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Federal Liens and Priorities-Agenda for the Next Decade II

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IV. Some Unresolved Federal Tax Collection Problems

A. The Reach of the Federal Tax Lien

The task of constructing a fair and equitable tax collection code was no more than begun in the Federal Tax Lien Act of 1966, which concentrated on the immediately pressing problems in the area of the priorities, obligations and procedural rights of creditors and other third parties who become enmeshed with federal tax liens. The report of the Special Committee on Federal Liens of the American Bar Association called attention to another set of problems involving the coverage of the federal tax lien, but concluded that such problems did not appear to demand the kind of coordinated effort for which the committee was appointed. It therefore commended those problems to the attention of the interested Sections of the American Bar Association.1

1. Exemptions From Levy, In General

In order to protect debtors and their families from pauperism and to encourage the rehabilitation of the debtors, state laws universally provide for the exemption of certain property, or a certain value of property, from seizure for general debts.2 The laws range in liberality...
from the most spartan subsistence standard to the extremes reflected in unlimited exemptions for homesteads and life insurance. Commonly, however, taxes are excepted from the effect of those exemption laws, which are more appropriately applied in circumstances where credit is voluntarily extended than where obligations are imposed for the support of government. Nevertheless, it is acknowledged that "[s]ome minimal necessaries should be exempt even from these highly meritorious claims."4

The federal tax law contains its own rather niggardly exemptions, and no other federal or state law can confer any exemption from levy for federal taxes. Even in bankruptcy, where state exemption laws are given effect, federal taxes may be collected from the exempt property set aside to the debtor. It has been suggested from time to time that, like the collection of federal court judgments (including judgments in favor of the United States), the collection of federal taxes should yield to state exemption laws. That would mean, however, that, depending entirely on each state's concept of the relative equities of debtors and creditors, the tax lien would be unenforceable in some states against life insurance policies, spendthrift trust income, and homesteads (ranging in value from $700 in Indiana to unlimited in Minnesota), while like property of taxpayers in other states would be subject to seizure.


7. United States v. Bess, 357 U.S. 51, 57 (1958); Treas. Reg. § 301.6334-1(f) (1945). However, as we shall see (note 49 infra), state exemption laws come into play when a taxpayer's property must be pursued into the hands of a transferee, unless a lien had attached before the transfer. Commissioner v. Stern, 357 U.S. 39 (1958).


11. Fink v. O'Neil, 166 U.S. 272 (1892); Fed. R. Civ. P. 69. If, however, the state exemption law is inapplicable to judgments obtained by the state, it also does not bind the United States. United States v. Miller, 229 F.2d 899 (3d Cir. 1956).
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It seems preferable, therefore, for Congress to consider enlargement of the exemptions, on a uniform national basis.\(^2\)

A central problem affecting all exemption laws, state and federal, is that they "have failed to grow up. The dollar has depreciated. Wealth forms and occupational patterns have changed. Economic stability at high living standards has been achieved. New attitudes toward governmental responsibility for financial disaster have developed. But . . . exemptions have inadequately responded to these phenomena."\(^3\) The federal law was purportedly "modernized" in 1954,\(^4\) after 88 years without change.\(^5\) True, the 1954 revision did away with the archaic enumeration of such things as one cow, two hogs, five sheep and the wool thereof, along with their fodder for 30 days, $25 worth of fuel, $50 in provisions, and $300 in furniture, and replaced it with a more flexible $500 overall allowance for fuel, provisions, household furniture and personal effects, arms for personal use, livestock and poultry.\(^6\) The total exemption today, however, is scarcely more than the sum of the amounts allowed for the specific items a century ago. Consideration should be given to substituting a flat dollar exemption, adjusted (and periodically readjusted)\(^7\) to modern economic conditions, and perhaps varying according to the delinquent's family responsibilities, which would be taken in whatever form of property or money best allows the individual to satisfy his family's needs for subsistence and a fresh start.\(^8\)

The federal exemption law contains some remarkable inconsistencies which should also be re-examined. It exempts federal and state unemployment benefits, certain military pensions, and railroad retirement pensions,\(^9\) but not other veterans' benefits\(^10\) nor old age benefits under

\(\text{12. See 84 A.B.A. Rep. 681 (1959).} \)
\(\text{13. Note, Bankruptcy Exemptions: Critique and Suggestions, 68 Yale L.J. 1459, 1497 (1959).} \)
\(\text{15. Int. Rev. Code of 1939, \S 3691, corresponds to U.S. Rev. Stat. \S 3187 (1875), which in turn came from the Act of July 13, 1866, ch. 184, 14 Stat. 98, 108.} \)
\(\text{16. This allowance is only for a head of a family. A delinquent taxpayer who lives alone may be deprived of his gun and even his rocking chair, but he may take advantage of the further exemption for "necessary" wearing apparel and school books (unlimited in amount), as well as a $250 allowance for books and tools necessary in his trade, business or profession (increased from the 1866 standard of $100, to allow for a century of inflation).} \)
\(\text{17. The amount might be geared to a price index, since Congress is no more likely than most state legislatures to keep the figure in line with conditions.} \)
\(\text{18. See Note, Bankruptcy Exemptions: Critique and Suggestions, 68 Yale L.J. 1459, 1507-09 (1959). The exemption should be conditioned on the delinquent's producing his other property for levy; otherwise, any levy could be defeated by designating that property as the exempt property, while other assets remain concealed or beyond reach of a levy.} \)
\(\text{19. Int. Rev. Code of 1954, \S 6394(5)(6) and (9).} \)
\(\text{20. 28 U.S.C. \S 3101 (1964).} \)
the Social Security Act. It exempts workmen's compensation awards, but not social security disability payments.

2. Wage and Salary Levies; Other Recurrent Income

The federal tax collector can collect delinquent taxes by levy on wages, free of any minimum subsistence exemption and of any other restrictions such as state laws commonly impose upon such levies. From time to time, bills have been proposed to establish a minimum exemption for wages, but the difficulties involved are great. Minimum needs vary in different sections of the country and among individuals with disparate family and other responsibilities. Changes in the cost of living will soon outdate figures frozen into the law today. If, to overcome that problem, the exemption is based on a percentage of earnings, it would almost have to be on a graduated scale, and the gradations themselves would become obsolete with the passage of time.

In practice, the absence of a minimum exemption has the salutary effect of prompting the taxpayer to work out with the District Director an installment payment arrangement, coupled with a partial assignment of wages agreed to by the employer. On the perhaps questionable assumption that all collection officers, if not reasonable men, at least are practical men conscious of the need to keep the taxpayer working if the tax is ever to be collected, that flexible procedure may well be preferable to any arbitrary scale of exemptions, since it allows consideration of the taxpayer's particular circumstances.

