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FEDERAL TAX LIENS — A STUDY IN CONFUSION AND CONFISCATION

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The importance of the subject matter in this discussion cannot be over-emphasized in view of the peculiar development of the law in the field of Federal tax liens. We shall not discuss tax priorities governed by the Bankruptcy Act under Section 64 or Section 67 and Chapter X and XI. Nor shall we discuss Section 3466 of the United States Statutes dealing with tax priorities in estates or other special taxes, as the fit tax lien or the distilled spirits lien or maritime liens. This has been the law since 1879. We shall concern ourselves with the subject of the general federal tax lien law, its impact upon finance problems, its conflicts with state lien laws and exemption law, and the overall dangers that may accrue by our failure to understand the all embracing extent of the general tax lien. We are discussing federal collection law, which is now an important part of substantive tax law and business law.

The federal tax liens law being a creature of statute, our first step is to determine from the statute the nature, extent and impact of its terms upon property rights and the latent mischief which it has created in the commercial world.

Under Section 6321 of the 1954 Revenue Code, it is provided:

> If a person against whom an assessment has been made neglects or refuses to pay the amount assessed after demand, a lien in favor of the United States is created against all the real and personal property belonging to the taxpayer in the amount assessed and costs and interest.

You will note at once that the statute does not say the government lien is prior. It simply says that the government shall have a lien on the property of the taxpayer. Nor does the statute say what is "property", or which law, state or federal, interprets the word "property". Hence much is judicial interpretation, and therein lies the headache.

The problem that immediately arises is: What property or rights belong to the taxpayer at the moment the tax lien comes into operation? That question is complicated by the fact that while what is a property right that "belongs to" the taxpayer is governed by state law,[1] the issue of priority between a federal tax lien and a competing lien is a federal question.[2]

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[1] United States v. Bess, 357 U.S. 51 (1958). The Code does not create any property rights but merely attaches the rights created under the applicable law.

[2] United States v. Acri, 348 U.S. 211 (1958). The court in United States v.

Numerous and important cases come to mind that revolve around this issue. But before we discuss the cases and to what property rights the tax lien attaches, we must first determine *when* the lien attaches. The statute, Section 6322 states: "The lien shall arise at the time the assessment is made," and the assessment list is received by the Director. *Goldstein v. Bankers Commercial Corp.*, 152 F. Supp. 856 (1958). Within sixty days thereafter, the District Director is, by Section 63030, required to send notice after assessment to the taxpayer assessed and demand payment. Regulation 301.6301-1 (a) says that failure to give the notice within sixty days after assessment does not invalidate the notice. If the demand is made, even though informal, the lien ataches automatically at the time of assessment.[3]

In other words, the lien comes into being when the assessment is noted on the secret records or "summary record," as it is called, of the District Director's Office, which records are generally not available to the public.[4] And herein lies the major problem. The government tax lien is thus a secret lien and entraps the public into transactions which presumably appear free and clear of any liens—in which transactions, credit is extended.[5] The nature of the lien is such that it is tantamount to an encumbrance on property and subjects it to the payment of the tax. It is in the nature of a secured claim whereby the government has an interest in taxpayer's property, thus securing to the government a privileged position superior to that of taxpayer's creditors whose liens, notwithstanding, may have been prior in time.[6] We were taught in law school that if a lien is prior in time, it is prior in right. That doctrine, while theoretically still correct, is somewhat abrogated in tax

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American National Bank of Louisville, 255 F. 2d 504 (5th cir. 1958) said that liens for federal taxes and the manner for this enforcement are matters which are governed by federal laws. Also see United States v. Bleasby, 153 F. Supp. 724 (D.N.J. 1957). The general tax lien is a sweeping lien and embraces all kinds of property including tangible property and equitable interests. What is "property" is well defined in Citizens State Bank v. Vedal, 114 F. 2d 380 (10th cir. 1940). The court in determining that a "debt" is "property," down down three tests: 1) that it is subject to ownershp; 2) that it is transferable; 3) that it can beb rought under the dominion of a court by any of its usual processes. The federal courts' disregard of state interpretation is exemplified in Deitsch v. Bd. of Liquor License Comm., 58-1 USTC ¶9496 (Cir. Ct. Md. 1958) wherein it was held that a state liquor license is "property" although under state law it is not so regarded.

[3] Int. Rev. Code of 1954, §6322.

[4] The secret lien is defended by the government on the ground that if the government filed its lien in all instances for the general public to know, the credit of the taxpayer would be impaired or destroy it. The secret lien is criticized by others on the ground that secrecy entraps creditors into extending unsecured credit to the taxpayer who is doing his job carrying on his business for the benefit of the government at the expense of creditors. See Felton, *What the Supreme Court says about the Federal Tax Lien*, 37 Taxes 45 (1959).

[5] United States v. Saslavsky, 160 F. Supp. 883 (S.D. N.Y. 1957).

[6] The federal tax lien has the effect of a judgment. Nat'l. Trust etc. Bank v. United States, 135 F. 2d 527 (9th Cir. 1943).

law by the fact that tax liens are not ordinary liens—they are liens of a sovereignty and a sovereign can do no wrong.[7] Not only is the doctrine of sovereignty a limiting factor to the "first in time, first in right" doctrine, but also the sovereign's interpretation of the state statutory lien and contractual lien law limits the doctrine. The federal court's invention of the words "inchoate" and "unperfected," as we shall see, have defeated considerable liens that have heretofore been considered valid by reason of priority in time. For example, a mechanic's lien filed according to statute for all the world to know, is inferior to the government's secret lien assessed in its office, say a year later, because, says the Supreme Court of the United States, the mechanic's lien is an "inchoate and unperfected lien" until it is reduced to judgment.[8] We shall discuss the cases later. Thus, the mechanics or materialmen who furnished goods or services to the taxpayer are entrapped into giving their service and property for nothing to the government on account of the taxpayer's unpaid taxes. One author aptly describes the government as one who "robs Peter to pay Paul's taxes".[9] In this manner, the government acquires rights in property more than the taxpayer has himself. It is incredible, but true! To otherwise explain this anomaly, let us consider the legal nature of property or title thereto. We have traditionally considered title to be property, be it realty or personalty, as a bundle of rights. The taxpayer owns part of this bundle and various lien holders own the rest of this bundle. Now comes the government, who, without being required to file its tax lien so the public may know of its exist-

[7] The court in United States v. Bess, 357 U.S. 51 (1958), said that the government lien creates no property rights but merely attaches consequences, federally defined, to rights created under State Law. The court in Pipola v. Chicco 169 F. Supp. 229 (S.D. N.Y. 1959) defined the assessment as an administrative determination that one is indebted to the government for taxes—in effect, it is a judgment for taxes found due. The lien is defined as the means authorized by law to protect the government's position as a creditor.

[8] The early cases preferred the antedated state lien over the federal tax lien. See list of cases in 63 YALE L. J. 905 at 908 n. 16. Frank R. Kennedy, *The Relative Priority of the Federal Government., The Punicious Cancer of the Inchoate and General Lien.* However, in Spokane v. United States, 279 U.S. 80 (1929) the United States Supreme Court for the first time launched the doctrine of the inchoate and general lien and held that the federal priority defeats an antedated lien that is not choate. The inchoate lien doctrine took on strength in Ill. *ex rel* Gordon v. Campbell, 329 U.S. 262 (1946). Here the state recorded its unemployment compensation lien which by statute became a first lien on the personal property of the employee. In order to protect its security, the state had a receiver appointed and had the court enjoin other creditors from attempting to interfere with the property. The court found that this lien was not "sufficiently specific or perfected" for federal tax purposes. Hence the lienor was identified; the amount of the lien was certain; but the court held the property to which the lien was attached was uncertain since the lien was on "all the personal property used in the business." That is a fluctuating and variable matter. This case further stands for the doctrine that in addition to the requirement of identity, certainty and definiteness, "perfection" required a transfer of title or possession.

