (W.D. La. 1929).

<sup>41</sup> *Wallace v. Salome*, 36 A.F.T.R. 1651 (D.C. Tex. 1946).

<sup>42</sup> *Tildesley Coal Co. v. American Fuel Corp.*, 45 S.E.2d 750 (W. Va. 1947); *Moran v. Leccony Smokeless Coal Co.*, 10 S.E.2d 578 (W. Va. 1940), *cert. denied*, 311 U.S. 714 (1940).

<sup>43</sup> 3 WILLISTON, SALES § 579e (Rev. ed. 1948).

<sup>44</sup> UNIFORM CONDITIONAL SALES ACT §§ 17, 18, 21, 22. See 3 WILLISTON, SALES § 579d.

<sup>45</sup> *United States v. Warren R.R.*, *supra* note 21; *Karno-Smith Co. v. Maloney*, 112 F.2d 690 (3d Cir. 1940); *United States v. Winnett*, 165 F.2d 149 (9th Cir. 1947); *McGraw & Co. v. Sherman Plastering Co.*, 60 F. Supp. 504 (D.C. Conn. 1943), *aff'd*, 149 F.2d 301 (2d Cir. 1945); *Board of Supervisors v. Hart*, 210 La. 78, 26 So.2d 361 (1946); *United States v. Yates*, 204 S.W.2d 399 (Tex. Civ. App. 1947).

tions owing to the taxpayer by third parties will be subject to any set-off the third party debtors might possess against the taxpayer. Thus, where the taxpayer had loaned money to *A* under a promissory note providing that *A* should have the right to set-off his claims against the taxpayer, the lien of the United States could be enforced only to the net amount owed by the debtor. *A* has been permitted to set-off his unsecured claims against the taxpayer, although these claims arose after the lien of the Federal Government had been filed for record.<sup>46</sup>

Correct as an application of this rule may be in certain situations, its use by the courts in other places leads to absurd results. Illustrations are abundant to show that the "in his shoes" principle has been severely abused, clouding issues of priorities and rights that otherwise would be clear. To guard against such misapplications of the doctrine, one should keep in mind certain factors. In the first place, the time of application is important. Once the federal tax lien has attached to certain property, the taxpayer is powerless to affect or to destroy the rights of the Government. Conveyances, releases, disaffirmances or other actions by the taxpayer after that date will not prejudice the rights of the United States.<sup>47</sup> As of the date that the lien attaches, the property has, in effect, two owners, the United States and the taxpayer.<sup>48</sup>

Second, the rule should be considered in its proper context. Its application is dependent upon the nature of the question to be answered. For instance, the principle may be a valid guide to measure the quantum of property reached by the lien, but it is totally useless as a touchstone for determining priority between competing creditors to the same property. One court, in dealing with the relative priorities of the Federal Government and an attaching creditor, reasoned that since the taxpayer's interests were burdened by the attachment, the Government's rights were similarly bur-

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<sup>46</sup> *United States v. Wimett*, *supra* note 45. *Accord*, *Karno-Smith v. Maloney*, *supra* note 45; *United States v. Long Island Drug Co.*, *supra* note 21. Similarly, a bank holding credits of a taxpayer may set off its debts against a levy made by the Collector: *United States v. Bank of United States*, 5 F. Supp. 942 (S.D.N.Y. 1934); *United States v. Bank of Shelby*, 68 F.2d 538 (5th Cir. 1934). *Contra*, where bank's set-off limited to special indemnity agreement: *Commonwealth Bank v. United States*, 115 F.2d 327 (6th Cir. 1940). See statutory recognition of this rule in FEDERAL BANKRUPTCY ACT § 68, 11 U.S.C. § 110 (1946). Furthermore, the United States itself would be entitled to a set-off if it were the obligor and also held a tax claim: *Seaboard Surety Co. v. United States*, 67 F. Supp. 969 (Ct. Cl. 1946); REV. STAT. § 236 (1878), 31 U.S.C. § 71 (1946); 18 STAT. 481 (1933), 31 U.S.C. § 277 (1946). See 47 AM. JUR. 718 *et seq.* (1943); *United States v. Earle*, P-H 1952 FED. TAX. SERV. ¶72,339 (1952).

<sup>47</sup> *Knox v. Great West Life Assurance Co.*, *supra* note 34; *United States v. Vega*, 34 A.F. T.R. 1712 (S.D. Cal. 1945); *United States v. Haskell Tel. Co.*, 42 F. Supp. 498 (N.D. Tex. 1939); *Benson v. Burke*, 30 A.F.T.R. 1639 (D.C. Kan. 1942). See, prior to the 1913 amendment, *Blacklock v. United States*, *supra* note 9, and *United States v. Snyder*, *supra* note 7. Nor does a tax sale by a municipality cut-off an earlier tax lien. *United States v. Gilbert Associates, Inc.*, 73 S. Ct. 701 (1953).

<sup>48</sup> *United States v. City of Greenville*, *supra* note 14.

dened.<sup>49</sup> To use this reasoning between competing claimants is nonsense. Naturally the Government, or any other party, will be denied priority if placed in the taxpayer's shoes; the creditor not so shod will always be preferred. The question of priority between lien creditors cannot be decided fairly by attributing to either the rights of the debtor. To place a decision upon the principle that one creditor is limited to the rights of the debtor is to build the judgment upon sand.

Similarly, the rule has little value if employed to decide whether or not a third party has any right of set-off upon an obligation owed to the taxpayer, where the obligation is also subject to the federal tax lien. Clearly, if the third party debtor has a right of set-off under local law, he will be entitled to assert that right against both the taxpayer and the federal tax lien.<sup>50</sup> Also, if the debtor has the right of set-off under the terms of the obligation, he may assert a set-off against the Federal Government. But in the absence of these conditions, should the obligor be permitted to make a set-off?<sup>51</sup> Furthermore, should the rights of the United States, in the face of a set-off, be limited to those of the taxpayer? Since the position of the United States is here similar to that of a garnishing or attaching creditor,<sup>52</sup> its rights should be higher than those of the taxpayer. Once notice has been given to the third party debtor by the United States, the normal rights and obligations of a garnishee-garnishor relationship should arise. Defenses and set-offs arising after such notice that would not be valid as against a garnishor should not, by analogy, be available to a debtor upon whom the United States has served a notice of levy to collect the taxes. Some support for this view is found in the decision that a lessee of the taxpayer's premises was not entitled to a set-off against the taxpayer when both the lease and the set-off had arisen after the tax lien had attached to the property. Both the rights of the taxpayer and the lessee under the lease "were born with the tax lien impressed thereon."<sup>53</sup>

### *Property Exempt or Immune from Creditor's Process*

Of crucial importance is the fact that exemptions and immunities of property from creditor's processes provided by state law are ineffective to

<sup>49</sup> *Board of Supervisors v. Hart*, *supra* note 45. For similar reasoning see *United States v. Yates*, *supra* note 45.

<sup>50</sup> *Karno-Smith Co. v. Maloney*, *supra* note 45.

<sup>51</sup> *United States v. Winnett*, *supra* note 45; *United States v. Long Island Drug Co.*, *supra* note 21. See *Commonwealth Bank v. United States*, *supra* note 46, where the obligor was unable to prove such an agreement. The federal courts have held that equitable principles of set-off would be applied to benefit third party obligors in a controversy with the tax collector, apart from rights arising under local law or contract. *United States v. Bank of Shelby*, *supra* note 46; *United States v. Bank of United States*, *supra* note 46.

<sup>52</sup> See *United States v. Bank of Shelby* and *United States v. Bank of United States*, *supra* note 46.

<sup>53</sup> *United States v. Graham*, *supra* note 17. See *United States v. Manufacturers Trust Co.*, P-H FED. TAX SERV. ¶72,555 (2d Cir. 1952), holding that the Collector's right to a bank account is superior to the rights of the depositor-taxpayer.

bar the federal tax lien.<sup>54</sup> These decisions are based upon the supremacy clause of the Federal Constitution: to permit each state to exempt property from the federal lien would impair the pre-eminent right of the United States to collect its revenue.

Thus, homestead protections designed by state law to free certain property from creditor's levy are of no effect against the federal tax lien.<sup>55</sup> Furthermore, state exemption of insurance proceeds does not bind the Federal Government.<sup>56</sup> Similarly, the interest of a taxpayer as the beneficiary of a spendthrift trust, although immune from other creditors under state law, is subject to foreclosure of the federal tax lien.<sup>57</sup> Nor are the immunities of a state stock-transfer act or of a workmen's compensation act of any effect.<sup>58</sup>

On the other hand, exemptions and immunities provided by federal law will prevail. Thus, the property listed in Section 3691, Internal Revenue Code, is immune from foreclosure of the federal tax lien.<sup>59</sup> Similarly, the cash-surrender value of veterans' war-risk insurance policies was held to be free of the tax lien, because the exemption had been set up by federal statute.<sup>60</sup>

Although state exemptions of property are not controlling, a state may

<sup>54</sup> *United States v. City of Greenville*, *supra* note 48.

<sup>55</sup> *United States v. Heffron*, 158 F.2d 657 (9th Cir. 1947); *Shambaugh v. Scofield*, 132 F.2d 345 (5th Cir. 1942); *Jamison v. Geers*, 16 A.F.T.R. 1040 (W.D. Okla. 1935); *Staley v. Vaughn*, 50 S.W.2d 907 (Tex. Civ. App. 1932). See *Jones v. Kemp*, 144 F.2d 478 (10th Cir. 1944).

<sup>56</sup> *Kieferdorf v. Commissioner*, 142 F.2d 723 (9th Cir. 1944), *cert. denied*, 323 U.S. 733 (1944); *Cannon v. Nicholas*, *supra* note 21; *Kyle v. McGuirk*, *supra* note 21; *Pearlman v. Commissioner*, 153 F.2d 560 (3d Cir. 1946); *Smith v. Donnelly*, *supra* note 21; *United States v. Steele*, *supra* note 21; *Christine D. Muller*, 10 T. C. 678 (1948); *Knox v. Great West Life Assurance Co.*, *supra* note 34.

<sup>57</sup> *United States v. Dallas National Bank*, *supra* note 20; *Mercantile Trust Co. v. Hofferbert*, 58 F. Supp. 701 (D.C. Md. 1944), *aff'd*, 62 F. Supp. 837 (D.C. Md. 1945); *United States v. Canfield*, *supra* note 21. See GRISWOLD, SPENDTHRIFT TRUSTS § 345 (1936). The tax lien reaches the interest of a beneficiary in a spendthrift trust created by restraining the beneficiary's power of alienation: *In re Rosenberg's Will*, *supra* note 21.

<sup>58</sup> Workmen's Compensation Act: *United States v. Ocean Accident & Guaranty Corp.*, *supra* note 21. Stock Transfer Act: *United States v. Rosenfield*, 26 F. Supp. 433 (E.D. Mich. 1938).