If the taxpayer is recalcitrant, however, the tax collector must levy each payday and bear the risk that the employer will cooperate with his employee to defeat the recurring levies by prepaying wages. The Fed-

24. See Joslin, supra note 3, at 360-64. The proposed "Internal Revenue Administrative Code," which the Treasury exposed to public comment in 1941 but which was never enacted, contained in Section 4122(a)(8) a graduated scale of exemptions, ranging from 50 per cent if the annual wage is below $2,400 to 20 per cent if over $10,000. In its recent proposal designed to head off legislation for the discharge of "stale" taxes in bankruptcy (see note 248 in the first installment of this article, 77 YALE L.J. 228 (1967) [hereinafter cited as First Installment]), the Treasury urged that the bankrupt be required to devote 10 per cent of his net after-tax income to payment of his back taxes, unless the bankruptcy court ordered payment of a larger amount. S. Rep. No. 999, 89th Cong., 2d Sess. 9, 20-21 (1966). No such court supervision, however, would be available in the case of a levy, although provision could be made for it.
26. Cf. United States v. Long Island Drug Co., 115 F.2d 983 (2d Cir. 1940); United States v. Penn, 266 F. Supp. 655 (D. Ariz. 1967). The American Bar Association proposal contained a provision, Section 6332(b)(5), which was not adopted by Congress, imposing liability on the employer who prepaid in "bad faith" to enable the employee to beat a
eral Tax Lien Act of 1966, confirming prior law, expressly declares that “[a] levy shall extend only to property possessed and obligations existing at the time thereof.” That principle may be desirable in relieving banks, for example, from the necessity to be alert for new deposits in an account on which there is an earlier, unsatisfied levy. The rule is unnecessarily restrictive, however, when applied to levies on regularly recurring income such as wages and salaries, trust distributions, annuities, rentals and royalties. While it is true that garnishments traditionally reach only accrued income, the appropriateness and utility of continuing levies has often been recognized.

A continuing levy raises practical problems, however. It is essential to require the tax collector to assume an affirmative obligation to notify the payor when the liability is extinguished, since the tax might be collected by other means and the payor would have no way of knowing when to resume normal payments to the taxpayer. More importantly, a continuing levy is much too drastic unless coupled either with an exemption provision or with a discretionary power in the District Director to designate, in the light of the particular circumstances, the fraction of the recurring payments to which the levy applies.

Mention should be made at this point of another matter involving...
tax levies on wages. It is now firmly established that federal taxes owed by employees of state and local governments may be collected by levy upon the proper officials of those governments.\textsuperscript{34} But, in the absence of express consent by Congress, the state and local governments do not enjoy a like privilege of collecting their taxes by levy on federal salaries.\textsuperscript{35} The states cooperated with remarkable good will when Congress instituted the system of collection by wage withholding,\textsuperscript{36} and Congress responded by accepting a federal obligation to withhold state taxes from federal wages,\textsuperscript{37} declaring that "it is the policy of the Federal Government to cooperate with the states in the administration of their tax laws to the fullest extent practicable . . . in view of their cooperation with the Federal Government in fiscal matters generally, and particularly in withholding federal income tax from their employees."\textsuperscript{38} Congress ought now to reciprocate by accepting also the small administrative burden\textsuperscript{39} involved in honoring wage levies for state and local taxes. It would thus complete the process, begun over a quarter-century ago, of preventing employment by one level of government from becoming a haven for avoidance of taxes fairly imposed by another.\textsuperscript{40}

3. Liability of Gratuitous Transferees

If a taxpayer transfers property after he has incurred a federal tax liability but before the tax has been assessed, no lien for an assessment thereafter made against the taxpayer can attach to the property in the transferee's hands.\textsuperscript{41} Nevertheless, the transferee may incur liability "at

34. Sims v. United States, 359 U.S. 108 (1959); Massachusetts v. United States, 296 F.2d 233 (1st Cir. 1961); Hoye v. United States, 277 F.2d 116 (8th Cir. 1960). See Plumb, May the States be Required to Assist in the Collection of Federal Taxes on Their Employees? 30 Geo. L.J. 534 (1942).
36. INT. REV. CODE of 1954, § 3401(c), expressly requires withholding by states and their political subdivisions.
38. S. REP. No. 1309, 82d Cong., 2d Sess. 2 (1952). See also H.R. REP. No. 2474, 82d Cong., 2d Sess. (1952). The Senate version provided also for federal withholding of municipal income taxes, but this was eliminated in the House as too burdensome. Since the cities must withhold for the Federal Government, this inequity should be corrected. See 1953 NIMLO MUN. L. REV. 69.
law or in equity" for such unassessed tax if the transfer was without adequate consideration and left the taxpayer without sufficient assets to pay his tax liabilities, or if the transfer was otherwise fraudulent as to creditors, or if the transferee assumed the taxpayer's liabilities. In such cases, federal law has provided an efficient remedy against the transferee by assessment in the same manner as a tax liability is determined and assessed, without the need for a creditor's bill or other cumbersome procedure under state law. But the substantive question of whether the transferee is responsible for the taxpayer's liabilities is left largely to the laws of the several states.

The result is that whereas a transferee of property to which a federal lien had already attached (by assessment, notice and demand) before the transfer may be pursued without regard to the exemptions and other provisions of state law, the absence of a state law remedy against a gratuitous transferee of property not yet subject to lien is fatal to the federal claim, even if it is a state exemption law that makes the remedy unavailable. It is highly desirable in the even-handed administration of the federal tax system that transferees should not be free of liability in one state and liable in another when they stand in precisely the same

42. Unknown tax deficiencies subsequently determined may subject the transferee to liability, Scott v. Commissioner, 117 F.2d 30 (8th Cir. 1941), and even the tax accruing for the year during which the transfer occurs may be covered, if the "trust fund doctrine" is the basis for the liability. Updike v. United States, 8 F.2d 915, 916-17 (8th Cir. 1929), J. Warren Leach, 21 T.C. 70 (1955), although possibly not if a fraudulent conveyance is asserted. Hartman v. Luchini, 238 F.2d 681 (8th Cir. 1955). See Plumb, Federal Tax Liens and Transferee Proceedings, Tul. 15th Tax Inst. 148, 186 (1964). This question may be subject to the vagaries of state law.

43. See Plumb, supra note 42, at 183-84.

44. Estate of Samuel Stein, 37 T.C. 945 (1962); Meyer Fried, 25 T.C. 1241 (1956).


46. Dec. Rev. Corp. of 1954, § 6901. With limited exceptions, however, this procedure is not available in the collection of taxes other than income, estate and gift taxes. Id. § 6901(a)(3); Lawrence v. United States, 67-1 U.S. Tax Cas. p 9929 (N.D. Tex. 1967). State law procedures may be availed of by the Government in any case if it prefers. Leighton v. United States, 289 U.S. 506 (1933); United States v. Scott, 167 F.2d 301 (8th Cir. 1948).