[9] Wm. T. Plumb, Jr., *Federal Tax Collection and Lien Problems,* 13 TAX L. REV. 459.

ence, nullifies that part of the bundle of rights owned by the other lienors. Thus the government obtains property rights against the taxpayer which do not even belong to him. A builder may build a $10,000 home for a purchaser and not get a dime—so he files his lien. After the filing, the government's lien arises and prevails over the builder's prior lien. The government isn't taking the land owner's property to pay the owner's taxes, but takes that of the builder to pay the land owner's taxes.[10] By standards of state law, this is federal confiscation.

At this point, we might consider that part of the tax law which protects certain categories of people. The secret and unfiled tax lien is not, under Section 6323 of the Internal Revenue Code of 1954, valid against mortgagees, pledgees, purchasers and judgment creditors who have filed and recorded according to state law. We shall later discuss the rights and problems, and there are many, even among this protected class.

Before we discuss the categories of cases where tentacles of the tax lien consume and become superior to prior filed liens, let us consider the usual types of property to which the general lien attaches. As has been said, the general tax lien attaches to all the property of the taxpayer—and this includes anything that is subject to ownership capable of transfer and subject to jurisdiction in the process by a court. The tax lien automatically attaches not only to all such property, but also to the after-acquired property of the taxpayer[11] and against third persons for services rendered and materials furnished. In short, the federal lien has a built-in after-acquired property clause. The secret lien attaches to the bank accounts of the taxpayer, including deposits made after the lien arises, rights to liquidating dividends or distribution, to equities of redemption[12] to landlords for rent, and the

[10] Even where a gambler loaded his car with gambling equipment and he himself was loaded with the cash of others, all of which was confiscated under the New York gambling laws, all was ordered turned over to the government on the theory that this was property of the taxpayer and the government had a lien. United States v. Lenci, 160 F. Supp. 715 (E.D. N.Y. 1958).

[11] Glass City Bank v. United States, 326 U.S. 265 (1945). The federal tax lien also prevails over a previously recorded security interest in such after-acquired property, whether or not it relates to future advances. United States v. Phillips, 198 F. 2d 634, (5th Cir. 1952) as to future advances. Stockholders Publishing Co. v. Smith, 56-1 USTC ¶9420 (S.D. Cal. 1956) as to substituted security for a prior debt. Also see United States v. Phillips, 198 F. 2d 634 (5th Cir. 1952) and United States v. Saslavsky, 160 F. Supp. 883 (S.D. N.Y. 1957). Here there was a conflict of the government with an attorney who created funds for a client-taxpayer against whom a lien existed. The government contended the fund was "after-acquired" property. The attorney claimed a lien for his fees. The government won and counsel received nothing. As to "after-acquired" increased cash value of an insurance policy held by a bank as security, the court held in Travelers Ins. Co. v. Mercantile Nat. Bank of Miami Beach,—— F. Supp. —— (S.D. Fla. 1958) that the government must prevail as to the increased cash value in the policy. Also see United States v. People's Bank, 197 F. 2d 898 (5th Cir. 1952).

[12] Government's lien against a conditional vendee is good against vendor for sums paid by the conditional vendee which could be procurred in an unjust

government can even force a transferree in fraud to account for tax due the government from grantor. The tax lien probably attaches to property which by law or by special provisions of the contract are not transferrable without the consent of a state or a third party as a franchise or liquor license or a leasehold. *Stagecrafters Club v. D. C. Division of Amer. Legion,* 110 F. Supp. 481, (D.D.C. 1953), 211 F. 2d 811 (D.C. Cir. 1954).

Lawyers dealing with creditor-debtor relations are confronted with numerous problems. For example, if you garnishee wages and a secret tax lien intervenes before a court issues a pay-in-order, what happens? Or what happens if you garnishee the debtor of a judgment debtor and a secret tax lien intervenes? Likewise, what is the result if you make a settlement or a common law composition with a debtor-taxpayer against whom a secret lien exists, and he uses funds and property subject to the lien to make the settlement? If "A", for example, owes "B", the taxpayer, $1,000, and a secret lien exists, "B" then settles his acount with "A" for $500, what are the rights of the government against "A" for the balance? Suffice it for the present to answer these questions by stating that the sovereignty generally will prevail. The government is not bound by the rights of any third persons except in the statutorily protected group. It is not bound by creditors' agreements; by rights of joint tenants, executory contracts, assignments or assignments for the benefit of creditors, assignment of wages, atachment liens, open-end mortgages, surety liens, liens for services,[13] set-offs or defenses of third parties to the tax debtor, or trust mortgages for the benefit of creditors,[14] state lien and exemption laws,[15] and yes, even warehousemen's liens.[16] And if ths is law, what of a bank who honors a check of a depositor against whom a secret tax lien exists? What of the state statutory lien of a lawyer on the papers, money and property of his taxpayer client for services rendered, which property the lawyer has in his possession and which property or money his services created? What about the buyer of realty on land contracts where the owner-taxpayer is subjected to a secret tax lien and the property is sold? Can the buyer get his money

enichment action under local law. Bensinger v. Davidson 147 F. Supp. 240 (S.D. Cal. 1956).

[13] As to legal services, see United States v. Saslavsky, 160 F. Supp. 883 (S.D. N.Y. 1957) and United States v. Pay-o-Matic Corp., 162 F. Supp. 154, *aff'd* 256 F. 2d 581 (2d Cir. 1958).

[14] In Rev. Rule 56-592, the service ruled that a "Trust Mortgage" executed to trustees for the benefit of unsecured creditors of taxpayer is not a mortgage within meaning of Section 6233. Therefore, trustees under such a trust mortgage do not have priority over a subsequently recorded federal tax lien. The contrary position taken in Benjamin Gorgill, Trustee, 218 F. 2d 556 (1st cir. 1955) will not be followed by Internal Revenue Service.

[15] United States v. Bess, 357 U.S. 51 (1958) *held:* State insurance exemptions are inoperative—to prevent attachment of liens created by federal statutes.

[16] Styles v. Eastern Tractor Co., 154 F. Supp. 393 (S.D. N.Y. 1957).

back? The reader now has sufficient background in the problems so that we may now examine some significant cases and decisions in the field of tax lien priorities.

Attachments and Garnishments

The United States Supreme Court on January 10, 1955, made two important decisions. One was *United States v. Acri,* 348 U.S. 211 (1955), which involved an attachment lien; the other, *United States v. Liverpool Ins. Co.,* 348 U.S. 215 (1955), involved a garnishment lien. In both cases the tax lien of the government arose after the attachment and garnishments were filed. The *Acri* case was one where certain bonds and cash were attached under the Ohio law. The attachment suit was filed and judgment was subsequently obtained. However, before the judgment was rendered, the government tax lien arose. The Ohio Supreme Court held that under Ohio law an attachment is an execution in advance and the lien is perfected at the time *of the attachment.* Therefore, the Ohio court held, that the *Acri* case is distinguishable from other types of cases such as *United States v. Security Trust and Savings Bank,* 340 U.S. 47 (1950). In the *Security Trust* case the plaintiff secured an attachment lien against four parcels of real estate of the defendant. Thereafter, a federal tax lien arose against the defendant and was later filed, after which plaintiff got judgment. The court held the federal tax lien superior. The court held the attachment was a mere notice of a more perfect lien to come. The *Security Trust* case was the first to apply the term "choate" to a tax priority issue in solvency cases.[17] The government took the *Acri* case to the United States Supreme Court, and the Supreme Court said the Ohio court's distinction between the *Security Trust* case and the *Acri* case is immaterial for the purposes of federal tax law, and that an attachment lien in the state of Ohio is for federal tax purposes an inchoate lien, because, at