<sup>59</sup> That section provides, "There shall be exempt from distraint and sale, if belonging to the head of a family (1) School books and wearing apparel—The school books and wearing apparel necessary for such family; also (2) Arms—Arms for personal use; (3) Livestock—One cow, 2 hogs, 5 sheep and the wool thereof, provided the aggregate market value of said sheep shall not exceed \$50; (4) Fodder—The necessary food for such cow, hogs, and sheep, for a period not exceeding thirty days; (5) Fuel—Fuel to an amount not greater in value than \$25; (6) Provisions—Provisions to an amount not greater than \$50; (7) Household furniture—Household furniture kept for use to an amount not greater than \$300; and (8) Books and tools of trade or profession—The books, tools, or implements, of a trade or profession; to an amount not greater than \$100."

<sup>60</sup> G.C.M. 16092, XV-1 CUM. BULL. 499 (1936).

reach the same result for certain property by redefining the rights of the taxpayer therein. For instance, if the state legislature, instead of decreeing an immunity for existing property rights, creates a new estate in which the taxpayer's rights cannot be divested, the tax lien cannot be foreclosed upon the newly created estate. For example, in Texas and Oklahoma the homestead protection given to a husband and wife is not a statutory immunity; rather, it is a new estate consisting of a joint and indivisible right in the husband and wife which cannot be conveyed or divested without the consent of both spouses. Under such circumstances, a federal tax lien against one of the spouses cannot be foreclosed against the homestead because a forced sale or forced partition would be tantamount to taking the property of a third party to satisfy the tax liability of the taxpayer.<sup>61</sup>

Following this line of reasoning, the courts have held that a taxpayer's interest in a tenancy by the entireties is not subject to the federal tax lien, unless the non-taxpaying spouse consents to the foreclosure.<sup>62</sup> An interesting variation of this concept was presented in *Schwarz v. United States*.<sup>63</sup> There the husband taxpayer claimed that certain real property was not reached by the federal tax lien because the property was held by the entireties with his wife. The court, however, found that the parties were not validly married at the time of the transfer of the property to them; hence, no tenancy by the entireties had been created. However, the court found that the putative wife had paid for the property and had believed herself, in good faith, to be married to the taxpayer at the time of the purchase. Refusing to permit the Government to profit by the wrong of the taxpayer, the court held that the property belonged to the wife under a resulting trust (failure of parties' intent to create a tenancy by the entireties) or under a constructive trust (fraud of taxpayer on wife). Thus, the property was not caught by the tax lien.

Concerning community property, the result is difficult to foresee. If both spouses have a vested interest in the community and if they have filed a joint return for the tax liability upon which the assessment arose, the Federal Government may clearly foreclose its lien.<sup>64</sup> But where the liability is that of only one spouse, the solution is less apparent. In California, where the interest of each spouse is a present vested interest and the *husband* is

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<sup>61</sup> *Bigley v. Jones*, 64 F. Supp. 389 (W.D. Okla. 1946); *Morgan v. Moynahan*, 86 F. Supp. 522 (S.D. Tex. 1949); *Paddock v. Siemoneit*, 218 S.W.2d 428 (Tex. Civ. App. 1949).

<sup>62</sup> *United States v. Hutcherson*, 188 F.2d 326 (8th Cir. 1951); *United States v. Nathanson*, 60 F. Supp. 193 (E.D. Mich. 1945); *Shaw v. United States*, 94 F. Supp. 245 (W.D. Mich. 1939); *Ullman v. Rothensies*, 24 A.F.T.R. 1200 (E.D. Pa. 1939), *appeal dismissed*, 110 F.2d 590 (3rd Cir. 1940); *Wallace v. Mestichelli*, 36 A.F.T.R. 1650 (Pa. Com. Pleas 1946); *Raffaele v. Granger*, P-H 1952 FED. TAX SERV. ¶72,444 (3rd Cir. 1952).

<sup>63</sup> *Supra* note 21.

<sup>64</sup> *Smith v. Donnelly*, *supra* note 21.

generally given the power to manage and control the community,<sup>65</sup> it should follow that his separate tax liability can be satisfied out of one-half of the community. Having the power to convey the community assets,<sup>66</sup> the husband can offer no defense to the foreclosure of the tax lien against his interest. It would further appear that the *wife's* one-half interest in the community can be reached by the Federal Government under rights conferred upon creditors by California law, making *all* the community property liable for the debts of the husband.<sup>67</sup> However, the tax liability of the wife is another matter. No rights may be claimed by the Director under California law since community property is not liable for the debts of the wife arising after marriage.<sup>68</sup> True, the wife has a vested one-half interest which would appear to qualify as "property" within the meaning of Section 3670, but her right to manage and to convey that interest is absent, except in the case of her own earnings.<sup>69</sup> If the theory of the homestead estate and the tenancy by the entireties cases is adopted, it should follow that none of the community (other than the wife's earnings) is liable for the wife's taxes; the disability upon the wife is more in the nature of a limitation upon her rights in the community estate than an exemption or immunity from process. To seize community assets to satisfy her liability would deprive the husband without his consent of his right to control and to enjoy all of the community estate. However, if the tax liability of the wife has arisen from the receipt of *community income* split between the spouses, the income itself would be subject to his control. Under such circumstances, equity may demand that the tax lien be satisfied out of community assets. As one of the few reported cases in this field has reasoned, "[the husband] as sole manager of the community enterprise, is personally liable for the payment . . ." of the wife's separate tax liability on her share of community income.<sup>70</sup> But where the wife's taxes were produced out of her separate property, the result may well be different; no power exists in the husband which can serve as a handhold for decreeing personal liability on his part.<sup>71</sup>

<sup>65</sup> CAL. CIV. CODE §§ 161a, 172. This statement does not apply to the wife's earnings, which are subject to her management. CAL. CIV. CODE § 171c.

<sup>66</sup> Subject to certain exceptions noted in CAL. CIV. CODE §§ 172, 172a.

<sup>67</sup> *Ibid.*

<sup>68</sup> CAL. CIV. CODE § 167. This section, being a state immunity, would have no effect on the rights of the United States.

<sup>69</sup> CAL. CIV. CODE § 161a. Community property arising from the wife's earnings would probably be subject to liens for her taxes to the same degree other community property is for the husband's taxes, under CAL. CIV. CODE § 171c, enacted 1951, giving the wife management of her own earnings.

<sup>70</sup> *In re Ryan*, P-H 1951 FED. TAX SERV. ¶72,669, 2 CCH 1951 FED. TAX SERV. ¶9493 (S.D. Cal. 1949), which dealt with the liability of community property in a bankrupt husband's estate for the wife's taxes arising out of her share of community income.

<sup>71</sup> Additional support for this distinction is furnished by a ruling of the Bureau of Internal Revenue that a resident husband is required to withhold the amount of his wife's income taxes arising out of her share of their community income. I.T. 3859, 2 CUM. BULL. 98 (1947). The same argument may apply to community property arising from the wife's earnings.

These cases illustrate the general rule that the definitions of the terms "property" and "rights to property" used in Section 3670, Internal Revenue Code, must be found by reference to state law. So long as no definition of either term is specified in the federal statutes, state laws measuring the quantum and nature of property interests will control.<sup>72</sup>

### *Priority of the Federal Tax Lien*

In determining priority, one must carefully keep in mind the fact that the tax lien is valid against all parties, except those listed in Section 3672, Internal Revenue Code, *from the date that the assessment list was received* by the local Director of Internal Revenue.<sup>73</sup> As to the classes named in Section 3672, the lien is effective from the date upon which notice of lien is filed. With this distinction in mind, one can state that the normal rule of priority—first in time, first in right—applies to the federal tax lien.<sup>74</sup> State law to the contrary is ineffectual,<sup>75</sup> for the matter of priority between the federal lien and any other interest is a federal question.<sup>76</sup> State law is useful, however, to define the extent of the opposing claim of lien by determining whether or not the lien under local law is treated as a "perfected" lien or merely as a "caveat of a more perfect lien to come."<sup>77</sup>

The place for filing the notice of tax lien in order that it operate against Section 3672 classes can be determined by state legislation. The federal statute provides that notice of lien should be filed in the place designated

<sup>72</sup> *Karno-Smith Co. v. Maloney*, *supra* note 45; *Cannon v. Nicholas*, *supra* note 21; *Metropolitan Life Ins. Co. v. United States*, *supra* note 15; *United States v. Winnett*, *supra* note 45; *United States v. Dallas National Bank*, *supra* note 20. But see *Glass City Bank v. United States*, *supra* note 17, where the taxpayer argued that an obligation to pay for services was not "property" or a "right to property" under Pennsylvania laws and therefore not subject to the federal tax lien. In refuting this contention, the Supreme Court stated, "Moreover, the Congressional meaning is not to be determined by resorting to the local law of Pennsylvania."

<sup>73</sup> See INT. REV. CODE § 3671 and note 151, *infra*.

<sup>74</sup> *United States v. City of Greenville*, *supra* note 48; *United States v. Sampson*, *supra* note 40; *Citizens State Bank of Barstow, Texas v. Vidal*, *supra* note 17; *Cobb v. United States*, *supra* note 17. This rule of priority is followed despite a state statute declaring specifically that the competing lien shall be a first lien upon the property. *United States v. Reese*, *supra* note 15; *Littlestown Nat'l Bank v. Penn. Tile Works Co.*, 352 Pa. 238, 42 A.2d 606 (1945).

There are several decisions to the contrary. *City of Winston-Salem v. Powell Paving Co.*, *supra* note 15; *In re Mt. Jessup Coal Co.*, 7 F. Supp. 603 (M.D. Pa. 1934) (where state statute made the local lien a "first lien" upon the premises); *In re Wyley Co.*, 292 Fed. 900 (N.D. Ga. 1923) (distribution in bankruptcy to tax liens of federal government and local authority made pro-rata, because the federal statute does not specify that the federal tax shall first be paid); *Adams v. O'Malley*, *supra* note 17 (pro-rata distribution in bankruptcy among statutory liens for taxes upon analogy to § 64a of the Bankruptcy Act providing for such pro-rata among unsecured tax claims); *Miners Savings Bank v. Joyce*, 97 F.2d 973 (3d Cir. 1938) (local tax lien payable first in bankruptcy because local law made it a "first lien").

<sup>75</sup> *United States v. Reese*, *supra* note 15; *Littlestown Nat'l Bank v. Penn. Tile Works Co.*, *supra* note 74.

<sup>76</sup> *United States v. Security Tr. and Sav. Bank*, 340 U.S. 47 (1950).