49. Commissioner v. Stern, 357 U.S. 59 (1958). It has been held that the requirements of exhaustion of remedies against the transferor, and notice of deficiency to the transferor as conditions precedent to pursuit of the transferee, are procedural and hence governed by uniform federal standards (to be found in the decisions, since the statute is silent). Commissioner v. Kuckenber, 309 F.2d 292, 293-97 (9th Cir. 1962), cert. denied, 373 U.S. 909 (1963). The Government also cannot be bound by state statutes barring claims not timely presented when the Government is enforcing its rights in a court proceeding. United States v. Summerlin, 310 U.S. 414 (1940). Nevertheless, one recent questionable decision holds that the state court's decree of distribution in a probate proceeding, in which the Government did not participate, bars collection from the gratuitous transferees. United States v. Vibradamp Corp., 257 F. Supp. 321, 327-38 (S.D. Cal. 1966). See First Installment 258 n.191.
position. Congress unquestionably has the power to prescribe a uniform federal rule of transferee liability, as it has in fact already done with respect to the estate and gift tax.

Four decades of experience with the federal transferee procedure have provided a solid base for a codification of such federal rules, which could also draw upon such sources as the Uniform Fraudulent Conveyance Act. It would be well, however, to make clear that any liability imposed upon a transferee by state law may also be enforced by the Government, using the simplified federal procedure, in order to guard against oversight and to make available any state rule which goes beyond the federal standard. If such a codification is not undertaken, Congress should at least provide that, whenever a transferee would be liable but for the effect of a state exemption law, such liability shall be imposed.

Whether the general rules of transferee liability are to be governed by federal or state standards, they should be supplemented by specific federal substantive rules, the need for which will become evident in the discussion of later subtopics hereunder. The principal such rule would impose liability upon one who succeeds, upon the taxpayer's death, to any property or right to property which, immediately before his death, the taxpayer was entitled to take for his own benefit by partition or by the exercise of any power or right.

4. Life Insurance and the Widow's Allowance

Nearly every state, out of tenderness for the bereaved, and in order to encourage provision for family protection, has exempted life insurance from the reach of creditors of the insured (and sometimes also of the beneficiary), either with or without limit on the amount. Congress, however, has never thought it appropriate to encourage investments in life insurance to the point of making them a safe haven from the federal tax collector. It underscored its position in 1966 when it

52. Personal liability imposed on certain transferees by Int. Rev. Code of 1954, §§ 6324(a)(2) and (b), is enforced through the usual transferee procedure (id. § 6901(h)), but free of the exemptions, conditions precedent and other requirements of state law. Schuster v. Commissioner, 312 F.2d 311, 315 (9th Cir. 1962); Commissioner v. Chase Manhattan Bank, 259 F.2d 261, 266 (5th Cir. 1958). See Part IV.D, in the third installment of this article.
53. See the discussions of life insurance, family allowances, revocable trusts, powers of appointment, and joint tenancies, in Sections 4, 6 and 10 of Part IV.A infra.
54. 1 G. Glenn, Fraudulent Conveyances and Preferences §§ 172-81 (Rev. ed. 1940).
moved to simplify the procedure for, and thus to facilitate, the application of lifetime policy values to federal tax liabilities. Accordingly, if a federal tax lien is enforced during the taxpayer's lifetime, the District Director may now obtain, by simple levy upon the insurance company, the loan value of the taxpayer's insurance (reduced by outstanding loans having priority).6 If for any reason (such as absence of a loan value) the tax collector wishes to cause the surrender of the policy and application of the cash value on the tax, that can be done by foreclosure suit.9

Given the policy of Congress that life insurance values over which a taxpayer has complete command in his lifetime should be amenable to seizure for his tax liabilities, it follows that his death should not free those values from the burden. Yet under present law the question whether the proceeds can be followed into the beneficiaries' hands depends upon the procedural accident of whether federal or state law governs in the particular case.68 A lien which had attached to the net cash surrender value in the taxpayer's lifetime will follow that much of the proceeds into the hands of his beneficiary, notwithstanding any state exemption law.69 But if the family was fortunate enough to lose its breadwinner before his tax liability was assessed and became a lien,60 no part of the proceeds can be reached unless the exemption laws of the particular state permit.61 That distinction in treatment should be eliminated.62

That leaves the question, however, of what the uniform rule ought to be. The Supreme Court, even in the case where the lien had attached

56. INT. REV. CODE of 1954, § 6332(b), as amended by the Federal Tax Lien Act of 1966. Formerly, there was a practical impediment to the Government's reaching policy values during the taxpayer's lifetime, because the only way a surrender of the policy could be compelled was through a judicial proceeding for foreclosure of the lien, a cumbersome and time-consuming procedure during which policy values were eroded by premium loans, or by levy on the policy itself as held by the insured. United States v. Sullivan, 333 F.2d 100, 114-15 (3d Cir. 1964). The new simple procedure may encourage the tax collector's resort to this source of payment, but it has the advantage of avoiding the destruction of often irreplaceable family protection through surrender of the policy. For the procedure, see Temporary Treas. Reg. § 400.3-1.

57. INT. REV. CODE of 1954, § 6332(b)(3); Equitable Life Assur. Soc'y v. United States, 331 F.2d 29 (1st Cir. 1964).

58. See p. 611 & note 49 supra.


60. This would inevitably be the case with the income tax for the decedent's final taxable year, and the normal delays incident to audit and litigation may result in other deficiencies still being unassessed at death.


to the policy before death, has held that only the cash value at the time of death was property belonging to the taxpayer and subject to the lien. The balance of the proceeds—despite the fact that the insured had power to designate his estate or his creditors to receive the proceeds—was held not to have been property belonging to him, because "the insured could not enjoy the possession of the proceeds in his lifetime."\footnote{63}

Yet a power of disposition is as much an incident of ownership as the right to possess;\footnote{64} and Congress and the courts have never doubted, for estate tax purposes, that life insurance is "property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another," and is the subject of a transfer, testamentary in character, to the full extent of the amount thus disposed of.\footnote{65} If the taxpayer had made the proceeds payable to his estate, the entire amount thereof could be subjected to his tax liabilities in the hands of his distributees; that he exercises his continuing power under the insurance contract by ordering payment directly to them rather than to his estate should not change the result.\footnote{66}

The problem is complicated by the fact that if only the amount of the cash value is subject to tax collection, the insured may deplete that fund during his lifetime by borrowing from the insurance company; such loans have priority even over previously filed federal tax liens unless the insurer had actual notice or knowledge thereof.\footnote{67} Although the policy loan can be satisfied from the entire proceeds, the Supreme Court—stressing the spirit of the exemption laws which it had itself said earlier were not applicable to federal tax claims—has refused to marshal the decedent's assets by satisfying the federal tax lien from the amount of the cash value and the policy loan from the excess proceeds.\footnote{68}

That decision may cast some doubt on an earlier court of appeals decision which held that if general assets of an estate, which could have