[17] Prior to the *Security Bank* case, the federal courts gave literal interpretations to the doctrine of "first in time, first in right" and respected state statutes as to their respective interpretation of what is a valid lien. Professor Frank Kennedy in his excellent article on the Relative Priority of the Federal Government, etc., 63 YALE L. J. p. 905 lists in his note 115, at page 924, thirty cases involving mechanic's liens, equitable liens of sureties, garnishment liens, assignments, local tax liens, statutory liens of landlords, etc. in all of which priority was granted over a federal tax lien. However, all these cases were decided before the Supreme Court spoke in the *Security Bank* case. Some lower courts, thereafter rebelled against the seeming inequity of the *Security Bank* case and have obderrately resisted the efforts of the government to enforce the law of the *Security Bank* case. Thus in U.S. Fidelity and Guaranty Co. v. United States, 201 F. 2d 118 (10th Cir. 1952), the surety's equitable lien was held prior to the federal tax lien. Even a conditional sale was upheld against a federal tax lien in United States v. Anders Contracting Co., Inc., 111 F. Supp. 700 (W.D.S.C. 1953). A materialman's lien, too, was sustained as superior to a government tax lien in United States v. Griffin-Moore Lumber Co., 62 So. 2d 589 (Fla. 1953). The impact and implications were recognized as revolutionary in several Law Review articles of that day. 39 GEO. L. J. 496 (1956); 35 MINN. L. REV. 580 (1951); 26 N.Y.U.L. REV. 373 (1951).

the time of the attachment, the *fact* and *amount* of the lien were contingent upon the outcome of the suit for damages upon which the attachment was based. Even the argument that the plaintiff did everything it could to protect its lien by attachment was held untenable. The court relied upon *United States v. Security Trust, etc.*, 340 U.S. 47 (1950). The argument—that once the judgment was obtained, the effect thereof was retroactive to the date of the attachment lien—was likewise held controvertible. Moreover, the *Acri* case held: the determination of when a lien is choate is a federal question.[18]

In the case of *United States v. Liverpool Ins. Co.*, 348 U.S. 215 (1955), the subject of litigation was a fund due under a fire insurance policy. A garnishment was served on the insurance company in connection with a suit on an open account. After judgment against the defendant (debtor-taxpayer) but before the court issued a pay-in-order for the garnishor, the federal tax lien arose. The court, citing the *Acri* case and the *Security Trust* case, held the federal tax lien paramount to that of the garnishor.[19]

At this point we should discuss another oft used argument of the attaching lineor. He argues that Section 6323 of the Internal Revenue Code of 1954 excepts a *judgment creditor* from the secret lien priority, and that as such the lienor is within the protected class as a judgment creditor. The courts have consistently held that an attachment lienor is neither a "purchaser" nor a "judgment creditor" within the meaning of the Statute, Section 6323, allowing protection to lienors in such categories;[20] that attachment proceedings are merely notices to acquire a lien yet to arise and therefore an "unchoate" lien; that attachment proceedings are contingent interests which are not determined until judgment; that even judgments are not enough where the state law requires more to be done to secure a judgment lien.[21] The question is—what about states which by the *terms of their statutes* give attachment liens an immediate lien upon filing of the proceedings? The govern-

[18] The court said: "The State's characterization of its liens while good for all state purposes does not necessarily bind this court." Also see United States v. Lenci, 160 F Supp. 715 (E.D. N.Y. 1958); Leipert v. R. C. Williams & Co., 161 F. Supp. 355 (S.D. N.Y. 1958); United States v. Pay-o-Matic Corp., 162 F. Supp. 154, *aff'd* 256 F. 2d 581 (2d cir. 1958); Fidelity & Deposit Co. of Md. v. New York Housing Authority, 157 F. Supp. 87, (S.D. N.Y. 1957) as to non-retroactivity of mechanical lien, see United States v. Hulley, 358 U.S. 66 (1958).

[19] In Oxford Distributing Co. v. Famous Roberts Inc., 173 N.Y.S. 2d 468 (1958), the government filed its tax lien after the judgment creditor got his judgment. The judgment creditor then brought a third party proceedings and succeeded in causing the taxpayer-debtor to surrender a liquor license and thereby created a fund. Government lien was held paramount.

[20] MacKensie v. United States, 109 F. 2d 540 (9th Cir. 1940); United States v. Hawkins, 228 F. 2d 517 (9th Cir. 1955).

[21] Miller v. Bank of America, 166 F. 2d 415 (9th Cir. 1948); Beeghly v. Wilson, 152 F. Supp. 726 (N.D. Iowa 1957); Ersa, Inc. v. Dudley, 234 F. 2d 178 (3d Cir. 1956).

ment's answer to that is: that notwithstanding what the state statute says, the federal courts have the right to re-examine the state statutes and only the federal interpretation thereof governs. *Ill. v. Campbell,* 329 U.S. 362 (1946) and *United States v. Acri,* 348 U.S. 211 (1955) hold that state given liens are a matter of federal court interpretation and are binding even though the state court has custody of the property in question. The rationale of the federal courts is that the attachment lien is unperfected since both the fact of the lien and the amount thereof is unknown until the outcome of the suit. *United States v. Jewel Hankins,* 228 F. 2d 517 (9th Cir. 1955); *United States v. Security Trust and Savings Bank of San Diego,* 340 U.S. (1950).

Mechanic's Liens

Nowhere does there appear greater inequity than in the mechanic's lien area, where the decisions permit the enforcement of federal taxes at the cost of innocent third parties who improved or even created the property of the taxpayer or who relied upon the credit of taxpayer's property—all before the secret tax lien existed.

Mechanic lienors suffered three setbacks in the United States Supreme Court.

1. In *United States v. Vorreiter,* 355 U.S. 15 (1957) the Supreme Court reversed without opinion the Colorado Supreme Court which held that a prior recorded mechanic's lien had priority over a federal tax lien.[22]

2. *United States v. Collotta,* 350 U.S. 808 (1955), involved tax liens which arose during the work and before mechanic's lien were perfected.

3. In *United States v. White Bear Brewing,* 350 U.S. 1010 (1956), the court subordinated the mechanic's lien of a mechanic who completed his work, filed his lien and commenced foreclosure proceedings before the tax lien arose. The court succinctly held the lien inchoate.[23]

Under present law, the prior filed mechanic's lien is subordinated to a later secret federal tax lien arising thereafter. The courts in the said three cases have applied the "choate" tests set forth in the *New Britain* case.[24] In applying the choate lien doctrine in the foregoing cases, we can readily say that the private lienor is identifiable; the

[22] Aquilino v. United States, 3 N.Y. 2d 511, 146 N.E. 2d 774 (1957), involved taxes of a contractor. It was there held that the government may take the proceeds and the tax lien prevails over the rights of those whose labor and materials erected the property and for which they had a mechanic's lien.

[23] See also United States v. Hulley, 358 U.S. 66 (1958) reversing 102 So. 2d 599 Fla. 1958). Also see Shott, Admr. v. Peoples Bank, 157 N.E. 2d 47 (1957), where it was held that a federal tax lien prevails over an adverse mechanic's lien which arises prior in time but has not become perfected or made choate. The court defined "choate" as when the lien is perfected so there is nothing more to be done; when the identity of the lienor, property subject to the lien and the amount of the lien, are established.

[24] 347 U.S. 81 (1954).

property is the particular realty improved by the mechanic. Although the amount is presumably the correct price, the courts say that the amount is not determined and certain until the courts have reduced the amount to judgment. Hence, they are inchoate, and the later federal tax lien prevails. The theory of the courts is that the mechanic's lien is not a property right, but a substtiute for a property right, or an intent to assert a property right.

The Effect of White Bear Brewing Case on Real Estate Titles

The *White Bear Brewing* case[25] was one where the lienor had commenced foreclosure proceedings before the federal tax lien arose. The Supreme Court gave priority to that lien that *arose* after the equity suit was filed.

A basic and cardinal principle of law is the doctrine of Lis Pendens, that if an interest is acquired during the pendency of a suit, that interest is bound by the decree of the court.[26] Suppose we have an equity foreclosure of a mechanic's lien or a suit involving title to realty after which the government lien arises. Isn't the government bound by the law of Lis Pendens? This was argued in the *White Bear Brewing* case, but the court did not decide that question. It stepped aside from the issue. Can the government sit by in a foreclosure action, let the property go to decree of foreclosure and sale, and then step in and take over the realty for its lien? At this point it seems so.