<sup>77</sup> *Spokane County v. United States*, 279 U.S. 80 (1929).



by the state; in the absence of such designation, the proper place is with the clerk of the United States district of the district in which the property is located.<sup>78</sup> Most state statutes enacted pursuant to this federal authorization provide that notice of lien be filed with the local recorder of the county in which the property is situated.<sup>79</sup> Under these statutes, the general rules of situs of property are applied.<sup>80</sup>

Despite this enabling act, the requirements of state law for recording an instrument do not apply to the federal tax lien. The congressional delegation of authority to state legislatures goes only to designating the *place* in which notices of tax lien may be filed; the states are not empowered to attach other conditions to the filing of the notice, such as, that instruments affecting real property contain a description thereof,<sup>81</sup> that the instrument be acknowledged,<sup>82</sup> or that the filing of the lien be accompanied by other acts.<sup>83</sup> The rule in the Sixth Circuit, however, is contrary to this statement: there, notice of tax lien is ineffective to burden real property unless a description is contained in the notice.<sup>84</sup>

A federal statute that requires a particular place for filing a lien will

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<sup>78</sup> INT. REV. CODE § 3672 provides, "Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Collector (1) In the office in which the filing of such notice is authorized by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law authorized the filing of such notice in an office within the State or Territory; or (2) In the office of the clerk of the District Court of the United States for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law authorized the filing of such notice in an office within the State or Territory . . ."

<sup>79</sup> See table of statutes gathered at P-H 1952 FED. TAX SERV. ¶19,912 (1952).

<sup>80</sup> Thus, for intangibles or other personal property, the situs is at the domicile of the owner. *Investment & Securities Co. v. United States*, *supra* note 17; *United States v. Spreckels*, 50 F. Supp. 789 (N.D. Cal. 1943). But where the property is located in one state and the lien filed in another, the lien did not reach a vessel to the detriment of other securities. *Gulf Coast Marine Ways Inc. v. The Trawler J. R. Hardee*, P-H 1952 FED. TAX SERV. ¶72,604 (S.D. Tex. 1952).

<sup>81</sup> See *United States v. City of Greenville*, *supra* note 48. *In re Dartnont Coal Co.*, 46 F.2d 455 (4th Cir. 1931) held invalid a state statute adopted pursuant to § 3672 which provided that all previous notices of lien filed with the district court prior to the state statute be invalid four months after the state enactment was passed.

<sup>82</sup> G.C.M. 26419, 1 CUM. BULL. 125 (1950).

<sup>83</sup> Such as meeting the requirements of the Uniform Warehousing law. *United States v. Caldwell*, *supra* note 17.

<sup>84</sup> *United States v. Maniacci*, 116 F.2d 935 (6th Cir. 1940); *Youngblood v. United States*, 141 F.2d 912 (6th Cir. 1944); *United States v. City of Detroit*, 30 A.F.T.R. 1714 (E.D. Mich. 1942); *Hicks v. Carpenter*, P-H 1950 FED. TAX SERV. ¶72,432 (1950). This problem is no longer one of constitutional law under Art. II, § 8 and Art. VI of the United States Constitution which permit Congress to levy and collect taxes free of state interference as emphasized in *United States v. Snyder*, *supra* note 7. It is now a matter of legislative construction to determine the scope of authority delegated to the states by Congress under § 3672. For a thorough discussion of the difficulties that the decision of the Sixth Circuit has caused, see L. Hart Wright, *Title Examinations in Michigan as Affected by the General Federal Tax Lien*, 51 MICH. L. REV. 183 (1952).

take precedence over Section 3672. For instance, in order to have an effective lien upon an airplane, the Director must file his notice of lien with the Civil Aeronautics Board as required by the federal Civil Aeronautics Act.<sup>85</sup>

If the notice of lien has been properly filed for record, the most important question to be answered in deciding priorities is whether or not the competing lien comes within the protection of Section 3672 as against the assessment lien. Each class therein protected is named by the statute, but the limits-defining the scope of the class are established by the cases. As a general rule, the burden is upon the competing lien claimant to show that he is within one of the favored classes.<sup>86</sup>

The first group is entitled "mortgagees." Consequently, one having the status of a mortgagee, or beneficiary under a deed of trust, can claim a superior lien if his mortgage or deed of trust was recorded before notice of tax lien was filed.<sup>87</sup> This rule is followed even though the mortgage may have been recorded after the assessment lien had arisen.<sup>87a</sup> Furthermore, under the words of Section 3672, the fact of recording would appear to be immaterial. In other words, a mortgage *executed* before notice of lien was filed would be superior to a federal tax lien, although not recorded until after notice of tax lien was filed. However, the courts have been reluctant to reach this conclusion. Where the mortgage is capable of being recorded, the courts fear the possibility of fraud on the part of the taxpayer and his mortgagee. District Judge Kennamer well expressed this fear in *Exchange National Bank of Tulsa v. Davy*.<sup>88</sup>

<sup>85</sup> See *All American Airways Inc. v. United States*, 2 CCH 1949 FED. TAX REP. ¶9373 (S.D. Cal. 1949) affirmed as consent judgment, 180 F.2d 592 (9th Cir. 1950). Also notice of lien should be filed with the Collector of Customs in the home port of a vessel under the Preferred Ship Mortgage Act. *Gulf Coast Marine Ways Inc. v. The Trawler J. R. Hardee*, *supra* note 80.

<sup>86</sup> *MacKenzie v. United States*, *supra* note 8; *Filipowicz v. Rothensies*, *supra* note 17.

<sup>87</sup> *Metropolitan Life Ins. Co. v. United States*, *supra* note 15; *Miners Savings Bank v. Joyce*, *supra* note 74; *United States v. Sampsell*, *supra* note 40; *Bigley v. Jones*, 64 F. Supp. 389 (W.D. Okla. 1946); *Sherwood v. United States*, 5 F.2d 991 (E.D. N.Y. 1925); *Ormsbee v. United States*, 23 F.2d 926 (S.D. Fla. 1928); *Fox v. Queens County Sales Co.*, 52 F.2d 794 (E.D. N.Y. 1931); *In re Fahnestock Mfg. Co.*, 7 F.2d 777 (W.D. Pa. 1925); *McLaughlin, Taylor Co. v. United States*, 15 A.F.T.R. 515 (W.D. Wash. 1927); *Trust Co. of Texas v. United States*, 3 F. Supp. 683 (S.D. Tex. 1933); *First Nat'l Bank of Waco v. McCune*, 34 A.F. T.R. 1637 (W.D. Tex. 1945); *Bank of America v. United States*, *supra* note 40; *Minn. Mut. Life Ins. Co. v. United States*, 47 F.2d 942 (N.D. Tex. 1931); *Exeter Banking Co. v. Sleeper*, P-H 1952 FED. TAX SERV. ¶72,349 (1952); *Hopkins v. Eureka Coal Co.*, 33 A.F.T.R. 1627 (Cir. Ct. of W. Va. 1944); *United States v. Beggerly*, P-H 1952 FED. TAX SERV. ¶72,465 (S.D. Cal. 1952); *Bannister v. Yakima-Sloshone Mining Co.*, 26 A.F.T.R. 1010 (D.C. Idaho, 1939).

<sup>87a</sup> *Ferris v. Chic-Mint Gum Co.*, *supra* note 8.

<sup>88</sup> 13 F. Supp. 226, 228 (N.D. Okla. 1936). This language is dictum, for the court was dealing with an assignment of an equitable interest not capable of being recorded. Consequently, its rationale quoted above was not appropos, and the court held that the unrecorded assignment was entitled to priority from its date of execution. Accord, on this latter point concerning instruments not within the recording acts. *Equitable Life Assurance Co. v. Moore*, 29 F. Supp. 179 (E.D. Ill. 1939); *In re Van Winkle*, 49 F. Supp. 711 (W.D. Ky. 1943).

No case has been submitted which extends the ruling (that the tax lien, until filed for record, is subordinate to a mortgage) to unrecorded mortgages, and in my opinion, to so extend it, would open a way for fraud and wrongdoing, to the great prejudice of the government. The act should not be construed to declare the tax liens invalid as against a mortgagee who has not recorded his mortgage, because of the provisions relating to the filing of notice. This clearly is intended to place the government in the same position as any other lienholder who is diligent in filing or recording liens, and it is to be accorded the same rights and benefits of the recording statutes which are given individuals.

Thus, although the statutory wording is not clear, courts have held that a mortgagee is not entitled to superiority over a federal tax lien unless he has recorded his mortgage.<sup>89</sup> Furthermore, if the mortgage has not been recorded, the government may be entitled, *under state law*, to attack it as an unrecorded conveyance.<sup>90</sup>

Section 3672 does not say anything about the effect of actual notice on the mortgagee's priority. If the mortgagee must be a bona fide encumbrancer, actual notice to him of the existence of an assessment lien against the mortgagor at the time the mortgage is given would void the mortgage as to the federal tax lien. In *United States v. Beaver Run Coal Company* this question was squarely presented. The court reasoned that it had no power to "read into the Act (§ 3672) restrictions and limitations which are not there" and therefore held that the good faith of the mortgagee was immaterial. The mortgagee there, possessing actual notice of the taxes, was therefore entitled to priority over the tax lien.<sup>91</sup> This rule was subsequently applied in a case where the trial court had found that the mortgage was given for the purpose of evading the payment of the federal tax!<sup>92</sup>

Extending the rationale of these cases, the courts have also held that the mortgagee need not give a present valuable consideration in order to assert his mortgage against the tax lien. An antecedent debt is sufficient consideration,<sup>93</sup> and presumably so too would be promises of future services or payments.

What then of future advances under a mortgage expressly providing for additional loans after the date of execution of the mortgage? If the future advances by the mortgagee are mandatory under the terms of the

<sup>89</sup> *In re F. MacKinnon Mfg. Co.*, 24 F.2d 156 (7th Cir. 1928); *Underwood v. United States*, 37 F. Supp. 824 (E.D. Tex. 1939), *aff'd*, 118 F.2d 760 (5th Cir. 1941); *Plains Motors Inc. v. Clark*, P-H 1952 FED. TAX SERV. ¶72,594 (D.C. Wyo. 1952). The converse is also true; a federal tax lien does not burden real property in which the taxpayer has but an unrecordable equitable interest. *United States v. Dickerson*, 101 F. Supp. 262 (E.D. Mo. 1951).

<sup>90</sup> *Underwood v. United States*, 118 F.2d 760 (5th Cir. 1941); *Edmundson v. Scofield*, 92 F. Supp. 91 (S.D. Tex. 1950).

<sup>91</sup> *United States v. Beaver Run Coal Company*, *supra* note 8.

<sup>92</sup> *Schmitz v. Stockman*, 151 Kan. 891, 101 P.2d 962 (1940).