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  \item \footnote{63. United States v. Bess, 357 U.S. 51, 55 (1958).}
  \item \footnote{64. Cf. Helvering v. Horsst, 311 U.S. 119, 118 (1940).}
  \item \footnote{65. Int. Rev. Code of 1954, § 2042(2); Chase Nat'l Bank v. United States, 278 U.S. 327, 334, 337 (1929).}
  \item \footnote{66. Mary Stoumen, 27 T.C. 1014, 1024 (1957). The Supreme Court's premise, in United States v. Bess, 357 U.S. at 56, that it is the cash value that is subject to lien during the taxpayer's lifetime also seems faulty. While withdrawal of the cash value was the most practical, and hence the customary, method of realizing on insurance, the policy might lawfully have been sold, if that would realize a greater value, perhaps reflecting the imminence of death. United States v. Mitchell, 249 F.2d 94, 105 (6th Cir. 1965). But for the practical problem of maintaining the policy, the Government itself might have bid in the policy (Int. Rev. Code of 1954, § 7403(c); 31 U.S.C. § 195 (1964)) and realized the full proceeds at the taxpayer's death.
  \item \footnote{67. Int. Rev. Code of 1954, § 6322(b)(6).}
  \item \footnote{68. Meyer v. United States, 375 U.S. 233 (1963), overruling United States v. Behrens, 230 F.2d 504 (2d Cir.), cert. denied, 351 U.S. 919 (1956).}
\end{itemize}
}
been reached for the decedent's income tax liabilities, are used instead to pay the estate tax, the excess insurance proceeds (which might have been taken for the estate tax) may be reached under the marshaling principle to satisfy the income tax.\(^69\)

Those problems are not to be resolved analytically, however. Whether the margin between the net cash value and the full proceeds of an insurance contract is to be preserved as a sanctuary for the beneficiary can be determined only by Congress' weighing the interests of the revenue against its sympathy for the widows and orphans.\(^70\) But Congress should address itself to the issue.

Closely analogous problems arise with respect to the allowances for the support of widows and dependents which are provided by many state laws.\(^71\) Although sometimes analogized to common law dower, these allowances differ in the vital respect that they are set aside only out of what the husband possesses at his death, while dower ordinarily cannot be defeated by an *inter vivos* conveyance by the husband.\(^72\) The family's rights are "vested," if at all, only in the sense that a forced heir's right to a share in a decedent's estate is vested.\(^73\) In substance, they are exemption laws rather than rules of property,\(^74\) and are no more entitled to recognition against federal tax claims than the usual homestead exemption law.\(^75\)

Nevertheless, there are a number of rulings and court decisions acknowledging the priority of such family allowances in the estate of an insolvent decedent, on the ground that the allowance is not a debt of the decedent but a charge against the estate, in the nature of an admin-

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\(^70\) Other aspects of the marshaling problem, where it cuts the other way, are considered in Part V.E, in the third installment of this article.

\(^71\) It should be noted that, if the widow is the beneficiary and the liability arose out of a joint income tax return, Congress has felt no such concern for the widow, but holds her jointly and severally liable (Int. Rev. Code of 1954, § 6013(d)(3))—and hence permits reaching the full insurance proceeds—even if little or none of the income involved was hers or even came into her hands. Cf. Estate of Ginsberg v. Commissioner, 271 F.2d 511 (5th Cir. 1959).

\(^72\) The laws are reviewed in G. Glenn, *The Law Governing Liquidation* § 509 (1925).

\(^73\) Dower rights, therefore, are preferred over post-marital liens for the husband's taxes, unless state law makes them subject to defeat by the husband's transfers or by his debts. See Plum & Wright, ch. 5, § 4.

\(^74\) See United States v. First Nat'l Bank & Trust Co., 297 F.2d 312, 315 (5th Cir. 1961). In some states, the right is not "vested" even in that sense. Jackson v. United States, 376 U.S. 503 (1964).

\(^75\) Sources cited note 193 infra.
administration expense. The fact that the money or property thus set apart is not deemed part of the assets subject to administration does not fully answer the question, however. It is analogous to exempt property set aside and excluded from a bankrupt estate, which is nevertheless subject to pursuit into the hands of those to whom it is delivered. Certainly, if a federal tax lien had attached to the property before death, it could not be defeated by an award of the property for the family's support. Where the lien had not arisen before death, on the other hand, the absence of a remedy for private creditors under state law would now leave the Government powerless to pursue the survivors. Consistently with the recommendations herein, the exempt property should be made subject to federally governed transferee liability rules, regardless of whether the tax is assessed before or after death.

If Congress—contrary to its general policy against allowing exempt havens from federal tax collection—should decide, upon examination of the problem, to relent in favor of widows and orphans, the exemption should be coordinated with whatever is done about life insurance and

(1) Applied on a uniform national basis rather than by reference to the widely varying policies of state laws and the discretion of probate judges, some of which go far beyond the allowance of what could "be classed as a 'widow's mite';"

(2) Limited to a certain dollar amount (against which any excess

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79. See p. 615 & note 61 supra.

80. See also the discussions of life insurance, revocable trusts, powers of appointment, and joint tenancies, in Sections 4, 6, and 10 of Part IV.A.

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of insurance proceeds over cash value should be charged, if such excess is to continue to enjoy unlimited immunity);

(5) Applied to all property of whatever kind passing to dependents, whether the decedent chose to invest in life insurance or leaves his dependents only a modest home, a savings account, or other property; and

(4) Applied without regard to whether the tax lien arises before or after death.

5. Trust Income and Future Interests

It is beyond question that a taxpayer's beneficial interest in the income or the remainder of a trust may be reached for his federal tax obligations. Whether the trust was created by the taxpayer or by a third party, no spendthrift clause in the instrument itself and no exemption provided by state law can immunize such beneficial rights from the federal tax collector. If the taxpayer's rights are subject to the discretion of the trustee, the tax collector can reach whatever the trustee elects to distribute; and if that discretion is governed by an enforceable standard (such as the amount necessary for support), the Government is entitled to the amount the taxpayer could have required the trustee to distribute. No change in those rules is recommended, for no private arrangement should make unavailable to the tax collector income which a taxpayer is free to enjoy as his own.

If the taxpayer's property right is a future interest, it cannot, of course, be reduced to immediate possession by the tax collector, but it can probably be sold by him, whether it is vested or contingent.

82. Life insurance is essentially a means of setting aside a fund of savings (with provision for acceleration of the accumulation in case of premature death), the fund being available at will to the insured in his lifetime (to the extent of its then value) and passing to his designee, like any investment, at his death. See 1 G. Glenn, FRAUDULENT CONVEYANCES AND PREFERENCES § 176 (Rev. ed. 1940). The needs of the dependents are the same whatever the form of the provision made for them. It is of interest that, as long ago as 1942, Congress abolished the special $40,000 exemption of life insurance from the estate tax, and imposed the same tax whatever form the decedent's property might take. Revenue Act of 1942 § 404, 56 Stat. 798, 944, amending Intr. Rev. Code of 1939, § 811(g).

83. Concerning a continuing levy on trust income, see note 29 supra.

84. Leuschner v. First W. Bank & Trust Co., 341 F.2d 705 (9th Cir. 1965); United States v. Dallas Nat'l Bank, 152 F.2d 582 (5th Cir. 1945); United States v. First W. Bank & Trust Co., 261 F.2d 705 (9th Cir. 1959); United States v. First W. Bank & Trust Co., 261 F.2d 705 (9th Cir. 1958); United States v. Dallas Nat'l Bank, 152 F.2d 582 (5th Cir. 1945).