If the government is not bound by Lis Pendens, real estate lawyers have enormous problems confronting them. Any attorney foreclosing a mortgage must then check for revenue liens every day until sale day or the date on which the sheriff executes his deed. Now supposing the revenue lien does arise after the sale, what steps do the lawyers take to clear the title? Will a new suit be required to clear the title pursuant to Section 7424 of the Internal Revenue Code? What happens to the costs, attorney fees and expenses of suit which would ordinarily be covered by the mortgage lien, or payment of mechanic's liens or other liens in the foreclosure action that are considered inchoate?[27]

And speaking of mortgages, what about a mortgage foreclosure under a power of sale contained in the instrument rather than by judicial procedure, and a federal tax lien arises subsequent to mortgage but prior to mortgagee's sale—can the government lien be cut out? The Sixth Circuit says "NO" in *Metropolitan Life Insurance Co.*

[25] 350 U.S. 1010 (1956).

[26] The federal courts have heretofore held that the United States is bound by the doctrine of Lis Pendens when acquiring a non-tax right in real estate, United States v. Mayse, 5 F. 2d 885 (9th Cir. 1925); United States v. Calcosieu Lumber Co., 236 F. 2d 196 (5th Cir. 1916).

[27] United States v. Ball Construction Co., 355 U.S. 587 (1958); United States v. Land 155 F. Supp. 195 (D.C. N.H. 1957). It is sought by the American Bar Association to change §2410 of the Judicial Code, making the doctrine of Lis Pendens applicable to the government.

v. United States, 107 F. 2d 311 (6th Cir. 1939). The Fifth Circuit says "YES" in *United States v. Boyd,* 246 F. 2d 477 (5th Cir. 1957) *cert. denied* in 355 U.S. 889 (1957).

Quaere: Is a mortgage with a power of sale more choate than a mechanic's lien? We do not know.

Miscellaneous Liens

What is the status of the lien of an attorney to whom 25% interest in a cause of action had been assigned? It was held inchoate and subordinate to federal tax lien arising thereafter because: judgment fixing the amount for the attorney was not rendered and therefore not determined as a sum certain. *United States v. Goldstein,* 58-1 USTC, ¶9478; 256 F. 2d 581 (2d Cir. 1958), *cert. denied* 358 U.S. 830 (1958). *Re: New Haven Clock etc. Co.,* 253 F. 2d 577 (2d Cir. 1958), where the amount was unknown, therefore inchoate; *First State Bank of Medford v. United States,* 166 F. Supp. 204 (D.C. Minn. 1958); *Commercial Standard Insurance Co. v. Campbell,* 254 F. 2d 432 (5th Cir. 1958).[28] An equitable vendor's lien was subordinated to a later federal tax lien on ground that the former was enforceable only by suit—hence, inchoate until judgment; and further, it is subject to defeat by a bona fide purchaser.[29]

But where the taxpayer sold part of his interest in a pending case, even though a government tax lien had already arisen but was unfiled, the court held that the attorney was a purchaser and protected under Section 3672, Internal Revenue Code of 1939, as a "purchaser." *Sherman B. Roth, Inc.* (D.C. Mass. 1957), also a district court case, held a fund in the attorney's hands created by him must first be used to pay the attorney for his services before the federal tax lien is paid. *C. Sullivan Co., Inc. et al.,* (D.C. R.I. 1957). These cases preceded the *Goldstein* case and the *New Haven Clock* case.

What is the result where a warehouseman has a lien on goods stored in his warehouse before a tax lien arises? The government still won—the "Lien is inchoate," said the court.[30]

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[28] In United States v. Liverpool and London Globe Ins. Co., 348 U.S. 215 (1955) the issue involved the superiority of the tax lien over a garnishment. The question of attorney fees was also involved and the court held that since the garnishor's lien was not prior to the tax lien the attorney fee in the garnishment proceeding could not be prior either. On March 5, 1958 the Court of Appeals refused to follow the Goldstein case in United States v. Coblentz—N.E. 2d—(1958) where the court sustained an attorney's lien in a condemnation award. The court said that by his percentage contract, the lawyer became a "purchaser" in his share. Only the United States Supreme Court can resolve this conflict. To the same effect see: United States v. Bates, 158 F. Supp. 32 (E.D. Ky. 1957) and Marteney v. United States, 245 F. 2d 135 (10th cir. 1957).

[29] United States v. Morrison, 247 F. 2d 285 (5th Cir. 1957). See Morris Sasbosky (D.C. N.Y.) where lien arose before work done.

[30] Styles v. Eastern Tractor Mfg. Co., 154 F. Supp. 393 (S.D. N.Y. 1957).

Even a Trust Receipt under the Uniform Trust Receipts Law is held as nothing more than a promise to pay. *United States v. Profaci,* 137 F. Supp. 795 (E.D. N.Y. 1955).

There is one area where the government has not fared well or made too many court tests. That is where the lien holder has possession and maintains such possession by virtue of his lien as an innkeeper, garageman, etc., and, while subject to government seizure for sale, the distribution is subject to the possessory lien. In *United States v. Gilbert Associates, Inc.,* 345 U.S. 361 (1952), the court held the priority over a federal tax lien must rest upon possession by the private lienor. To protect creditors, the safer security is the possessory one rather than the non-possessory or changeable one.

Of course, if the federal tax lien is on file prior to the acquisition of a possessory lien, the federal tax lien prevails without doubt, and if unfiled, the possessory lienor might claim protection under the statute as a pledgee—as one holding the property to secure the charges. Nevertheless in *Styles v. Easter Tractor Co.,* 154 F. Supp. 393 (S.D. N.Y. 1957), the court held that the lienor is unprotected until he secures a judgment. In *Clyde Lucas, et al.,* (D.C. N.C.) the district court held in favor of a federal tax lien over the certificate of a claimed assignment, where the assignee did not have physical possession of the certificates.

We have thus far been talking about the creditors of the taxpayer and how the government lien has enveloped the property of creditors; but the government reaches all forms of property, including rights against the debtors of the taxpayer. The debtors of the taxpayer have fared no better than creditors. For example, a taxpayer's debtor was denied the benefit of the statute of limitations on the debt when the debt was not barred at the time the unfiled lien arose, but was barred under state law long before the government sued and levied.[31] The government may be bound, however, when it accepts a derivative right. *Guaranty Trust Co. v. United States,* 304 U.S. 126 (1938).

While the debtor is permitted certain defenses such as—that no debt is due the taxpayer, or that a set-off exists,[32] or that prior judicial process was effected or that the government levy was not valid, the debtor of the taxpayer is not permitted to contest the merits of the tax against the taxpayer. The burden, however, is upon the government to prove ownership of the property or debt due the taxpayer. For ex-

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[31] United States v. Jacobs, 155 F. Supp. 182 (D.C. N.J. 1957). Also see United States v. Sommerlin, 310 U.S. 414 (1940).

[32] Bank's right of set-off ceases once a federal tax lien has been filed even though it holds demand obligations created prior to the day the federal tax lien arises. Bank of Nevada v. United States, 251 F. 2d 820 (9th Cir. 1957). In this case the loan was made before the tax lien was filed but after it became a secret lien.

ample, see *United States v. Stock Yards Bank of Louisville,* 231 F. 2d 628 (6th Cir. 1956), which involved a distraint upon Series E Savings bonds jointly held. Also, although a levy by the government against a debtor reaches only the debt or property held at the time of the levy and not what there may be later, if the debtor fails or refuses to pay over to the government such debt, the penalty is 100% of the tax or the amount not paid over, whichever is the less. Internal Revenue Code of 1957, Section 6332.

However, in the event the creditor-taxpayer sues the debtor, payment to the government is a good defense.