<sup>93</sup> *Ferris v. Chic-Mint Co.*, *supra* note 8.

mortgage, those advances should be entitled to the same priority as the original loan. If, however, the advances are optional with the mortgagee, the federal tax lien might well be preferred to advances made after the date of filing notice of lien. These advances are analogous to the creation of a new mortgage in favor of the same party for the additional amounts loaned. In the case of a new mortgage for an additional loan, of course, the tax lien is clearly prior, if filed in the interim between the original and the new mortgage.<sup>94</sup> Nor should the mortgagee take comfort in the doctrine of relation back, that is, that the later advance will be related back in time to the date of the original loan for priority purposes. The Supreme Court has stated, in a federal tax lien controversy, that the doctrine is a fiction which will not "operate to destroy the realities of the situation."<sup>95</sup> But where the jurisdiction has protected the mortgagee for optional future advances from the onslaught of other encumbrancers, it has been held that the federal lien is also subordinate to the later advances.<sup>96</sup>

Despite this favoring of the mortgagee, he is not entitled to priority as to additional security acquired by him after notice of tax lien has been filed against the mortgagor. Thus, an assignment of rents on mortgaged property to the mortgagee after notice of lien has been filed was ruled ineffective to bar the tax lien.<sup>97</sup>

The second class of Section 3672 given protection from the assessment lien is "pledgees." If a valid pledge of personal property is made by the taxpayer prior to the time that notice of tax lien is filed, the pledgee's rights to the property will be superior to those of the government. If the pledge arises after notice of lien has been filed, the tax lien is paramount.<sup>98</sup>

"Purchasers" constitute the third classification preferred by Section 3672. The term has been defined to include "one who, for a valuable present consideration, acquires property or an interest in property."<sup>99</sup> It has been

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<sup>94</sup> *United States v. Schwarz*, P-H 1951 FED. TAX SERV. ¶72,201 (D.C. Md. 1950), *rev'd on another point*, 191 F.2d 618 (4th Cir. 1951).

<sup>95</sup> *United States v. Security Tr. and Sav. Bank*, *supra* note 76.

<sup>96</sup> *The Peoples Bank v. United States*, 98 F. Supp. 874 (N.D. Ga. 1951), reversed on ground that new loan was not an "advance" under the mortgage, P-H 1952 FED. TAX SERV. ¶72,548 (5th Cir. 1952); but see *United States v. Phillips*, *supra* note 29.

<sup>97</sup> I.T. 3347, 1 CUM. BULL. 69 (1940).

<sup>98</sup> *United States v. Stripling*, 2 CCH 1952 FED. TAX REP. ¶9565 (N.D. Tex. 1952); *United States v. Caldwell*, *supra* note 17; *Union Guardian Trust Co.*, 41 B.T.A. 1306 (1940). This protection is given the pledgee only if the pledge was made after June 29, 1939, when the statute was amended to include pledgees. *Investment & Securities Co. v. United States*, *supra* note 17; *Equitable Life Assurance Soc. v. Moore*, *supra* note 88; *Warwick Hotel Inc. v. Scofield*, 32 A.F.T.R. 1756 (S.D. Tex. 1943). If the pledge is of securities, actual notice must be given the pledgee in order that the lien be effective. This point is discussed further, *infra*.

<sup>99</sup> *National Refining Co. v. United States*, 160 F.2d 951 (8th Cir. 1947).

held that the relinquishment of a debt is such present consideration.<sup>100</sup> Furthermore, the term includes a conditional sales purchaser.<sup>101</sup>

In applying the term "purchasers" as distinguished from the decisions concerning "mortgagees," some courts have been willing to read the bona fide purchaser doctrine into Section 3672. Thus, it has been stated that to be protected from the assessment lien, one must be a "bona fide purchaser"<sup>102</sup> or must be a "purchaser without notice."<sup>103</sup> This question has arisen most frequently in the sale of the assets of a business, where the present owners wish to change the form of business ownership from, for instance, a partnership to a corporation. Since the human owners of the business are the same before and after the transaction, the courts have held that the successor to the business assets does not take free of a pre-existing assessment lien, although valuable consideration may have been given for the transfer. The courts point out that the successor firm, composed of the same humans, had actual notice of the tax liability and therefore took the assets subject to the federal lien.<sup>104</sup>

The fourth class of protected parties within the terms of Section 3672 is "judgment creditors." Thus the question of priority depends upon whether the judgment became a lien before the notice of tax lien was filed.<sup>105</sup> As implied in the preceding sentence, the judgment creditor must take the proper steps under state law to reduce his judgment to a lien against specific property of the taxpayer before he is entitled to priority

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<sup>100</sup> *United States v. Rosebush*, 45 F. Supp. 664 (E.D. Wis. 1942); but past consideration is insufficient; *Faddis v. Schobert*, P-H 1953 FED. TAX REP. ¶72,421 (1953); *contra*, *Hawkins v. Savage*, 1 CCH 1953 FED. TAX REP. ¶9343.

<sup>101</sup> *Tildesley Coal Co. v. American Fuel Corp.*, *supra* note 42.

<sup>102</sup> *United States v. Rosebush*, *supra* note 100.

<sup>103</sup> *Heyward v. United States*, 2 F.2d 467 (5th Cir. 1924); *United States v. Dickerson*, 101 F. Supp. 262 (E.D. Mo. 1951).

<sup>104</sup> *Heyward v. United States*, *supra* note 103; *United States v. Woodside*, 27 A.F.T.R. 1076, 1080 (W.D.S.D. 1940), *rev'd on other grounds*, 118 F.2d 963 (4th Cir. 1941); *In re Glover-McConnell Co.*, 9 F.2d 683 (N.D. Ga. 1925). To the contrary is *In re Juvenile Products of Pasadena*, 1 CCH 1951 FED. TAX REP. ¶9176 (S.D. Cal. 1950), *rev'd on other grounds*, 193 F.2d 154 (9th Cir. 1952). The same result can also be reached on a theory of transferee liability.

<sup>105</sup> Tax lien filed first, held superior: *Miller v. Bank of America*, 166 F.2d 415 (9th Cir. 1948); *In re Fielder*, 15 A.F.T.R. 789 (S.D. Fla. 1932); *United States v. Widdekind*, P-H FED. TAX SERV. ¶72,480 (D.C. Iowa 1950); *Roberts & McInnis v. Emery's Motor Coach Lines*, *supra* note 16; *Citizens National Trust & Savings Bank v. United States*, *supra* note 6; *United States v. Spreckels*, 50 F. Supp. 789 (N.D. Cal. 1943); *Equitable Life Assurance Soc. v. Moore*, *supra* note 89. Creditor reduced his claim to judgment and lien first, held prior: *In re Northwest Wood Products Co.*, 168 F.2d 639 (7th Cir. 1948); *United States v. Record Publishing Co.*, *supra* note 15; *United States v. 52.11 Acres of Land*, 73 F. Supp. 820 (E.D. Mo. 1947); *United States v. 40.01 Acres of Land*, 38 A.F.T.R. 1553 (E.D. Mo. 1948); *Dannenberg v. Leopold & Co.*, 188 Misc. 250, 65 N.Y.S.2d 549 (1946); *In re Meyers' Estate*, 159 Pa. Super. 296, 48 A.2d 210 (1946); *Ferris v. Chic-Mint Gum Co.*, *supra* note 8.

over the assessment lien.<sup>106</sup> It is not enough for him merely to get judgment upon his claim. Until he secures a lien against specific property, the judgment creditor has no standing to challenge the foreclosure of the federal tax lien against property of the taxpayer. He is still, under state law, an unsecured creditor of the taxpayer.

A similar problem arises in determining the effect of an attachment or garnishment proceeding that is issued by the court prior to judgment. At such time the suing creditor may have a lien, but he does not hold a judgment and would not come within the classification of "judgment creditor." However, in almost all cases, the creditor will pursue his claim to judgment so that he may foreclose and realize upon his earlier attachment. Under these circumstances the courts have reached conflicting results. Those courts that give the attaching creditor priority over a tax lien filed for record after attachment but before judgment base their conclusion upon the fact that the private creditor has displayed more diligence than the Federal Government. The legal basis for this result is found in the concept of relation back—the priority of the judgment relates back to the time that the creditor attached specific property of the taxpayer.<sup>107</sup>

Other courts have concluded the contrary. They argue that Section 3672 must be construed strictly. Since the attaching creditor does not hold a judgment before notice of tax lien is filed, he is subordinate to the assessment lien.<sup>108</sup>

This divergence in approach has been settled by the Supreme Court in *United States v. Security Trust & Savings Bank of San Diego*,<sup>109</sup> but the decision is no guaranty that all conflict in this area is resolved. The

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<sup>106</sup> *Miller v. Bank of America*, *supra* note 105; *United States v. Fisher*, 93 F. Supp. 73 (N.D. Cal. 1948); *In re Mizner Industries Inc.*, 15 A.F.T.R. 789 (S.D. Fla. 1934). A decision to the contrary, *Manufacturers Trust Co. v. Sobel*, 175 Misc. 1067, 26 N.Y.S.2d 145 (1940) is based upon an erroneous interpretation of INT. REV. CODE § 3710. In a later decision, *Shenk Realty & Construction Co. v. Barrett*, 178 Misc. 857, 36 N.Y.S.2d 624 (1942) the same court held that a judgment creditor's claim was inferior to a federal tax lien because at the time the Collector has levied distraint upon the property, the property had not been attached pursuant to the judgment creditor's claim. Since § 3710 permits levy upon all property not "subject to an attachment or execution under any judicial process," the levy and lien of the federal government were superior. In the *Soble* case the Collector had made no levy, and with § 3710 in mind, the court held that the judgment, even though not reduced to a lien, was a superior claim against the property. But it has been shown that the validity of the federal tax lien does not require subsequent distraint action. Consequently, the distinction drawn by the New York court in the two cases would appear to be ill-founded.

<sup>107</sup> *Winther v. Morrison*, 93 Cal. App. 2d 608, 209 P.2d 657 (1949), *reversed sub nom.*, *United States v. Security Tr. & Sav. Bank*, *supra* note 76; *Board of Supervisors of La. State University v. Hart*, *supra* note 45; *United States v. Yates*, *supra* note 45.

<sup>108</sup> *MacKenzie v. United States*, *supra* note 8; *Miller v. Bank of America*, *supra* note 105; *United States v. Fisher*, *supra* note 106; *Bishop v. Black*, P-H 1951 FED. TAX SERV. ¶72,327 (1951).

<sup>109</sup> *Supra* note 76.

Court there held that an attachment, prior to judgment, under California law does not displace an assessment lien, notice of which has been filed between the dates of attachment and judgment. In writing its opinion, the Court issued the dictum that relation back is a mere fiction that will not "operate to destroy the realities of the situation."<sup>110</sup>

Unfortunately, this decision cannot be taken as a benchmark in all jurisdictions. Before voicing its ruling, the Supreme Court carefully scrutinized California law to discover how the state courts had viewed the attachment lien. The Court found that the California attachment lien was an inchoate lien under California law because (1) the attaching creditor could not proceed against the property attached until judgment was entered, and (2) judgment must be entered within three years after the attachment was issued. It would thus appear that attachment liens in other jurisdictions might be free of an assessment lien if the statutory framework for the liens differs from that found in California.<sup>111</sup>

What of statutory liens given the force and effect of a "judgment lien" under state laws, but not creatures of judicial process? State laws have been framed to give certain types of lien such priority, as, for instance, liens for state taxes or for wage claims. Are these liens entitled to protection from the effect of an assessment lien under Section 3672? Until recently, this question has resulted in much litigation, with conflicting decisions.<sup>112</sup> However, in *United States v. Gilbert Associates, Inc.*<sup>113</sup> the Supreme Court has settled the matter by adopting the arguments of the Federal Government. Briefly, the facts are as follows: First, the United States secured a series of assessment liens against the taxpayer. Second, the Town of Wal-

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<sup>110</sup> *Id.* at 50.