86. RESTATEMENT (SECOND) OF TRUSTS § 155 (1959); E. Griswold, SPENDTHRIFT TRUSTS §§ 307-68 (1947); cf. Boss Co. v. Board of Comm'rs, 40 N.J. 379, 192 A.2d 594 (1963) (federal lien attaches to liquor license subject to state's discretionary control of transfer).

87. United States v. Taylor, 294 F. Supp. 762 (N.D. Cal. 1968). There, the grantor sought to fortify the spendthrift provision by providing a forfeiture in the event of a levy, but the forfeiture was held to be a sham because of the provision for support of the beneficiary, who thus regained his interest through the back door.

despite some questionable judicial declarations in other contexts that contingent rights are not "property or rights to property" subject to the lien. It is entirely fitting that the lien should attach to such rights, for such value as the taxpayer may ultimately derive from them; but it is wrong to compel their sale. Such an interest, even when vested, either would be bought by a speculator, at heavy sacrifice to both the taxpayer and the revenue, or would be purchased for a song by a member of the family. Provision should be made for preserving the lien but deferring the sale until the interest becomes a vested interest in possession (or at least a present right to enjoy the fruits of the property), which could be sold at a fair price. Precedent for such a provision may be found in the law which permits deferral of estate tax payments on the value of a remainder or reversionary interest until after the termination of the preceding interests. In order to establish the necessity for resort to such property, and to resolve any controverted issues on the merits within the normal period of limitations, while memories are fresh and records are available, provision should be made for a judicial proceeding in which the lien would be determined but not enforced. The court could enter such order as it deemed necessary to protect the Government’s interest in the interim.

6. Revocable Trusts and Beneficial Powers

The tax collector may encounter difficulty if the taxpayer has employed any of several popular estate planning devices to avoid probate, interest in a tenancy by the entirety, where that is permitted under state law, subject to the survivorship rights of the other spouse. The procedure suggested below would be applicable in such cases also. See note 226 infra.


91. Proposed statutory language, amending Int. Rev. Code of 1954, § 7403, which (with variations) was submitted to, but not passed on by, the Special Committee on Federal Liens, follows:

When any interest in property, subject to the lien imposed by section 6321, may be affected by the contingency of the taxpayer’s survival of another person, or (whether vested or contingent) is postponed for the life of another person or persons, no sale of the interest of the taxpayer in such property shall be decreed during the lifetime of such other person or persons, but the court shall adjudicate all other matters involved and shall finally determine the merits of all claims to and liens upon the property, and shall make such order as it deems necessary to protect the lien of the Government upon such property. Such adjudication shall not preclude the collection of the tax liability from other sources; but, upon full satisfaction of the liability, the Secretary or his delegate shall promptly file with the court a release of the lien pursuant to section 6325(a)(1).
such as placing property in a revocable trust, or creating a legal or equitable life interest in himself with a power reserved to invade the corpus or to appoint the remainder.92

Under general law, creditors of the grantor are entitled to reach the corpus of property which he has transferred with a life interest and a power of appointment reserved, even if he does not exercise the power, and even if the transfer was not fraudulent.93 As one court said,

It is against public policy, and not consonant with natural justice and fair dealing, as between debtor and creditor, that a settlor should be permitted to play fast and loose with his property, in such manner as to have the use of the income during life and the right of disposing of the principal by will at any subsequent time he chooses to exercise the power, thus giving him all of the substantial benefits arising from the ownership thereof while he has safely put his property beyond the reach of creditors.94

Yet, even in such a situation, there is some authority that creditors cannot reach the property if the grantor chooses not to exercise his reserved power.95

If, on the other hand, the grantor reserves merely a power to revoke, the general rule, in the absence of statute to the contrary,96 is that the grantor's power to make the property his own is not a property right and cannot be reached by creditors of the grantor unless the transfer was fraudulent.97

Where someone other than the grantor has a power of appointment exercisable for his own benefit (including a power to invade corpus or to take income otherwise payable to another), the general common law rule is that his creditors cannot reach the property unless the person asserts his dominion by exercising the power.98

A number of state legislatures have determined that creditors should be permitted to reach property that is subject to such beneficial

92. See Heffernan & Williams, Revocable Trusts in Estate Planning, in 2 Estate Tax Techniques 1317 (J. Lasser ed.); Casner, Estate Planning—Avoidance of Probate, 60 Colum. L. Rev. 108 (1960). The devices here considered would not save income and estate taxes, but it appears they might stave off the tax collector's enforcement arm, if state law is applied.
93. 5 AERICAN LAW OF PROPERTY § 23.14 (A. J. Casner ed. 1952); Restatement of Property § 328 (Supp. 1948).
96. P. 620 infra.
97. Jones v. Clifton, 101 U.S. 225 (1879); Restatement (Second) of Trusts § 330, comment o (1959); 3 A. SCOTT, TRUSTS § 330.12 (3d ed. 1956).
98. 5 AERICAN LAW OF PROPERTY §§ 23.14-23.17 (A. J. Casner ed. 1952). When the power is exercised, the courts irrationally permit the property to be reached by creditors even if the exercise is in favor of someone other than the grantor. Id. § 23.16.
powers, on the ground that "as to my creditors, property is mine that becomes mine for the asking, and no words can make an instrument strong enough to hold it for me or keep it from them." and Congress itself long ago provided that powers which a bankrupt might have exercised for his own benefit shall be exercisable for the benefit of his creditors by the bankruptcy trustee. The wording of some of the statutes is such, however, that they wholly fail to reach powers exercisable by will; and powers exercisable inter vivos may also escape if the grantor or other possessor of the power has died.

Where a federal tax has become a lien during a taxpayer's lifetime, it is doubtful whether such rules of state law, even though they masquerade as rules of property rather than exemption laws, inhibit the tax collector in reaching property that is within the taxpayer's power to enjoy. Even if not "property," the power is a "right to property," and hence subject to the lien. It has been held in life insurance cases that the courts will exercise for the benefit of the revenue a taxpayer's power to vest property in himself. But the same life insurance analogy warns that the absence of a remedy against the property under state law will forestall federal tax collection if the lien did not arise before death—although the same disposition of property, effected more conventionally by testamentary means, would not have escaped the tax collector.