One of the more unpalatable debtor cases is *Bensinger v. Davidson,* 147 F. Supp. 240 (S.D. Cal. 1956) where the taxpayer had a tax lien filed against him and thereafter purchased a house under a land contract, but defaulted after paying to vendor the sum of $17,200. There the taxpayer-vendee had a right of unjust enrichment against the vendor, which claim the parties settled. The government disregarded the settlement and determined for itself the amount recoverable.[33]

Can a debtor pay his debt to the taxpayer without searching for secret liens? Yes he can, not by statute however, but by regulation, provided the debtor has no actual knowledge of a lien. A bank, in the ordinary course of business with its depositor, without actual notice or knowledge of the federal tax lien and in absence of fraud or negligence, incurs no liability if payment is made to the depositor or his order. Also an insurance company may pay or make loans on a policy if they lack actual knowledge of the lien, because the loan is tantamount to prepayment of the obligation. *Bd. of Assessors v. N.Y. Life Ins. Co.,* 216 U.S. 517 (1910). But suppose the government levies on a bank account. It now has knowledge. It pays over the amount on hand to the government. Must the bank now check the government records every day in the future to see if the balance of tax is paid by the taxpayer-depositor? It is important for business lawyers to constantly be aware that the bank problem of set-offs is—when does it have the "right?" *Held:* Not after notice of federal tax lien. *Bank of Nevada v. United States,* 251 F. 2d 820 (9th Cir. 1957), *cert. denied,* 356 U.S. 738 (1958).

The tax priority decisions have put in jeopardy open end mortgages; *i.e.* a mortgage providing that additional loans made after the original one shall be secured by the same mortgage. However, until the additional loan is made there is no perfected loan with respect to

[33] Inequity was compounded in Leipert v. R. C. Williams & Co., 161 F. Supp. 355 (S.D. N.Y. 1957), government again defeated persons acquiring houses under a Land Contract where purchaser had possession but not title, it was held: Purchaser is not a "purchaser" under the protecting statute—worse, buyer could not get his money back because vendee's lien was too "inchoate." The doctrine that possession is notice to all the world is meaningless where a tax lien is involved.

it, and an intervening federal tax lien has priority over later loans on the prior mortgage. The same rule applies to a recorded pledge, chattel mortgage or bill of sale given as security, where a creditor is obligated thereunder to give additional credit in goods or money, and an intervening federal tax lien arises. The federal lien invariably takes priority.[34] Whenever a revolving fund or ever changing property exists such as annuities and accounts receivable or changing inventory as security, the federal tax lien prevails.[35]

The argument that the lien relates back to the date of mortgage is futile, since the lien as to funds to be advanced at a later date is deemed inchoate as to that amount to be advanced.

The impact of the *Ball Construction* case[36] on mortgage security has actually upset the financial circles. Until the Supreme Court spoke in that case it was thought that Section 6323(a) Internal Revenue Code of 1954 protected mortgages properly filed with the secret federal tax lien imposed by Section 6321 of the Internal Revenue Code. Moreover, the 1956 Revenue Ruling further protected obligatory advances

[34] United States v. Peoples Bank, 197 F. 2d 898 (5th Cir. 1952); United States v. Lord, 155 F. Supp. 105 (D.C.N.H. 1957). Definitely contracted for obligatory advances made under a properly executed and recorded construction loan mortgage "were excepted from the open end mortgage" rule by an unpublished ruling A-619373—8/24/56, but this was before the *Ball Construction* decision.

[35] An interesting aspect of assignments and a revolving fund is found in the assignment of accounts receivable in Benedict v. Ratner, 268 U.S. 353 (1925). The *Ratner* case stands for the principle that a reservation or exercise of dominion over property assigned to secure a loan will invalidate the security of the assignment. The *New Haven Clock & Watch Co.* Debtor case (Chap. X in Bankruptcy) 253 F. 2d 577 (1958) came later, and held that since there was dominion exercised over the security by the holder of the security, it was not subject to Federal taxes and was the true security of the bank, the assignee. The court in the *New Haven Clock* case decided that, based upon the state law (Conn.), this assignment was valid. Quaere: What if this was not in bankruptcy and a government tax lien intervened, would the court recognize the assignment as creating a choate lien in the revolving fund? The court did apply the "choate doctrine" to the demand for attorney fees by the bank, stating that the bank lien on the fund for attorney fees was "inchoate" and so did not precede the government tax lien. The *Ball Construction* case, 355 U.S. 587 (1958) may give us the answer—that no matter what the dominion over accounts receivable, as long as it is unspecific and revolving, it involves an inchoate lien, and therefore subject to a federal tax lien.

[36] United States v. Ball Construction Co., 355 U.S. 587 (1958). While the case involved a contest between the government and a surety on the contractor's surety bond, the decision has an effect on mortgagee's rights to a lien for contractual disbursements made after a federal tax lien is recorded. The events of the *Ball* case were: 1. performance bond was executed and the bonding company got a pledge of the contract proceeds as security; 2. tax lien of the contractor recorded; 3. contractor defaulted and the bonding company finished the job with its funds after which contractor's proceeds were due to the bonding company. When the government contested the right of the bonding company to take the proceeds, the Supreme Court of the United States merely stated that the bonding company's lien was inchoate and held the government lien prior. The tragedy of this case is that when the federal tax lien was recorded the bonding company was under contract to fulfill its commitment and finish the job, and it had no freedom of choice. Then the government sat by and grabbed the developed asset.

"definitely contracted for and required to be made under a properly executed and recorded construction loan mortgage." If the *Ball* decision considers funds not paid to a mortgagee as subordinate to a secret federal tax lien, it places all bank loans in jeopardy. If the bank should not advance the future funds to the taxpayer-mortgagor under its agreement, what is the liability of the bank to the taxpayer mortgagor? We find no case to answer this question.

The *Ball* case has created another uncertainty in the law. Heretofore no one would question the right of the mortgagor to extend his security to interest generally, and even after a tax lien is filed.[37] Since some interest will accrue after the federal tax lien is filed, and therefore is "inchoate" or "unperfected" or "not determined" until after the lien is filed, will the after-accrued interest suffer the same fate as the after-advanced funds by a bank in open end mortgage cases?

The same issue arises as to contractual liens for mortgagee's foreclosure expenses, for insurance or any other act to be done for the benefit of the property. In at least two cases, the courts seem to hold against the mortgagee's priority.[38]

The *Ball* case stands as a warning against those who take a security for a future or contingent obligation, the theory being that if the obligation is contingent and does not exist, there can be no security for it and the lien is therefore unperfected and inchoate.[39]

Another area where the impact of the *Ball Construction* case will be felt is in the commercial field where the Uniform Trust Receipts Act, the Factors Act, the Inventory Lien Law, and the Assignment of Accounts Receivable Acts, exist. The open end mortgage theory as applied to the federal tax lien will likely apply since the lender must generally file a notice that he is going to do business under one of the above mentioned acts. He does not and practicably, cannot, check for federal tax liens every day. All business done under these acts is in constant jeopardy.

But worse—an important instrument in the banking business is the letter of credit. A customer asks a bank to issue a letter of credit to a

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[37] Glenn v. Ames Surety Co., 160 F. 2d 799 (6th Cir. 1947). In United States v. Lord, 155 F. Supp. 195 (D.C. N.H. 1957), the court said specifically that the mortgage is entitled not only to priority on principal but also on the interest, but that was before the *Ball Construction* case. See United States v. Sampsell, 153 F. 2d 731 (9th Cir. 1946).

[38] *Re* New Haven Clock & Watch Co., 253 F. 2d 577 (2d Cir. 1958). Legal expenses have been allowed priority though incurred after tax lien in the *Sampsell* case, but this was before the *Ball Construction* case. See United States v. Lord, 155 F. Supp. 105 (D.C. N.H. 1957). When priority was denied for payment of insurance and taxes required under the mortgage.

[39] Recent application of this doctrine is found in United States v. Ringles, 166 F. Supp. 544 (D.C. Ohio 1958). Here an attorney was given a mortgage for future services. Liens for taxes were filed against the mortgagor. *Held:* the attorney could receive only the dollar value for services actually rendered. The balance due for services after the lien was filed was inferior to the tax lien.

third party in which the bank agrees to honor drafts of that third party. As the drafts are sent the bank does honor them, and to be certain of payment, the bank often desires security. Is the bank lien on this security choate so as to supercede a later arising federal tax lien? It is probably unlikely because the lien is inchoate, for it is not even known if and when a draft will be sent by the customer! Unless the law is changed, the sanctity of commercial transactions is uprooted.