<sup>111</sup> This would not be true as far as Justice Jackson is concerned, for in his concurring opinion he states that "only a judgment creditor in the conventional sense is protected by § 3672. See, to the contrary, *United States v. Acri*, 2 CCH 1952 FED. TAX REP. ¶ 9104 (N.D. Ohio 1952) where the court, in dictum, expressed its opinion that the Ohio attachment lien would be preferred in this situation and *Hawkins v. Savage*, 1 CCH 1953 FED. TAX REP. ¶ 9343 (D.C. Alaska, 1953).

<sup>112</sup> *In re Northwest Wood Products Co.*, *supra* note 105; *United States v. Detroit*, *supra* note 84; *Texas v. Wynne*, 134 Tex. 455, 133 S.W.2d 951 (1939), *appeal dismissed*, 310 U.S. 610 (1940). See the dictum in *United States v. Fisher*, *supra* note 106, where priority was given to a statutory lien recorded before the assessment lien arose; as to a statutory lien arising after assessment, no priority was given. Note, also, the decisions which have held that a statutory lien for special assessments for street improvements has given a city the status of a "mortgagee" or "judgment creditor" under § 3672: *City of Winston-Salem v. Powell Paving Co.*, *supra* note 15; *Berrymont Land Co. v. Davis Land & Coal Co.*, *supra* note 15. Holding that the local lien, despite its language, is not the lien of a "judgment creditor" are the following decisions: *United States v. Reese*, *supra* note 15; *In re Capitol Cleaners & Dyers, Inc.*, 233 P.2d 377 (Utah, 1951). See *United States v. Record Publishing Co.*, *supra* note 15; *United States v. San Juan County*, 280 Fed. 120 (W.D. Wash., 1922); *In re Dartmouth Coal Co.*, *supra* note 81, which noted that § 3672 should be construed strictly in favor of the government.

<sup>113</sup> *Supra* note 47. Interestingly, respondent, Town of Walpole, made no appearance, nor does the record show the filing of any amicus curiae briefs on behalf of any state or local government, despite the importance of this decision to their tax administrative practices.

pole, New Hampshire, assessed an ad valorem tax against machinery of the taxpayer under state law characterizing a tax assessment as "in the nature of a judgment."<sup>114</sup> Next followed the filing of a notice of lien by the Director, which was ignored by the Town when it sold to itself the taxpayer's machinery at a tax sale. Despite these actions of the Town, the federal lien was held to be a prior encumbrance upon the moneys realized by a sale of the machinery. The Supreme Court reasoned that a state's characterization of a lien cannot control priorities between it and the Federal Government; to permit such control would be to destroy the uniform application of the federal tax structure throughout the several states.<sup>115</sup> The Court therefore adopted as its own the principle, foreshadowed by Justice Jackson's concurring opinion in the *Security Trust & Savings Bank* case,<sup>116</sup> that "the words 'judgment creditor' in §3672 [are used] in the usual, conventional sense of a judgment of a court of record, since all states have such courts."<sup>117</sup>

A similar question has arisen in bankruptcy. Is a trustee in bankruptcy a "judgment creditor" so that he takes free of the assessment lien? Section 70 (c) of the Bankruptcy Act now provides:<sup>118</sup>

The trustee, as to all property of the bankrupt at the date of bankruptcy, whether or not coming into possession or control of the court, shall be deemed vested as of the date of bankruptcy with all the rights, remedies and powers of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor actually exists.

Since any decision reached on this question will ultimately have uniform application throughout the nation, no objection on the ground of consistency may be made if the words of Section 70 (c) also define the status of the trustee as a "judgment creditor" for purposes of Section 3672. Furthermore, rules of statutory construction approve the use of one federal statute to determine the meaning of another. Thus, the only question to be resolved

<sup>114</sup> See the decision of the court below, *In re Gilbert Associates, Inc.*, 97 N.H. 411, 90 A.2d 499 (1952).

<sup>115</sup> See, for instance, *United States v. Pelzer*, 312 U.S. 399, 402 (1941), where Justice Stone stated for the court:

But as we have often had occasion to point out, the revenue laws are to be construed in the light of their general purpose to establish a nationwide scheme of taxation uniform in its application. Hence their provisions are not to be taken as subject to state control or limitation unless the language or necessary implication of the section involved makes its application upon state law.

<sup>116</sup> *United States v. Security Tr. & Sav. Bank*, *supra* note 76, at 52 (J. Jackson concurring): "The history of this tax lien statute indicates that only a judgment creditor in a conventional sense is protected."

<sup>117</sup> *United States v. Gilbert Associates, Inc.*, *supra* note 47 at 703; note that this holding is gratuitous, since the court further found the taxpayer to be insolvent, calling into play Rev. Stat. § 3466 (1878), 31 U.S.C. § 191 (1946).

<sup>118</sup> 11 U.S.C. § 110c (Supp. 1952).



in this context is whether or not a Section 3672 "judgment creditor" must possess the judgment of an actual court of law. On this, as on other lien questions, the courts are diametrically split. Several courts have held that the trustee in bankruptcy is a judgment creditor,<sup>119</sup> while other courts have denied that he is for the purposes of the lien statute.<sup>120</sup> Other courts have recognized the validity of the assessment lien under the provisions of Section 67 (b) and (c) of the Bankruptcy Act,<sup>121</sup> which give special protection to statutory liens, including those not perfected before bankruptcy.<sup>122</sup>

### *Priority Exceptions*

Exceptions to the normal rules of priority for the federal tax lien, delineated above, are few but are well recognized. The first of these is statutory, created by subdivision (b) of Section 3672. It is there provided that "even though notice of a lien provided in Section 3670 has been filed . . . the lien shall not be valid with respect to a security . . . as against any mortgagee, pledgee, or purchaser of such security, for an adequate and full consideration in money or money's worth if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien. "In brief, actual notice is substituted for constructive notice as to all, except judgment creditors, who acquire an interest in a security."<sup>123</sup> This statutory exception was added by

<sup>119</sup> *Barish v. Central School District*, 32 A.F.T.R. 1604 (S.D.N.Y. 1943); *United States v. Sands*, 174 F.2d 384 (2d Cir. 1949), in which the court reached a conclusion incompatible with its dictum. These decisions were reached under an earlier phrasing of the status of the trustee in bankruptcy which provided that the trustee, as to all property not within the possession of the bankruptcy court, should have "all the rights, remedies and powers of a judgment creditor then holding an execution duly returned unsatisfied." In view of this change in statutory language, the court in *In re Fisher Plastics Corp.*, 89 F. Supp. 446 (D.C. Mass. 1950), decided to find the trustee to be a "purchaser" rather than a "judgment creditor." These decisions are hard to reconcile with the reasoning expressed above in *Gilbert Associates, Inc. v. United States*, *supra* note 47.

<sup>120</sup> *In re Taylorcraft Aviation Corp.*, 168 F.2d 808 (6th Cir. 1948); *In re Ann Arbor Brewing Co.*, *supra* note 15. See Feigebaum, *Tax Problems*, 30 TAXES 448 (June 1952).

<sup>121</sup> 11 U.S.C. § 107(b) and (c) (1946).

<sup>122</sup> *United States v. Sands*, *supra* note 117; *United States v. Heffron*, *supra* note 55; *United States v. Sampsell*, *supra* note 40; *Heyward v. United States*, *supra* note 103; *In re F. MacKinnon Mfg. Co.*, 24 F.2d 156 (7th Cir. 1928); *In re Fahnestock Mfg. Co.*, *supra* note 87. However, if the assessment is made after bankruptcy, no lien is created on the property in the bankruptcy estate. *In re Eagle Frosted Foods Corp.*, P-H 1951 FED. TAX SERV. ¶72,441 (D. C. Del. 1951).

<sup>123</sup> "Security" is defined in § 3672(b)(2) to mean "any bond, debenture, note, or certificate, or other evidence of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase any of the foregoing; negotiable instrument; or money." Only the securities listed herein are given special protection; as to all other intangibles, the normal priority applies. *Equitable Life Assurance Soc. v. Moore*, *supra* note 88.

Congress in 1939, but was expressly made applicable to transactions in securities "regardless of the time when the mortgage, pledge or purchase was made or the lien arose." At the time the provision was added, a case, *United States v. Rosenfield*,<sup>124</sup> was on appeal to the Sixth Circuit Court of Appeals. The district court had held a bona fide purchaser of stock to be subordinate to a tax lien filed for record before the purchase. Congress quickly amended Section 3672 by the addition of the above provision, and the court of appeals was powerless to do other than reverse the district court in view of the stipulation for retroactivity.<sup>125</sup>

A perplexing problem not answered by the statute is whether the tax lien must be in fact filed for record in order for it to take precedence over the interests acquired by a party having actual notice of his transferor's tax delinquency. If subsection (b) is read as giving mortgagees, pledgees and purchasers *additional* protection to that granted them in subsection (a) of Section 3672, then clearly the assessment lien is without effect against them. On the other hand, if the provisions of subsection (b) are *in lieu of* the safeguards of subsection (a), then the assessment lien alone would be sufficient to displace the interest of a later transferor having knowledge thereof. As a matter of statutory construction the former would appear to be the better; subsection (b) commences with the words, "Even though notice of a lien . . . has been filed . . .," which indicates that subsection (b) is an *additional* safeguard. Furthermore, the terms of subsection (a) are broad enough to cover the mortgagee, purchaser or pledgee of a security, protecting them from the assessment lien. In any event, it should be kept in mind that judgment creditors are not entitled to the special rules governing securities, but can look to only the terms of subsection (a) of Section 3672.

The other exceptions to the normal rules of priority are judicially created. One of the most obvious is, of course, the attorney's lien. Where he has performed services that have created a fund or property against which the Federal Government asserts a lien, the attorney is preferred, although his lien arises after the federal tax lien.<sup>126</sup> However, under other circumstances where the equities do not favor the attorney so greatly, the normal rule of first in time, first in right is followed.<sup>127</sup>

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<sup>124</sup> *United States v. Rosenfield*, *supra* note 58.