For estate tax purposes Congress has long treated a revocable trust, and property subject to a general power of appointment, as part of the gross estate of the person possessing the power to revoke or appoint,

99. E.g., N.Y. REAL PROP. LAW §§ 139, 163 (1945). The New York law was applied in favor of the federal tax collector, to reach property subject to a power in the grantor, and other property subject to a power in his wife, for taxes of the grantor and his wife respectively. United States v. Peelle, 159 F. Supp. 45, 56 (E.D.N.Y. 1958).
100. Ullman v. Cameron, 158 N.Y. 539, 540, 72 N.E. 1074, 1076 (1909).
105. "By the execution of deeds and the creation of trusts, the settlor did indeed succeed in divesting himself of title and transferring it to others . . . , but the substance of his dominion was the same as if these forms had been omitted." Burnet v. Guggenheim, 288 U.S. 260, 284 (1933) (gift tax).
106. INT. REV. CODE of 1954, § 6321. While property rights are determined by state law, state characterizations are not controlling on whether the rights which he has constitute property rights. Glass City Bank v. United States, 295 U.S. 225, 268 (1945).
107. See note 57 supra.
108. See note 51 supra.
110. INT. REV. CODE of 1954, §§ 2038 and 2041(a)(2).
and has subjected the property to the special lien provided to secure the estate tax liability.\footnote{111} Congress has also disregarded for income tax purposes a trust which a grantor can revoke or which a third party can take as his own,\footnote{112} but it has failed to provide expressly for the enforcement of the tax liability against such property.

The law should make clear that the federal tax collector can reach during a taxpayer's lifetime any income or corpus (whether in trust or a legal interest) which the taxpayer could reach by the exercise of a power of revocation, appointment or invasion for his own benefit, including a power to appoint by will to his estate or his creditors.\footnote{113} Resort to judicial proceedings, rather than levy, should be required where someone other than the taxpayer has an interest, even though defeasible, in order to assure that property arrangements shall not be disturbed if the taxpayer has sufficient other property of his own;\footnote{114} the considerations that moved Congress, in respect of life insurance, to eliminate the need for court proceedings in the normal case\footnote{115} do not apply, as these cases do not arise so often that such procedure would be burdensome to the revenue, nor would the consequent delay normally erode the values involved. On the other hand, if the title-holder is a mere nominee, or if no one but the taxpayer or his estate has an interest in the trust, administrative action should suffice.

The law should, however, safeguard the interests of third parties who rely on the record ownership of property standing in the name of a trustee or nominee, since the true ownership may not be discoverable from any recorded document.\footnote{116} In order that such trusts or nominee arrangements may not become a haven from which a taxpayer can freely sell or encumber his property unimpeded by intervening federal tax

\footnote{111} INT. REV. CODE of 1954, § 6324(a)(1); cf. First W. Bank & Trust Co., 32 T.C. 1017 (1959); rev'd on other grounds sub nom. Schuster v. Commissioner, 312 F.2d 311 (9th Cir. 1962). See PLUMB & WHITE, pt. II, ch. 2.

\footnote{112} INT. REV. CODE of 1954, §§ 676, 678; see Corliss v. Bowers, 231 U.S. 376, 378 (1913); Mallinckrodt v. Nunan, 146 F.2d 1 (8th Cir.), cert. denied, 324 U.S. 871 (1945).

\footnote{113} If the interest subject to the power is a future interest, the deferral provision suggested at pp. 617-18 supra should be applicable.

\footnote{114} 5 AMERICAN LAW OF PROPERTY § 23.18 (A. J. Casner ed. 1952).

\footnote{115} See note 56 supra.

\footnote{116} See Chicago Fed. Sav. & Loan Ass'n v. Cacciatore, 23 Ill. 2d 585, 183 N.E.2d 670 (1962), in which the Government unsuccessfully asserted priority of its filed lien as against later mortgagees of property held for the taxpayer by a land trust, however, if third parties are not prejudiced (United States v. Lewis, 67-2 U.S. Tax Cas. ¶ 9593 (N.D. Ill. 1967); Southwest Fed. Sav. & Loan Ass'n v. Cosmopolitan Nat'l Bank, 23 Ill. App. 2d 174, 161 N.E.2d 637 (1958); and, if the taxpayer's interest is known, those dealing with the trustee should likewise be bound by liens filed against the taxpayer. United States v. Code Prod. Corp., 216 F. Supp. 281, 284 (E.D. Pa. 1963).}
liens, the law should expressly impose on trustees and nominees the responsibility of advising the appropriate District Director of the existence of any power over corpus or income which any person may be entitled to exercise for his own benefit, and should provide suitable sanctions for the enforcement of such responsibility.\textsuperscript{117}

If the taxpayer dies before his power is thus exercised for the benefit of the revenue, and if his estate subject to payment of debts is insufficient to satisfy his taxes,\textsuperscript{118} those who succeed to the property by virtue of the taxpayer's exercise or failure to exercise his power should be made subject to transferee liability, under the principle stated in Section 3 of this Part.\textsuperscript{119}

7. Income Taxable to the Grantor or Assignor

The income of a revocable trust is, of course, taxable to the grantor, because of his power to retake the property as his own.\textsuperscript{120} But the tax laws go much further in taxing the income of a trust to a grantor who does not receive the income, and who cannot recapture the property, where his powers under the trust instrument, or in actual practice, are nevertheless such that he is considered to be "in substance the owner."\textsuperscript{121} In the case of a family partnership, one may be taxed on the income distributed to others if he retains too much "dominion and

\textsuperscript{117} Reacting to the Cacciatore case, the Revenue Service directed that trustees under Illinois land trusts give notice of their fiduciary relationship under \textit{Int. Rev. Code} of 1954, \textsection 6903, naming the beneficiaries. \textit{Rev. Rul. 63-16, 1963-1 CUM. BULL. 350, as modified by letter of April 25, 1963, reported in 7 CCH 1963 STAND. FED. TAX REP. \textsection 6401. But Section 6903 was enacted for a different purpose, and provides no sanction. See First Installment 260, n.201; cf. \textit{Int. Rev. Code} of 1954, \textsections 6042(a)(1)(B) and 6049(a)(1)(B), on furnishing of information by nominees concerning actual ownership. Legislation directed expressly to the problem is desirable.

\textsuperscript{118} As in the case of life insurance, pp. 614-15 supra, it should not be permissible for the executor to exhaust the general estate by paying therefrom the estate tax occasioned by inclusion of the revocable trust or power property in the gross estate, leaving nothing from which the decedent's other taxes can be collected.

\textsuperscript{119} \textit{P. 612 supra.}

\textsuperscript{120} \textit{Int. Rev. Code} of 1954, \textsection 676. Power to cause the income to be distributed to or accumulated for him will make the grantor taxable under Section 677. A person other than the grantor may be taxed under Section 678 if he has comparable power over corpus or income.

\textsuperscript{121} See Helvering v. Clifford, 309 U.S. 331, 335-36 (1940), the rule of which has since been modified and codified in the statute. The grantor, with certain exceptions and limitations, may be taxed on the income if he has a revocatory interest in a short term trust for others (\textit{Int. Rev. Code} of 1954, \textsection 673), if he or a related nonadverse party can direct the disposition of corpus or income among others (\textit{id. \textsection 674}), if he retains or exercises "administrative powers" (\textit{id. \textsection 675}), if a nonadverse party has power to revest the property in the grantor (\textit{id. \textsection 676}), if a nonadverse party has power to cause the income to be distributed or accumulated for his benefit or used to pay premiums on insurance on his life or in certain circumstances to support his dependents (\textit{id. \textsection 677}), or if part of the income of a divorce trust is designated for the support of his minor children (\textit{id. \textsection 682(a)).
control” over their interests, and in any event to the extent of the “reasonable compensation” for his services if that is not properly reflected in his own distributive share. One who assigns the income from property, while retaining the ownership of the property itself, may remain taxable on that income. And one who assigns the right to his earnings from personal services, rendered or to be rendered, cannot escape the liability for the tax thereon.