Construction loans, crop and livestock mortgages, chattel mortgage clauses in leases, wage and rent assignments and assignments of earnings under a contract, fluctuating inventories given as security, all are in jeopardy because of the *Ball Construction* case.

Does this *Ball Construction* case put in jeopardy subrogation by insurance companies in tort cases when the cause of action arises in the plaintiff, after which a tax lien arises? Does the lien have priority to the subrogation? We do not yet know.

Another area of serious importance is the problem arising out of purchases of automobiles. Those who lend on automobiles as security generally rely solely upon a certificate of title. If the government has filed a lien against the taxpayer-owner and a loan is made solely upon the title showing it free of lien, the lender's lien is inferior. Yet few lenders go beyond the certificate of title to the automobile. Thus in *Merchants Loan Co.*, 57-2 USTC, ¶9741, (D.C. Ariz. 1957), the court held a tax lien superior to a chattel mortgage lien on a motor vehicle where tax lien was filed first even though not filed with the Bureau of Motor Vehicles as required by state law.[40]

In jointly owned property with survivorship, the government can enforce partition and enforce the tax lien against taxpayer's share to the exclusion of other owners. *United States v. Brandenburg,* 106 F. Supp. 82 (S.D. Cal. 1952). The same is true as to joint bank accounts. *United States v. Third National Bank and Trust Co.,* 111 F. Supp. 152 (M.D. Pa. 1952).[41] State-granted exemptions in life insurance are ineffective against a government secret tax lien, for the government can take the cash value even after death, in the hands of the beneficiary, *United States v. Bess,*[42] provided the lien attached before death. If no lien

[40] To same effect, see Union Planters National Bank v. Godwin, 140 F. Supp. 528 (E.D. Ark. 1956). Kelly Kar Co. v. United States, 56-1 USTC ¶9481 (SD. Cal. 1956); Merchants Loan Co. v. United States, 57-2 USTC ¶9741 (D.C. Ariz. 1957); Liberty Bldg. Co. v. Riddell, 53-1 USTC ¶9404 (S.D. Cal. 1953).

[41] The same rule exists as to co-owned United States Savings Bonds, United States v. U.S. Stockyards, 231 F. 2d 628 (6th Cir. 1956).

[42] 357 U.S. 51 (1958) a curious part of this opinion is that the court limited the government's priority to the cash surrender value because the balance of the proceeds consisted of property in which the decedent himself has no interest *under State law.* Here the court defines what is "property" based upon state law. Should this be different from other state law interpretation. *In re* New

accrued until after death, the government does not get a lien on any of the proceeds . *Commission v. Stern,* 357 U.S. 39 (1958). This is also true while the taxpayer is living. *Knox v. Great West Life Ins. Co.,* 212 F. 2d 207 (6th Cir. 1954).

Even a spendthrift trust, whether protected by the contract giving rise to the trust, or protected by the law of the state, is subject to an intervening government lien.[43] *In re Rosenberg's Will,* 269 N.Y. 247, 199 N.E. 206 (1936); likewise see: *United States v. Dallas Nat'l Bank,* 152 F. 2d 582 (5th Cir. 1946); *Leuschner v. First Western Bank & Trust Co.,* 57-2 USTC ¶9734. In a revocable trust, if the tax lien arises against the trustor, *i.e.* against the one with the power of revocation, the government may force revocation. The state exemption given to Workmen's Compensation,[44] employment insurance and disability insurance proceeds[45] and even rights to alimony are subordinated to intervening federal tax liens. *Fried v. N.Y. Life Ins. Co.,* 241 F. 2d 504 (2d Cir. 1957).[46] The lien of the government even disregards the state homestead and exemption laws. *United States v. Heffron,* 158 F. 2d 657 (9th Cir. 1947).

Some states give the landlord a lien. The landlord's lien suffered the same fate as other statutory liens. In *United States v. Scovil,* 348 U.S. 218 (1954) the landlord had a receiver appointed to enforce his lien against the tenant and his assets were sold for the rent. The government secret tax lien arose before the appointment of a receiver. The United States Supreme Court held that the landlord's lien was not perfected in the federal sense because, said the court: "The state law allowed defendant to file a bond and defeat the lien and the landlord's lien is only a caveat for a more perfect lien to come." Prior to that, the Supreme Court, in *United States v. Waddill etc., Inc.,* 323 U.S. 353 (1945) said that only after the lien is asserted by way of execution, and the levying officer severed the goods from the general assets, can the lien

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Haven Clock & Watch Co., 253 F. 2d 577 (2d Cir. 1958) the court upheld the priority of an assignment of accounts receicable where the creditor assumed sufficient domain over the accounts receivable in accordance with state law. Here again the court relied upon state law to determine property rights. See William T. Plumb Jr., *Federal Tax Collection and Lien Problems,* 13 Tax L. Rev. 247, at p. 255 (1957) for a comparative analysis of insurance and tax lien priorities. Also see Pyle, *Liability of Life Insurance, etc. for unpaid income taxes, etc.,* 9 Tax L. Rev. 205, 325 (1954).

[43] *In re* Rosenberg Will case, 269 N.Y. 247, 199 N.E. 206 (1936) and in United States v. Fid. and Dep. Co., 214 F. 2d 565 (5th Cir. 1954) which involved a homestead exemption, the courts allowed a subordinate federal tax lien to take exempt property. See United States v. Dallas Nat'l Bank, 152 F. 2d 582 (5th Cir. 1946), 167 F. 2d 468 (5th Cir. 1948).

[44] United States v. Ocean Accident Co., 76 F. 2d 277 (S.D. N.Y. 1948).

[45] Fried v. N. Y. Life Ins. Co., 241 F. 2d 504 (2d Cir. 1957), *Cert. denied,* 353 U.S. 922 (1957).

[46] Rev. Rul. 89, 1953, 1 Cum. Bull. 474, United States reaches all property by foreclosing the tax lien including property exempt by state law. United States v. Hoper, 242 F. 2d 468 (7th Cir. 1957).

be said to be perfected as against a government's secret tax lien. The government argument seems to be that the lien to be perfected must be indefeasable.[47] Actually, the *Ball Construction* case which extended the "choateness" doctrine to contractual consensual liens, *makes* such liens as landlords' liens, or leases with chattel mortgage clauses, ineffective against an intervening federal tax lien.

State and Local Tax Liens

Not only do private persons have their problems with the government tax lien, but so does the state. In *United States v. New Britain,*[48] the United States Supreme Court held thus where the statutory lien was asserted by Pennsylvania under the Pennsylvania Unemployment Compensation law by delivering a writ of execution to the sheriff after which the government made a secret assessment before the actual execution on goods. The court held in *Ersa, Inc. v. Dudley,* 234 F. 2d 178 (3d Cir. 1956), that the property was not relieved of a prior federal tax lien; that until actual execution on the goods, the lien is unchoate. In *United States v. Texas,* 314 U.S. 480 (1941) the court held a federal tax lien prior to a state gas tax lien; where statute declared the state lien to be a first and preferred lien on all property used in taxpayer's business. The court said that the state lien is neither specific nor constant and the amount uncertain, and therefore must be subordinated to the federal tax lien. A basic case is that of *Illinois v. Campbell,* 329 U.S. 362 (1946), wherein the Supreme Court was confronted with a lien on all personal property used in business, recorded and filed in amount and the court still found the state lien inchoate on the tenuous ground that the lienor could not know what property was subject to the lien until the inventory was filed. The *Gordon* case doctrine was again challenged in *United States v. Gilbert Associates, Inc.*[49] In the *Gilbert* case, New Hampshire's Supreme Court found that a lien of a town property tax on machinery, which had been foreclosed by advertisement and sale prior to the time that the federal tax lien arose, was a complete fulfillment of the United States Supreme Court's prerequisite for a valid prior lien. *Gilbert Associates, Inc.,* 97 N.H. 411, 90 A. 2d (1952). TheSupreme Court of the United States in 345 U.S. 361 (1953) did not question that the lienor was identified, or that the amount of the lien was certain or that the property subject to the lien was definite, but based its holdings on the fact that the taxpayer had not been divested by the town of either title or possesion. Thus once

[47] The rationale of the court was that up to the instant any lien is terminated by payment there can be no certainty that the lienor will insist upon his full rights under the lien. How far will the courts go to sustain a position of unchoateness as to the competing lien? Payment of course distinguishes every lien; however, perfected otherwise.