<sup>125</sup> *Morrison v. United States*, 26 A.F.T.R. 1205 (6th Cir. 1939). The reason for the passage of the legislation was stated in H. R. REP. NO. 855, 76th Cong., 1st Sess. 56 (1939) 2 CUM. BULL. 504, 523 (1939):

. . . it is inequitable for the statute (§ 3672) to provide that it (filing of notice) constitutes notice as regards securities . . . An attempt to enforce such liens on recorded notice would in many cases impair the negotiability of securities and seriously interfere with business transactions.

<sup>126</sup> *Filipowicz v. Rothensies*, *supra* note 17; *In re Eagle Frosted Foods Corp.*, *supra* note 122; *Railway Express Agency Inc. v. Jones*, *supra* note 21.

<sup>127</sup> *United States v. McKay Engineering & Const. Co.*, 30 A.F.T.R. 1574 (N.D. Ill. 1942); *Harrisburg Trust Co. v. Snyder*, 36 A.F.T.R. 1575 (Pa. Ct. Com. Pleas 1947).

In admiralty, the federal tax lien is subordinated to certain classes of maritime liens, regardless of time of creation. Thus, materialmen who had furnished materials for repairing a vessel were given priority in payment over an earlier tax lien.<sup>128</sup> Similarly, seamen are entitled to their wages out of the proceeds from the sale of a ship ahead of an earlier assessment lien.<sup>129</sup> Nor is the federal lien considered a preferred maritime lien when its priority is questioned by a Preferred Ship Mortgage; such a mortgage, meeting the requirements of the admiralty statute, is superior to an earlier tax lien.<sup>130</sup> Since these decisions are predicated upon the priorities of federal admiralty law, it should follow that other preferred maritime liens, such as bottomry liens, would also be first paid, regardless of the priority in time of the federal tax lien.

"Relation back" is a fourth exception to the normal rules of tax lien priority. This fiction has been used in a variety of situations to defeat the earlier arising federal lien, as pointed out in their discussion concerning an attaching creditor. In view of the recent Supreme Court pronouncement on the doctrine, tax lien cases which rest upon "relation back" must necessarily be considered with a jaundiced eye.<sup>131</sup> However, in areas of special hardship to the competing claimant, courts are prone to use the fiction to give priority to him although his rights are otherwise junior to the tax lien. Illustrative of these cases are those dealing with labor and materialmen liens. Since the laborer has contributed his effort toward improving the property subject to the lien, the courts often protect him against the federal lien by holding that his lien is effective from the date he commenced work on the property, whether or not he has an enforceable lien under the state law from the date work commenced.<sup>132</sup> However, decisions to the contrary are also on the books: equitable considerations cannot govern the incidence of the tax lien, since the hardship here produced is but one of the manifestations of hardship imposed by the power to tax.<sup>133</sup>

"Relation back" has also been applied to other liens inchoate when the tax lien arose. By this technique the tax lien is subordinated in payment

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<sup>128</sup> *The River Queen*, 8 F.2d 426 (E.D. Va. 1925).

<sup>129</sup> *United States v. The Pomare*, 92 F. Supp. 185 (D.C. Haw. 1950); *Gulf Coast Marine Ways Inc. v. The Trawler J.R. Hardee*, *supra* note 80.

<sup>130</sup> *United States v. The Pomare*, *supra* note 129.

<sup>131</sup> *United States v. Security Tr. & Sav. Bank*, *supra* note 76 at 50.

<sup>132</sup> *In re Taylorcraft Aviation Corp.*, *supra* note 120; *Schmitz v. Stockman*, *supra* note 92.

<sup>133</sup> *In re Capital Foundry Corp.*, 64 F. Supp. 885 (E.D.N.Y. 1946). Of course, if the laborer's lien is perfected before the assessment lien, the labor lien is prior in payment. *Harrisburg Trust Co. v. Snyder*, *supra* note 127; *United States v. Yates*, *supra* note 45; *In re Caswell Const. Co.*, 13 F.2d 667 (N.D.N.Y. 1926) *Samms v. Chicago Title and Trust Co.*, 1 CCH 1953 FED. TAX REP. ¶9270 (1953); *Republic National Life Insurance Co. v. Hedstrom*, 346 Ill. App. 555, 105 N.E. 2d 782 (1952).

to the later arising lien. For instance, in suretyship cases, the courts have held that the lien of the surety, after making good, relates back to the date of the suretyship contract. Any intervening tax lien is second in priority.<sup>134</sup> An equitable lien, replaced later by a legal lien, gives its priority to the subsequent legal lien although a tax lien may have arisen before the legal lien arose.<sup>135</sup>

Assignments by the taxpayer between the date of assessment and the date of filing notice of lien have given the courts a headache. If the assignment was made for consideration, there is temptation to give the assignee the same protection that a purchaser or mortgagee would be entitled to. Thus, some courts have held that an assignee is a "purchaser" within the meaning of Section 3672,<sup>136</sup> and others have agreed that he might be a pledgee.<sup>137</sup> To the contrary are the courts which have limited the rights of the assignee to those of his assignor, the taxpayer.<sup>138</sup> Whether or not the assignee is within Section 3672, he is subordinate to a tax lien of record before the assignment,<sup>139</sup> but is superior to an assessment lien arising after the assignment.<sup>140</sup>

A final word of caution should be added. All of the above decisions may be inapplicable where the taxpayer is insolvent at the time the question of competing liens arises. If the taxpayer's acts or position place him within

<sup>134</sup> *Glenn v. American Surety Co.*, 160 F.2d 977 (6th Cir. 1947); *In re Van Winkle*, 49 F. Supp. 711 (W.D.Ken. 1943); *N.Y. Casualty Co. v. Zwerner*, 58 F. Supp. 473 (N.D. Ill. 1944); *Gulf Coast Marine Ways Inc. v. The Trawler J. R. Hardee*, *supra* note 80; *United States v. Blair*, 34 A.F.T.R. 1651 (W.D. Tex. 1945); *United States Fidelity and Guaranty Co. v. Triborough Bridge Authority*, 297 N.Y. 31, 74 N.E.2d 226 (1947); *National Surety Corp. v. Barth*, 89 A.2d 104 (N.J. Ch. 1952). *Contra*, *Seaboard Surety Co. v. United States*, *supra* note 46, where the court placed reliance upon REV. STAT. § 3466, 31 U.S.C. § 191, dealing with insolvent debtors of the United States; the distinction seems immaterial since presumably in all cases where the problem arises the taxpayer-contractor is insolvent.

<sup>135</sup> *Equitable Life Assurance Society v. Moore*, *supra* note 88; *Exchange Nat'l Bank of Tulsa v. Davy*, 13 F. Supp. 226 (N.D. Okla. 1936).

<sup>136</sup> *National Refining Co. v. United States*, *supra* note 99, where the assignment was given for valuable present consideration. *Accord*, *United States v. Carrollo*, 29 A.F.T.R. 1294 (W.D. Mo. 1940). But in *Filipowicz v. Rothensies*, *supra* note 17, the court held that an assignment for a past consideration was not within § 3672. See *Barish v. Central School District*, *supra* note 119. But not as assignment to secure loans previously made to the taxpayer, *Faddis v. Schohert*, P-H 1953 FED. TAX SERV. ¶72,421 (1953).

<sup>137</sup> *Knight v. Knight*, 71 N.Y.S.2d 357 (1947); see *Investment & Securities Co. v. United States*, *supra* note 17.

<sup>138</sup> *United States Nat. Bank v. Earle*, *supra* note 46. See *Exchange Nat'l Bank of Tulsa v. Davy*, *supra* note 135 where an assignment was held superior to a tax lien without any discussion of the date of assessment.

<sup>139</sup> *Nelson v. United States*, *supra* note 17; *Citizens State Bank of Barstow v. Vidal*, *supra* note 17.

<sup>140</sup> *National Iron Bank v. Manning*, 76 F. Supp. 841 (D.C.N.J. 1948); *United States v. Midtown Bank of N.Y.*, 6 F. Supp. 931 (S.D.N.Y. 1933); *United States v. Trout*, *supra* note 21; *United States v. Certain Lands in St. Charles Co.*, 71 F. Supp. 76 (E.D.Mo. 1946); *Equitable Life Assurance Soc. v. Moore*, *supra* note 88; *Paulyn E. Tomfohr*, 44 B.T.A. 730 (1941).

the scope of Section 3466 of the Revised Statutes,<sup>141</sup> the United States may be entitled to priority for its taxes even in the absence of any lien whatsoever.

### *Circular Priority*

What priority is given the federal tax lien in the perplexing circular priority situation? Suppose a mortgage is first executed, followed by the filing for record of a federal tax lien. Last of all is created a local tax lien, given priority under state law over the mortgage. Clearly, local law cannot displace the priority in time of the federal lien. As a result the following circular situation exists: the mortgage is superior to the federal tax lien which is ahead of the local tax lien that, in turn, is preferred over the mortgage. None of the courts that have dealt with this situation have given the federal tax lien special prerogatives because it is a lien of the sovereign. To the contrary, the courts have treated it with no more respect than is accorded to the competing liens. In resolving this circle, some courts have preferred the mortgage, and with it the local tax lien, over the federal lien. Under this approach, local taxes are paid first, the mortgage second, and the federal lien out of any proceeds remaining.<sup>142</sup>

Since this result clearly places the federal lien at a disadvantage not warranted by the respective dates of creation of the liens, other courts have found different solutions. A second answer to the puzzle is to set aside an amount equal to the outstanding balance of the mortgage, out of which local taxes are paid. Secondly, payment is made out of the fund upon the federal tax lien, with the surplus, if there be any, to the mortgagee to make up for the amount withheld out of his share for the payment of local taxes.<sup>143</sup>

The alternative solution is also subject to criticism on equitable grounds because it gives the federal tax lien an unwarranted advantage at the expense of the prior mortgage.<sup>144</sup> Furthermore, the mortgage may, by its terms, permit the mortgagee to pay delinquent taxes and assessments, making the amount of such payments a part of the mortgage debt as

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<sup>141</sup> 31 U.S.C. § 191 REV. STAT. § 3466 (1878) (1946). See *United States v. Gilbert Associates, Inc.*, *supra* note 47, for an illustration of the effect of insolvency on the tax liens.

<sup>142</sup> *Ferris v. Chic-Mint Gum Co.*, *supra* note 8; *In re Ann Arbor Brewing Co.*, *supra* note 15; *Brown v. General Laundry Services, Inc.*, 1 CCH 1953 FED. TAX REP. ¶9272 (1952). This distribution was noted but not followed in *Spokane County v. United States*, *supra* note 77.

<sup>143</sup> *Hopkins v. Eureka Coal Co.*, 33 A.F.T.R. 1627 (Cir. Ct. W. Va.), 1 CCH 1941 FED. TAX REP. ¶9320 (1941); *Samms v. Chicago Title & Trust Co.*, *supra* note 133.