The purpose of those rules, some based on court decisions and others codified in the law, is to prevent tax avoidance through the shifting of taxable income from the one who earns it (or otherwise controls the source) to relatives in lower tax brackets. But on a number of occasions the Government has pursued to a successful conclusion its effort to tax the transferor in such situations, only to find that he is beyond the jurisdiction or has become unable to pay the tax as a result of either the transfer itself or reverses subsequently suffered. Frequently, the bundle of rights which sufficed to make the transferor taxable on the income did not include the power to retake the corpus or the income, or to apply either in satisfaction of his debts. And traditional concepts of transferee liability would not make the trust or other donee responsible for the transferor’s taxes beyond the year of the transfer, even if the transferor left himself wholly without assets to pay his debts.

The income then goes wholly tax-free, since there is no legal basis on which the Revenue Service can refuse to refund the tax paid on such income by the actual recipient merely because the Service is unable to collect from the person who, under the law, is taxable thereon.

The question then arises whether the tax owed by the transferor can, on any theory, be collected out of the income which is attributed to him, or out of the corpus of which he is deemed “in substance the owner.” Reference may be made to what the Supreme Court said in

122. Treas. Reg. § 1.704-1(c); Ballou v. United States, 370 F.2d 659 (6th Cir. 1966), cert. denied, 388 U.S. 511 (1967); Pflugradt v. United States, 310 F.2d 412 (7th Cir. 1963); Kuney v. Frank, 308 F.2d 719 (9th Cir. 1962).
123. INT. REV. CODE of 1954, § 704(e)(2).
126. American Trust Co., 18 B.T.A. 580 (1929). Conceivably, the transaction could be found fraudulent as against the Government as a future creditor, if the tax liability was anticipated; but proof of such fraud would be difficult. See Uniform Fraudulent Conveyance Act §§ 6-7, 10.
127. Although it has long been the practice of the Service to refrain from refunding the tax paid by the related taxpayers until the liability of the principal taxpayer has been satisfied, the practice has a legal basis only in limited classes of cases. See Plumb, The Problem of Related Taxpayers: A Procedural Study, 66 Harv. L. Rev. 225, 241-43 (1952).
holding the interest of a surviving tenant by the entireties subject to the special lien for estate taxes of the deceased spouse:

We cannot impute to Congress an intention . . . to exclude from the tax lien property which it directs to be included in the decedent's gross estate for the purpose of computing the tax.\textsuperscript{128}

The usefulness of that decision, however, is limited by the fact that the special estate tax lien is imposed on the "gross estate," a federal law concept identical with the base on which the tax is computed.\textsuperscript{129} In contrast, the income tax is collectible only from property and rights to property "belonging to" the taxpayer,\textsuperscript{130} or from property which he has transferred in violation of the rights of creditors—matters which are governed, respectively, by the state rules of property rights\textsuperscript{131} and of fraudulent conveyances.\textsuperscript{132} Although the substantive tax concepts by which income is taxed to one other than the recipient were themselves initially developed by the courts\textsuperscript{133} (before some of them were modified and codified in the statute) in the face of a law which likewise looked to "ownership" of income as the test of taxability,\textsuperscript{134} little progress has been made in extending those concepts to the collection law.

A leading case in point is \textit{G.P. Fitzgerald},\textsuperscript{135} involving a trust which a nonresident alien had created for his divorced wife and children, the income from which (as the Tax Court assumed arguendo) was taxable to the grantor, who was beyond the reach of the tax collector. The Government sought to collect the tax from the trustee, either as a withholding agent\textsuperscript{136} or as a fiduciary who had satisfied other debts in preference to those due the United States.\textsuperscript{137} The Tax Court, however, was unwilling to impose any obligation on the trust or the fiduciary, declaring that

there is a distinction between attributing income to a taxpayer for purposes of reporting income and incurring tax liability and the

\begin{itemize}
\item \textsuperscript{128} Detroit Bank v. United States, 317 U.S. 329, 333 (1943).
\item \textsuperscript{129} INT. REV. CODE of 1954, § 6324(a). See Part IV.D, in the third installment of this article.
\item \textsuperscript{130} INT. REV. CODE of 1954, §§ 6321, 6331(a).
\item \textsuperscript{131} Aquilino v. United States, 363 U.S. 559, 512-14 (1960).
\item \textsuperscript{132} See p. 611 & note 47 supra.
\item \textsuperscript{133} E.g., Commissioner v. Tower, 327 U.S. 280 (1946); Helvering v. Stuart, 317 U.S. 154 (1942); Helvering v. Clifford, 309 U.S. 331 (1940); Douglas v. Willcuts, 290 U.S. 1 (1933); cases cited notes 124 and 125 supra.
\item \textsuperscript{134} Substantive tax liability is based on income "of" the taxpayer (INT. REV. CODE of 1954, § 1(a)), which was construed to import the concept of ownership. Poe v. Seaborn, 282 U.S. 101 (1930). See also Blair v. Commissioner, 300 U.S. 5, 9-10 (1937).
\item \textsuperscript{135} 4 T.C. 494 (1944).
\item \textsuperscript{136} Tax must be withheld from the income of nonresident aliens under what is now INT. REV. CODE of 1954, § 1441.
\item \textsuperscript{137} REV. STAT. § 3467, 51 U.S.C. § 192 (1964). See Part II.B in First Installment.
\end{itemize}
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determination of ownership under general rules of property law.
... If the trust income did not belong to Fitzgerald from the standpoint of rights of property, as distinguished from concepts of income tax liability, ... the requisites for enforcement and collection out of the trust would fail.139

A single judge, concurring in the result on other grounds, disagreed with the majority on that issue, stating that "the income tax laws are not so mechanically deficient as to make it impossible for the [Government] to collect an income tax upon the income of the trust" where the income is attributed to the grantor.140

On the other hand, the courts have generally sustained the Government in situations where a taxpayer has gratuitously assigned the earnings from personal services,141 or where he has assigned the future income to be derived from property while retaining ownership of the property itself.142 In one such case, the Second Circuit said that

if those payments can be imputed to the lessor as income so that an income tax can properly be imposed upon them, it must follow that they are available to satisfy the tax; for it would be absurd at once to hold that the dividends were the lessor's income for the purpose of assessing a tax against it, but were the shareholder's income for the purpose of collecting that very tax. We start therefore with the premise that, if the shareholders are to be identified with the lessor in one aspect, they must be in the other.142

That line of argument may be suspect in the light of later Supreme Court decisions stressing the role of state law in the area of collection. Yet the Second Circuit itself deemed the principles entirely reconcil-