[48] 347 U.S. 81 (1954).

[49] 345 U.S. 361 (1953).

again we have the Supreme Court adding a fourth requirement to perfection of a lien, namely, *possession* and *title*. Then what about pledges or statutory possessory liens? The bailee may have possession and by reason thereof assert a lien; but to require title in addition thereto seems to be a legal solecism. There just seems to be no completely logical process that is followed in the fervent effort to hold a federal tax lien prior in right, although later in time.

In *New York v. Maclay et al,* 288 U.S. 290 (1933) the court held the government tax lien paramount over a franchise tax because the franchise tax was not specific or perfected, since the amount of liability was unliquidated and unknown.

In *City of Spokane v. United States,* 279 U.S. 80 (1929) the federal tax lien was paramount to the personal property tax of the state because the lien was inchoate. See also *Mass. Bonding Co. v. N.Y.,* 259 F. 2d 33 (2d cir. 1958).

The Exceptions to Section 6321

As heretofore indicated, mortgagees, pledgees, purchasers and judgment creditors who become such, or one of them, before notice of the federal tax lien is filed, are entitled to priority over the federal tax lien. The federal law governs as to whether a particular individual qualifies as a member of any of the excepted classes.[50] This protection is afforded members of each of the classes by Section 6323(a).

Mortgagees who have properly filed their mortgages have priority over federal tax liens filed later. The secret lien is ineffective against a properly filed mortgage.[51] The fact that a mortgagee has knowledge of an assessment against a taxpayer and does not execute or file his mortgage until after such knowledge, is immaterial to the priority of the mortgage.[52] Open end mortgages as has been noted do not enjoy the same privilege.[53] In any event, new concern exists as to all mortgages other than conventional mortgages notwithstanding Section 6323(a)(5). For example, a trust mortgage for creditors for purposes of reorganization or composition of debt where the ultimate goal is to return the business to the debtor has been held to be a "mortgage," for the purpose of tax lien priorities, in one case.[54] However this was

[50] United States v. Gilbert Associates, 345 U.S. 361 (1953).

[51] Underwood v. United States, 118 F. 2d 760 (5th Cir. 1941). This was applied to a mortgage for benefit of creditors in United States v. Gorgill, 218 F. 2d 556 (1st Cir. 1955) *contra.* Rev. Rul. 56-592, 1956—2 Cum. Bull. 945.

[52] United States v. Woodside, 40-2 USTC ¶9492, (D.C. S.C.) United States v. Beaver Run Coal Co. 99 F. 2d 610 (3d Cir. 1938) Profaci v. Maniapro Realty Corp., 54-2 USTC ¶9683 (S. Ct. N.Y.).

[53] United States v. Security Trust and Savings Bank of San Diego, 340 U.S. 47 (1950); United States v. Ball Construction Co., 355 U.S. 587 (1958).

[54] See federal lien as they affect mortgage lending. The Bus. Lawyer, Nov. 1957, p. 118; *Dangers under Recent Federal Tax Lien Decisions,* The Bus. Lawyer, Nov. 1958, p. 12, also see United States v. Gorgill, 218 F. 2d 556 (1st Cir. 1955).

an exceptional case, for the government insists that only "conventional" mortgages are given the protection of the statute.

What is the result where a mortgage is given for an antecedent debt after the tax lien arises but before the tax lien is filed? The cases are in conflict. Some cases deny it, and others grant the protection where consideration in the nature of forebearance or extension can be shown.[55]

As to pledgees, the courts have held that they are entitled to priority only where the pledge rests on a bona fide, valid and actual obligation. Required also is that the pledge be completed and perfected before the lien is filed.[56]

The statute granting priority to purchasers is beset with problems concerning the issue of who is a "purchaser." Within the meaning of the statute, a "purchaser" shall be one who "acquires property or an interest in property, for a valuable consideration" before notice of the federal tax lien is filed.[57] Of course, a "dummy" purchaser cannot qualify to defeat the lien.[58] However the statute itself does not specify when one becomes a "purchaser." Thus its definition has been left to the courts.

In *Leipert v. R. C. Williams & Co.*,[59] a purchaser of realty on a land contract basis was not protected as a "purchaser" against an after-arising federal tax lien. This is so even against a vendee's lien which was held "inchoate." Not included in the term "purchaser" is the holder of a landlord's lien,[60] attaching creditors[61] or mechanic's lien.[62]

While the statute grants priority to a judgment creditor there are many judicial ramifications to the interpretation of the term. Generally speaking, in order to qualify as a judgment creditor one must obtain a valid judgment for money or property in a court of record having competent jurisdiction—*plus* perfecting a lien under the judgment on

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[55] *Protection denied* in: Felipowicz v. Rothensis, 43 F. Supp. 619 (E.D. Pa. 1942); United States v. Franklin Fed'l. Savings, etc., 140 F. Supp. 286 (N.D. Pa. 1956). *Protection allowed:* Nat'l. Refining Co. v. United States, 160 F. 2d 949 (8th Cir. 1947); Schmitz v. Stockman, 151 Kan. 891, 101 P. 2d 962 (1940).

[56] United States v. Regensberg & Sons, 221 F. 2d 336 (2d Cir. 1955). Also see Knight v. Knight, 71 N.Y. S. 2d 337, where an assignment of wages as security to pay off a debt was held to be a pledge and given priority over the federal tax lien, if the assignment is for a past debt.

[57] Reg. Sec. 301-6323-1(a) (2), 6323(e) of Int. Rev. Code of 1954, Marteney United States, 245 F. 2d 135 (10th Cir. 1957); United States v. Scovel, 348 U.S. 218 (1955); Nat'l. Refining v. United States, 160 F. 2d 951 (8th Cir. 1947).

[58] United States v. Canadian American Co. Inc., 202 F. 2d 751 (2d Cir. 1953). If the transfer is without consideration the government may proceed as in a transfer in fraud cases. Leighton v. United States, 289 U.S. 506 (1933); Payne v. United States, 247 F. 2d 481 (8th Cir. 1957).

[59] 161 F. Supp. 355 (S.D.N.Y. 1957).

[60] United States v. Scovil, 348 U.S. 218 (1955).

[61] United States v. Hawkins, 228 F. 2d 517 (5th Cir.) 1955).

[62] United States v. Kings County Iron Works, 224 F. 2d 232 (2d Cir. 1955).

the property involved.[63] If recording is required after judgment is obtained, or if a levy is required, or if a certificate of judgment lien is required to be filed, the priority does not apply until that specific act is done to effect a judgment lien.[64]

The "judgment creditor" argument was employed by the City of Walpole, New Hampshire to induce the court to grant the state tax assessment priority, since under the state law of New Hampshire the city was given the status of a judgment creditor. The court in *United States v. Gilbert Associates*[65] rebuffed the state, and held that the term "judgment creditor" was limited to "the usual conventional sense of a judgment of a court of record." The term "judgment creditor" does not apply to quasi-judicial decisions, or decisions by commissions or bureaus.[66]

Another exception to the general tax lien law is a security in the hands of certain transferees. A "security" is a bond, debenture, note, share of stock, certificates of deposit, negotiable instruments, etc. As to the foregoing, a general tax lien, even though recorded is not valid against a mortgagee, pledgee or purchaser or adequate and full consideration, unless such person had actual notice of the tax lien. Internal Revenue Code of 1954, Section 6323(c)(1). This is true regardless of when the transaction is completed and applies to husband and wife if proper consideration passes and the spouse has no knowledge of the tax lien. *United States v. Rosebush,* 45 F. Supp. 664 (E.D. Wis. 1942). The purpose of the exception is to facilitate normal securities transactions, particularly in stock transfers of negotiable instruments. Enforcement of a tax lien against bona fide purchasers would seriously impede commercial transactions.