<sup>144</sup> But where the mortgage is by local statute or by its terms subordinated to another charge, the second solution is not subject to criticism on equitable grounds. The problem then is not one of true conflict of priorities but one of subrogation, i.e., the latest lien is given the priority of the earliest. The granting of the right of subrogation against the earlier local lien should have no effect on the priority of the federal lien. Note, 38 *Col. L. Rev.* 1267, 1268 (1938).

between the mortgagee and mortgagor. If so, it is argued, the local lien ought to be given the priority of the mortgage, as against the federal tax lien, since the priority of the local lien ought not to depend upon the election of the mortgagee whether or not to make payment.

Such an argument is not conclusive, despite its acceptance by some courts.<sup>145</sup> Even if the mortgagee has in fact paid the local lien, he is not by that fact alone entitled to priority over the federal lien; the mortgagee has merely made a subsequent advance, which may or may not be entitled to the priority of the original debt, as pointed out above.<sup>146</sup>

Consequently, there appears to be no logical solution to the dilemma; further thoughts on this matter are contained in the authorities cited below.<sup>147</sup>

However, in the bankruptcy field, an apparently similar situation is capable of logical analysis and solution. Section 67 (c) of the Bankruptcy Act<sup>148</sup> subordinates various statutory liens, including the federal tax lien, against personal property of the bankrupt taxpayer to costs of administration and wage claims if the lienor has not seized the property prior to the bankruptcy petition. The statute has become a prolific source of priority circles. Thus, if the Federal Government holds the earliest lien in point of time, but the later statutory lienor, such as a state taxing agency, has seized possession of the bankrupt's personal property, which is to be preferred? The Federal Government, subordinated to costs of administration and wage claims, is prior to the state, which is, in turn, superior to costs and wage claims. The answer lies not in an imperious cutting of the Gordian knot, but in analysis of the statute. The statute is written in terms of subordination, not in terms of priority. In other words, Section 67 (c) does not dictate priority between liens, but merely subordinates *each* lien not accompanied by possession to costs and wage claims. The priority *between the competing liens* is unaffected by the statute.<sup>149</sup> This being true, the solution is apparent: an amount is first set apart representing the total of the federal tax lien, out of which are paid costs of administration and wage claims, with the balance, if any, to the Director;

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<sup>145</sup> *Brown v. General Laundry Service, Inc.*, *supra* note 142.

<sup>146</sup> See the discussion concerning the priority of additional advances under the mortgage priority rule. *Samms v. Chicago Title & Trust Co.*, *supra* note 133, rejected the argument where the mortgagee had failed to make the payment.

<sup>147</sup> 4 AMERICAN LAW OF PROPERTY § 17.33 (1952); OSBORNE, MORTGAGES § 209 (1951); Benson, *Circuity of Liens—A Problem in Priorities*, 19 MINN. L. REV. 139 (1935); Note, 38 COL. L. REV. 1267 (1938).

<sup>148</sup> 11 U.S.C. § 107 (c) (1946).

<sup>149</sup> Note the language of § 67(c), 11 U.S.C. § 110(c) (1946), which refers only to the relationship between the subordinated lien and costs of administration or wage claims; no reference is made to its effect on competing statutory liens. See, also, the note in 38 COL. L. REV. 1267, 1268 (1938) on the related problem of subrogation between competing liens.

second, the state lien is paid in full; third, additional payments are made on the federal lien. By this solution, the relative priorities of the two liens are preserved and the subordination feature of the statute touches only the lien unaccompanied by possession. The priority between the federal and the state lien is unaffected; only the federal lien is subordinated and the amount of the subordination is limited to costs and wage claims; it does not include the competing lien.<sup>150</sup>

### *Duration of the Lien*

The federal tax lien arises after notice and demand for the payment of the assessed taxes has been made, as of the date that the Director of Internal Revenue received the assessment list from the Commissioner.<sup>151</sup> There appears to be a conflict in the cases as to whether a formal demand for payment by the Director is necessary, but it is clear that a "demand" of some nature is a necessary condition to the erection of the tax lien.<sup>152</sup> It is also necessary that the Government prove that the assessment list was received by the Director in order to show that a lien exists.<sup>153</sup>

For what period is the federal tax lien enforceable once having been created? Section 3671 of the Internal Revenue Code indicates that the general tax lien "shall continue until the liability for such amount [of assessed taxes] is satisfied or becomes unenforceable by reason of lapse of time." The first part of this disjunctive limitation is self-explanatory; the second part must be read in conjunction with Section 276 (c) of the Code, which provides a general statute of limitations upon collecting an

<sup>150</sup> For additional authorities on this point, see Feigenbaum, *Tax Problems*, 30 TAXES 448, 452 *et seq.* (June 1952).

<sup>151</sup> This appears to be the literal construction of INT. REV. CODE §§ 3670, 3671 and is supported by dicta in the following cases: *United States v. Security Tr. & Sav. Bank*, *supra* note 76; *Cobb v. United States*, *supra* note 15; *Metropolitan Life Ins. Co. v. United States*, *supra* note 15; *United States v. City of Greenville*, *supra* note 48; *United States v. Reese*, *supra* note 15; *United States v. Sampsell*, *supra* note 40; *Citizens State Bank v. Vidal*, *supra* note 17; *A. H. Graves*, 12 B.T.A. 124 (1928). *MacKenzie v. United States*, *supra* note 8 indicates that the date of lien is not certain; it may be either the date of receipt of assessment or the date of demand. 9 MERTENS, *LAW OF FEDERAL INCOME TAXATION* § 54.40 (1943) says that the time of demand is the time the lien arises.

In any event it appears that if the taxpayer disposes of property between the time of receipt of assessment and the time of demand, that property will be free of the tax lien. *United States v. Pacific R.R.*, *supra* note 2. As to other property of the taxpayer, the date of assessment receipt is the critical date.

<sup>152</sup> INT. REV. CODE § 3670. However, the taxpayer may waive the requirement of demand. *In re Baltimore Pearl Hominy Co.*, *supra* note 19. Formal demand was required in *United States v. Allen*, 14 Fed. 263 (M.D. Tenn. 1882), but *In re Baltimore Pearl Hominy Co.* noted that informal demand was sufficient. Filing a claim for taxes due by the decedent in his probate estate is a sufficient demand to erect the lien. *United States v. Ettelson*, 159 F.2d 193 (7th Cir. 1947); *United States v. Pettyjohn*, 84 F. Supp. 423 (W.D. Mo. 1949).

<sup>153</sup> *Kennebec Box Co. v. Richards Corp.*, 5 F.2d 951 (2d Cir. 1925); *Hill v. Firemen's Ins. Co.*, *supra* note 21; *Bach v. Blum* (Superior Ct. Conn. 1953) 1 CCH 1953 FED. TAX REP. ¶9349.

assessed tax.<sup>154</sup> Since Section 276 (c) prohibits collection after six years from the date of assessment, unless an extension of time is secured from the taxpayer prior to the expiration of the six-year period, the tax lien must also be enforced within the same period or it too will be barred. Some question has been raised as to whether or not an extension of time granted by the taxpayer will extend the time for enforcing the tax lien against his property if the rights of third parties have intervened in the meantime. However, the cases appear to be unanimous in permitting a taxpayer's waiver of the statute of limitations on collection to extend the time of enforcing the tax lien even as against third parties.<sup>155</sup>

Another method of extending the time to collect taxes, and concurrently the time for enforcing the tax lien, is for the United States to reduce its tax claim to judgment in a suit at law against the taxpayer. In such case, the tax assessment is merged into the judgment and is collectable as a federal judgment. Enforcement of the tax claim and lien will then be accomplished by an execution issued upon the judgment.<sup>156</sup>

It also appears that destruction of the property subject to the tax lien will terminate the lien as far as the specific property is concerned. One illustration of this statement is found in the situation in which the lien has attached to the taxpayer's interest as insured under a life insurance policy. Upon the taxpayer's death, the lien did not survive to burden the proceeds of the policy in the hands of the beneficiaries.<sup>157</sup>

#### THE ESTATE TAX LIEN

The lien for federal estate taxes is an animal of a different stripe. It is created by operation of law<sup>158</sup> long before the liability for taxes has matured or has been ascertained. Nothing is required of the Commissioner of Internal Revenue to perfect his lien; neither notice nor assessment is demanded. The very fact of death erects the lien,<sup>159</sup> although the amount of the taxes to be secured by the lien, if any, cannot be determined until a later day.

<sup>154</sup> *United States v. Spreckels*, *supra* note 105; *Equitable Life Assurance Co. v. Moore*, *supra* note 88 at 184; *United States v. Woodside*, *supra* note 104. Clark, *Federal Tax Liens and Their Enforcement*, 33 VA. L. REV. 13, 42 (1947).

<sup>155</sup> See citations note 154 *supra*.

<sup>156</sup> *Investment Securities Co. v. United States*, *supra* note 17; *United States v. Caldwell*, *supra* note 17. Filing a claim in probate proceedings for taxes of the decedent also serves to suspend the statute of limitations upon collection. *United State v. Ettelson*, *supra* note 152.

<sup>157</sup> *United States v. Steele*, *supra* note 34. The decision is a hollow victory for the beneficiaries since they are most likely liable for the taxes of the decedent as transferees. *Kieferdorf v. Commissioner*, *supra* note 56; *Pearlman v. Commissioner*, *supra* note 56; *Christine D. Muller*, *supra* note 56; *Eleanor Neeley*, 8 T.C.M. 698 (1949); *Marjorie O. Sullivan*, 9 T.C.M. 2 (1950).

<sup>158</sup> INT. REV. CODE § 827(a): "Unless the tax is sooner paid in full, it shall be a lien for ten years upon the gross estate of the decedent . . ."

<sup>159</sup> *Detroit Bank v. United States*, 317 U.S. 329 (1943).



Property reached by the lien includes all the property that comes within the purview of the decedent's "gross estate," as that term is defined in Section 811, Internal Revenue Code; the concept of "gross estate" or "decedent's estate" under local law in force in the jurisdiction in which the decedent died is immaterial to the reach of the estate tax lien.<sup>160</sup> Thus property that never comes within the jurisdiction of the local probate court may be burdened by the estate tax lien, for example, property transferred *inter vivos* but in contemplation of death. However, the statute releases from the lien any property otherwise included in the decedent's gross estate that "is used for the payment of charges against the estate and expenses of administration, allowed by any court having jurisdiction thereof."<sup>161</sup> This act of grace is not untrammelled; if the exempt property is transferred by the estate after assessment of a deficiency estate tax, it may be foreclosed upon for the payment of the deficiency under the *general* tax lien, although free of the estate tax lien.<sup>162</sup>

The relationship between this lien and the general tax lien is, as appears above, one of mutual independence. Just as the exemptions and requirements of the estate tax lien are not imposed upon the general tax lien, the provisions of the general tax lien for protecting certain creditors and for giving record notice are not read into the estate lien law. For instance, the estate tax lien is not affected by Section 3672, Internal Revenue Code, calling for the filing of notice of lien. That section is confined to the general tax lien, created under a different chapter of the Code.<sup>163</sup> Nor will a deficiency notice, assessment, notice and demand after death affect the date of the estate tax lien arising on death.<sup>164</sup> The two liens are, however, cumulative. If an assessment had duly been made and processed, the government has the option of proceeding to enforce either the general tax lien or the estate tax lien to collect an estate tax deficiency.<sup>165</sup> The estate tax lien is, therefore, enforceable by distraint and sale of the taxpayer's property under the same procedures employed to foreclose the general tax lien.<sup>166</sup>

The general rule of priority prevails in litigation concerning the estate

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<sup>160</sup> *Ibid.*

<sup>161</sup> INT. REV. CODE § 827(a): The burden of showing that the property was in fact used to pay charges or expenses is upon the person claiming the property free of lien. *Smythe v. United States*, 169 F. 2d 49 (1st Cir. 1948).