The Circular Priority Headache

The priority of the federal tax lien creates new problems when a third lien enters the arena.[67] For example, suppose we have a real estate tax lien or a mechanic's lien which by state law is prior to the real estate mortgage lien but subordinate to a federal lien under federal law. We have a situation where the mechanic's lien is prior to

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[63] Reg. Sec. 301-6323-1(a)(2) Miller v. Bk. of Amer., 166 F. 2d 415 (9th Cir. 1948); Beeghly v. Wilson, 152 F. Supp. 726 (N.D. Iowa 1957).

[64] Miller v. Bank of America Nat'l Trust & Savings Assoc., 166 F. 2d 415 (9th Cir. 1948). In any event, what is a "judgment creditor" is a federal question. United States v. Gilbert Associates, Inc., 345 U.S. 361 (1953).

[65] 345 U.S. 361 (1953). See United States v. England, 226 F. 2d 205 (9th Cir. 1955), relying upon the *Gilbert Associates* case. The England case arose in bankruptcy.

[66] Reg. Sec. 301-6323-1(a)(2), Miller v. Bank of Amer., 166 F. 2d 415 (9th Cir. 1948); Beeghly v. Wilson, 152 F. Supp. 726 (N.D. Iowa 1957).

[67] See Otis, Circuity of Liens—a First Rate Legal Puzzle in ABA Proceedings, Sec. of Real Property, etc. (Part II 5 (1956). Also see Perry, *Priority of Liens against Real Property,* etc. 1953-54, 361-371 (University of Michigan Law School Legislative Center, 1955).

the mortgage; yet the mortgage is prior to the federal lien and the federal lien is prior to the mechanic's lien.[68] We find ourselves in a priority circle. If the realty affected by the circle of priority is foreclosed and the sale is insufficient to pay all the liens, it is the mortgagee who must suffer. The solution to the problem logically but not legally, could begin at any place in the circle, and every solution can be said to be unfair depending upon who winds up last. Some courts have argued for the division of the inadequate fund on a pro rata basis.[69] However, the United States Supreme Court has spoken in *United States v. City of Britain.*[70] Here the court respected the state law to prefer the statutory lien and admitted at the same time its inability to reduce the federal tax lien. The court held that no more than the amount of the mortgagee's lien can be given preference over the federal tax lien and if the state wanted the statutory tax or local lien to have preference over the mortgage, it had to be taken out of the mortgagee's share.[71] No solution in the present state of the law is a fair one. The result of the court decisions is to give priority to the later filed federal tax lien over the prior recorded mortgage to the extent of the amount of the lien preferred by local law. However, if the state law affords no priority to the local lien, then the mortgagee's interest is not impaired.[72]

Proposed Statutory Changes

In an effort to persuade congress to legislate decency, fairness and equity into the tax law, the American Bar Association has offered many proposals and suggested legislation.[73] In general, the recommended draft divides the legislation into three titles. Title I seeks to protect the security of those who extend credit on the faith of contractual or statutory liens on the taxpayers' property, *i.e.,* mechanic's lien cases and surety lien cases. It would clarify the procedural rights and remedies of third parties whose property rights are invaded or threatened with seizure to pay the taxes of the taxpayer.

[68] Exchange Bank & Trust Co. v. Tubbs, 246 F. 2d 141 (5th Cir. 1957). Southern Ohio Savings Bank and Trust Co. v. Bolce, 135 N.E. 2d 382 (Ohio 1956); United States v. New Britain, 347 U.S. 81 (1953); Riverview Cemetery Co. v. Busczyk, 144 A. 2d 406 (Del. 1958).

[69] Bank of Amer. v. Green, 55-2 USTC ¶9658.

[70] 347 U.S. 81 (1953).

[71] The same solution was applied in Exchange Bank & Tr. Co. v. Tubbs Mfg. Co., 246 F. 2d 141 (5th Cir. 1957); an interesting situation arises when a the problem by totaling the mortgages and taking the local tax prepaid under state law out of the second mortgage. See Ohio Savings Bank v. Boice, 165 Ohio St. 201, 135 N.E. 2d 832 (1956). Also see Southern Ohio Savings Bank v. Boice (Ohio 1956) 135 N.E. 2d 382. In the matter of Lieb Bros. (D.C.N.J. 1957) 150 F. Supp. 68.

[72] Jefferson Standard Life Ins. Co. v. United States, et al, 247 F. 2d 777 (9th Cir. 1957).

[73] See final report of the Committee on Federal Liens. This may be obtained from the office of the ABA for $1.00 per copy at 1155 E. 60th St., Chicago, Ill. Draft of the proposed legislation is in the appendix of the report. See Resolutions of the ABA in 44 ABA Journal 384 (April, 1958).

Title II seeks to make the government's lien position in non-bankruptcy, *i.e.*, solvency cases, similar to that accorded under the National Bankruptcy Act. Title III involves legislation to remove clouds on title resulting from the existence of subordinate federal liens by forcing the United States to be joined in actions involving issues of liens, and by making the government bound by the doctrine of Lis Pendens. When the unfiled tax liena rises after a suit is filed involving the title to property, it is also suggested that the government intervene in all actions, after due notice, where there is a threat to the government lien; and that the government may be interpleaded when it asserts a claim to a debt or property to which others have adverse claims.

To recapitulate the lien law of federal tax lien priority based upon recent cases we must reach the following conclusions:

1. Federal law determines the validity of a commercial, private or state lien.
2. To compete with a federal lien, the private or state lien must be choate and perfected in the federal sense.
3. The tests of whether a private or state lien is choate are:[79]
   a. property subject to lien must be established.
   b. the identity of the competing lienor must be definite and certain.
   c. the private or state lien must be an exact amount which has been fixed with the finality of a judgment, or otherwise definitely ascertained.
4. Security for a future or contingent obligation may be futile.

One thing should be determined by the discussion: that if one practices law at the creditors' level, it requires taking a possessory, present, definite security and not a future or changeable one in order to beat the tax grab.

What we have said does not basically concern tax problems, but property problems. The issue is not between the government and delinquent taxpayers but between the government and third parties who owe the government nothing. The secret lien is destroying property rights of third parties who have often created that property which the government grabs for the taxes of another. Nothing has come closer to confiscation of property, and the fact that the government has a $77 billion budget and debt of approximately $300 billion does not justify the inequity in the law. Little wonder that the American Bar association and others have risen up, screaming for legislation to overcome these

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[74] As set forth in United States v. City of New Britain, 347 U.S. 81 (1953) the court there said "The liens may also be perfected in the sense that there is nothing more to be done to have a choate lien—when the identity of the lienor, the property subject to the lien and the amount of the lien are established. Under these circumstances, first in time is first in right.

gross inequities in the law.[75] Judicial proliferation of the doctrine of the inchoate lien has confused and confiscated property rights and secured transactions, and endangers the security of every lender in one way or another. Uniform selective rules should be enacted by Congress to do justice to the other lienors while protecting the needs of government income. Without some legislative reform commercial relationships will remain chaotic, uncertain and upsetting, and continue to shock the conscience of every thinking lawyer.[76]

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[75] See: *Federal Tax Liens: Proprosed Revision of the Law,* William T. Plumb, Jr., A.B.J., April, 1959, for an excellent discussion of the American Bar Association's proposal for new legislation.

[76] The writer has always felt that the courts could very easily and logically hold for the equitable owner of property in the mechanic lien cases and the land contract cases merely by recognizing the state law as to property rights and priorities, yet reserving to itself the right to determine priority as a federal question. We cannot escape the conclusion that if a state has a right by the Constitution to determine property rights that even a tax law can be confiscation at the taking of property without due process of law. Certainly history again emphasizes that the "power to tax is the power to destroy." The great American tax tragedy is that the government does not destroy the taxpayers—only the innocent third parties.