<sup>162</sup> *United States v. Security First National Bank*, 30 F. Supp. 113 (S.D. Cal. 1939).

<sup>163</sup> Parenthetically, it may be added that the estate tax lien is not subject to the recording requirements of local law. *Detroit Bank v. United States*, *supra* note 159; *Michigan v. United States*, 317 U.S. 338 (1943); *United States v. McGuire*, 42 F. Supp. 337 (D.C.N.J. 1941); G.C.M. 2663, VII-2 CUM. BULL. 355 (1928).

<sup>164</sup> *Rosenberg v. McLaughlin*, 66 F.2d 271 (9th Cir. 1933), *cert. denied* 290 U.S. 696 (1933).

<sup>165</sup> See *Detroit Bank v. United States*, *supra* note 159; *Michigan v. United States*, *supra* note 163; *United States v. Security First National Bank*, *supra* note 162.

<sup>166</sup> *Rosenberg v. McLaughlin*, *supra* note 164.

tax lien: first in time, first in right.<sup>167</sup> For instance, a bona fide pledge of personal property made by the decedent before death is prior to the estate tax lien.<sup>168</sup> Similarly, property of the decedent sold to the state before death under a lien for property taxes is not reached by the estate tax lien.<sup>169</sup> On the other hand, the lien for estate taxes is superior to local real property taxes that accrued after death upon property in the estate.<sup>170</sup> Of even more importance is the fact that the estate tax lien is entitled to prevail over a mortgagee of real property included in the gross estate who (1) took his mortgage from the decedent's widow and children who had title, (2) had no knowledge of the unpaid estate taxes, (3) paid value, and (4) recorded his mortgage long before notice of lien for estate taxes was filed.<sup>171</sup> Nor is a bona fide purchaser of property of the estate given protection against the incidence of the estate tax lien.<sup>172</sup> These results logically follow from the premise that the protective features of Section 3672 are not to be read into the estate tax lien law, but their application must give pause to potential mortgagees, purchasers, pledgees and judgment creditors who desire to deal with an estate.<sup>173</sup>

Some mitigation of these results is provided by statute for bona fide purchasers who buy property, included in the gross estate, that is in the hands of parties other than the executor or administrator "by reason of the exercise, non-exercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under Section 811 (b) [dower or curtesy], (c) [intervivos transfers in contemplation of death or taking effect at death], (d) [intervivos transfers subject to revocation by the decedent], (e) [joint interests], (f) [powers of appointment], or (g) [life insurance proceeds] \* \* \*." In these cases, the lien is transferred from the property previously subject to the lien to the proceeds in the hands of the person who made the transfer.<sup>174</sup>

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<sup>167</sup> *Michigan v. United States*, *supra* note 163.

<sup>168</sup> *In re Decker's Estate*, 335 Pa. 331, 49 A.2d 714 (1946), *cert. denied*, 331 U.S. 807 (1947).

<sup>169</sup> *United States v. Desmond*, 1 CCH 1945 FED. TAX REP. ¶10,192 (1944).

<sup>170</sup> *Michigan v. United States*, *supra* note 163.

<sup>171</sup> *Detroit Bank v. United States*, *supra* note 159; for a statement of the facts, see the opinion below, *United States v. Paul*, 41 F. Supp. 41 (E.D. Mich. 1940).

<sup>172</sup> *Smythe v. United States*, *supra* note 161; *United States v. Security First National Bank*, *supra* note 162.

<sup>173</sup> Nor can a creditor of the decedent gain priority over the estate tax by security judgment and execution thereon after death. *United States v. McGnire*, *supra* note 163.

<sup>174</sup> INT. REV. CODE § 827(b). It is interesting to speculate whether or not this provision, which was amended in the Revenue Act of 1942, § 411(a), to include purchasers from the surviving spouse of jointly owned property (including tenancies by the entirety) was prompted by the problem in *Detroit Bank v. United States*, discussed above. If the term "bona fide purchaser" includes a bona fide mortgagee, the result of the *Detroit* case would, of course, be contrary if the situation arose today. The reports to Congress shed no light on the matter, for they merely

Further protection is given to a bona fide purchaser for value who deals with the estate *after the executor has been discharged* of personal liability for any deficiency in estate tax.<sup>175</sup> The lien is released from the property so transferred but attaches in like manner "to the consideration received from such purchaser by the heirs, legatees, devisees, or distributees."<sup>176</sup>

This lien, as provided by statute,<sup>177</sup> remains in existence for a period of ten years "unless the tax is sooner paid in full."<sup>178</sup>

#### THE GIFT TAX LIEN

A separate and independent lien for federal gift taxes is imposed by Section 1009, Internal Revenue Code. It is similar in nature and in effect to the estate tax lien, and it too is a distinct and alternative lien to the general lien arising after assessment.<sup>179</sup>

The lien burdens to the amount of the unpaid gift tax all gifts made during the calendar year for which the tax liability arises. The statute provides that the lien shall be a charge on the gift property for a period of ten years, with no provision for extension. No requirement is expressed that the Commissioner need take any administrative action to perfect the lien, once the liability for taxes has accrued upon making the gift. The lien attaches to the property in the hands of the donee, but can be divested by sale from the donee to a "bona fide purchaser for an adequate and full consideration in money or money's worth." In such event the lien is not discharged but attaches to all of the donee's property not to exceed the value of the gift. By inference, it appears that a transfer to anyone less than a purchaser meeting the above test would pass the property subject to the lien.<sup>180</sup>

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indicate that the purpose of the amendment is to place the holders or recipients of § 811 assets all "on the same plane of personal liability for the tax." SEN. REP. NO. 1631, 77th Cong., 2d Sess., 2 CUM. BULL. 504, 681 (1942); H.R. REP. NO. 2333, 77th Cong., 2d Sess., 2 CUM. BULL. 372, 495 (1942). For further discussion on the term "bona fide purchaser," see Wright, *Title Examinations as Affected by the Federal Gift and Estate Tax Liens*, 51 MICH. L. REV. 325, 335 (1935).

<sup>175</sup> INT. REV. CODE § 825 provides for such discharge under certain conditions.

<sup>176</sup> INT. REV. CODE § 827(c).

<sup>177</sup> INT. REV. CODE § 827(a); the analysis below as to the running of the statute of limitations on assessment of the gift tax should apply *mutatis mutandis* to the estate tax lien.

<sup>178</sup> That this phrase refers to a possible date of termination of the estate tax lien rather than the date upon which the lien arises is shown by *Rosenberg v. McLaughlin*, *supra* note 164.

<sup>179</sup> "By this section [§ 510 of the Revenue Act of 1932, erecting the framework of the present gift tax lien] there is imposed a lien additional to that imposed by § 3186 of the Revised Statutes [the general lien] in that it attaches to the property transferred by gift as of the time of the transfer." H.R. REP. NO. 708, 72nd Cong., 1st Sess., 30, 1 (pt. 2) CUM. BULL. 457, 478 (1939); SEN. REP. NO. 665, 72nd Cong., 1st Sess., 42, 1 (pt. 2) CUM. BULL. 496, 526 (1939).

<sup>180</sup> INT. REV. CODE § 1009; Reg. 108, § 86.35. For speculation on the type of information required to put a purchaser upon notice of the gift tax lien, see Peters and Maxey, *The Gift Tax Lien and the Examination of Abstracts*, 5 MIAMI L.Q. 64 (1950), and Wright, *Title Examinations as Affected by the Federal Gift and Estate Tax Liens*, 51 MICH. L. REV. 325 (1952).

These provisions apparently are to be applied literally. Thus, it is no defense to the lien to assert that the particular gift received by one of the taxpayer's donees was made under the terms of the gift tax exclusion and therefore did not add to the tax base. The fact that the tax liability arose on a gift of other property to another person is immaterial.<sup>181</sup> Nor it is any defense to argue that the statute of limitations has run on an assessment against the donor, the person primarily liable for the tax.<sup>182</sup> Collection of the tax apparently can be extracted by sale of the donated property in the hands of the donee at any time within ten years after the gift, even though the tax itself cannot be assessed against either the donor<sup>183</sup> or his transferee.<sup>184</sup>

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<sup>181</sup> *Baur v. Commissioner*, 145 F.2d 338 (3d Cir. 1944); *Winton v. Reynolds*, 57 F. Supp. 565 (D.C. Minn. 1944), *dismissed on stipulation*, 148 F.2d 528 (8th Cir. 1945). Both of these cases arose under the Commissioner's enforcement of the donee's personal liability by way of transferee assessment under INT. REV. CODE §§ 1009, 1025, but the reasoning therein appears to be applicable *mutatis mutandis* to liability arising under the lien provisions.

<sup>182</sup> See cases cited in note 169; also *Mississippi Valley Trust Co. v. Commissioner*, 147 F.2d 186 (8th Cir. 1945); *Clara Ream*, 2 T.C.M. 1067 (1943), *dismissed on stipulation*, 7th Circuit, August 8, 1944. Again, these cases deal with the personal liability of the donee as transferee.

<sup>183</sup> INT. REV. CODE § 1016 provides a three-year limitation after the date of filing the return for assessing the tax against the donor.

<sup>184</sup> INT. REV. CODE § 1025 gives the Commissioner one additional year, or four years, to assess the deficiency against a transferee. A possible defense to a suit for collecting an unassessable deficiency in gift taxes by way of foreclosure of the gift tax lien can be erected upon the literal language of INT. REV. CODE § 1016: "... no proceeding in court without assessment for the collection of such (gift) taxes shall be begun after the expiration of three years after the return was filed." This defense has expressly been rejected by the Seventh Circuit Court of Appeals in a case arising out of an assessment of the tax against a transferee more than three years after the return had been filed. *Fletcher Trust Co. v. Commissioner*, 141 F.2d 36, 39 (7th Cir. 1944), *cert. denied*, 323 U.S. 711 (1944). "To so hold," the court stated, "would completely ignore this additional one year period [under § 1026]." The same reasoning appears to be applicable to the ten-year period of the gift tax lien.