138. 4 T.C. at 505.
139. 4 T.C. at 505.
140. In Van Meter v. Commissioner, 61 F.2d 817 (8th Cir. 1932), a corporate insurance agency was taxed on renewal commissions that it had directed to be paid to its stockholders; the latter were held liable as transferees, without discussion. Although the corporation had subsequently dissolved, the Board's opinion, 22 B.T.A. 1202, 1206 (1931), shows that the transferor liability was based not on a liquidating distribution but on constructive distribution of the commissions.
141. In Commissioner v. Western Union Tel. Co., 141 F.2d 774 (2d Cir.), cert. denied, 322 U.S. 751 (1944), a corporation had leased its assets to another, many years earlier, with a provision that rentals were to be paid directly to the lessor's stockholders. The lessor was taxable on the rents (United States v. Joliet & Chicago R.R., 315 U.S. 44 (1942)), but it had no assets from which to satisfy the tax other than the barren reversions after the 99-999 year leases. Since, as a matter of substantive tax law, the rentals were considered to have passed constructively through the corporation, the stockholders were held liable as transferees, as if they had received currently a dividend which left the corporation unable to pay the taxes on its current income. In United States v. Morris & Essex R.R., 135 F.2d 711 (2d Cir.), cert. denied, 320 U.S. 754 (1943), on similar facts, the court enjoined the lessee from paying rentals to the lessor's stockholders until the tax collector had an opportunity to levy on the income at its source, for the lessor's accumulated taxes on past rentals.
able, and saw no inconsistency in relying on the substantive federal tax law concept (that the income, although assigned many years earlier, constructively passed through the assignor when earned) as a premise for applying state law concepts of transferee liability as if that had actually happened. On the other hand, it must be noted that the courts have narrowly confined that "conduit" theory even for purposes of determining substantive federal tax liability, since they have declined to impose a gift tax on the income payments as if the transferor had received them when they were earned and had then passed them gratuitously on to his assignee or to the trust beneficiary.

The law should not allow the actual recipient of income which is taxable to another to enjoy it tax-free while the tax goes unpaid by the person on whom it is imposed. Therefore, Congress should impose transferee liability, measured by federal standards, on the recipients of such income without regard to whether the transferor was insolvent, either at the time of the instrument of transfer or when the income was received. Rather, like the donee's secondary liability for gift tax, the tax should be collectible from the recipient of the income whenever the transferor fails to pay; but, unlike gift tax liability, the transferee's obligation should be limited to the amount of tax attributable to the income so paid to the recipient. Congress should determine, as a matter of policy, whether the measure of such liability should be the full tax computed at the transferor's tax bracket (achieving the same ultimate result as if the income had in fact been received by the transferor and paid over by him after payment of his taxes), or should be limited to the tax which the recipient would have incurred had the income been received by the transferor.

144. See note 141 supra.
145. The "conduit" theory of gift tax liability has been rejected not only in trust cases (Commissioner v. Hogle, 165 F.2d 852 (10th Cir. 1947); Talge v. United States, 229 F. Supp. 836 (W.D. Mo. 1964)), but also in the case of assigned rentals from property retained by the assignor. Galt v. Commissioner, 216 F.2d 41 (7th Cir. 1955), cert. denied, 348 U.S. 951 (1959).
146. This would be in addition to the federal transferee rule proposed at p. 612 supra. Whereas that rule would embrace the transferor's entire tax liability, the present proposal is limited to the tax attributable to the specific income.
147. Inf. Rev. Code of 1954, § 6324(b). Solvency of the donor is immaterial. La Fortune v. Commissioner, 263 F.2d 186, 194 (10th Cir. 1959), See Part IV.D, in the third installment of this article.
149. Provided the transfer was not fraudulent, and the transferor's retained powers over income or corpus do not include the power to apply them on his debts, there would be no justification for charging the transferee with any tax liability of the transferor other than that on the income in question.
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income been taxed initially to him (leaving any excess to be collected, if at all, from the transferor).\textsuperscript{150}

The reasons which support that proposal do not apply, however, where the transfer was not gratuitous but satisfied or secured some obligation of the transferor, even though in that case also the transferor may remain taxable on the income.\textsuperscript{161} The imposition of liability on the transferee in such a case could not be supported on the "conduit" theory, because the Government would not have been able to reach the income even if it had actually, rather than constructively, been received by the taxpayer and paid over to his creditor within the taxable year.\textsuperscript{162}

Congress has, it is true, recently expressed its policy against permitting a taxpayer to tie up his future earning capacity by security agreements having priority over intervening federal tax liens. The Federal Tax Lien Act of 1966 provides, with carefully limited exceptions,\textsuperscript{163} that a security interest does not "exist," as against a federal tax lien, unless the property subject to the security interest is "in existence" when such tax lien is filed.\textsuperscript{164} Thus, liens for past years' federal taxes, if filed before the income is earned, may prevail over earlier security assignments of such income.\textsuperscript{165} But that would still not give the Government any preference with respect to the tax for the year in which the income is earned, since the income will not only have become property "in existence," but will be safely in the hands of the assignee before a lien for such tax can arise. No reason for imposing liability on the creditor-assignee for such tax is apparent.

\textsuperscript{150} See Plumb, supra note 127, at 265. Where the transferor does in fact pay the tax on the income, there would be much equity in providing him a right of reimbursement from the actual recipient. Id. 266-67. Such a provision is beyond the scope of this paper, but might well be coordinated with what is recommended above. Id. 218.

\textsuperscript{151} In the absence of express statutory change (cf. I.R.C. Rev. Code of 1954, §§ 677(h), 682(a)), income which is to be applied to the grantor's obligations is taxable to him. Helvering v. Stuart, 317 U.S. 154 (1942); Douglas v. Willcuts, 296 U.S. 1 (1935); Old Colony Trust Co. v. Commissioner, 279 U.S. 716, 729 (1929). If the transfer in trust itself discharges the obligation, however, irrespective of the sufficiency of the trust income, the transferor does not remain taxable on the income. Helvering v. Fuller, 210 U.S. 69 (1910).

\textsuperscript{152} The Government was unsuccessful in imposing transferee liability in such circumstances in Newman & Carey Subway Constr. Co., 37 B.T.A. 1163 (1938), acquiesced in, 1938-2 Conr. Bull. 23; Oroville Montgomery, 6 T.C.M. 983 (1947). The Fitzgerald case, 4 T.C. 494 (1944), discussed p. 624 supra, may also be explained on this ground, since the trust income satisfied the taxpayer's obligation under the divorce settlement.


\textsuperscript{154} See Plumb & Wright 89-96.
8. Co-ownership Generally; Partition

When two or more persons, not all of whom are indebted for a federal tax, share the ownership of property, the courts have had to struggle with the problem of applying the property rights “belonging to” the tax debtor upon his tax liability without prejudicing the interests of the non-indebted owners. The results have been far from satisfactory, and the guidance of Congress should be sought.

The federal tax collector can, of course, levy upon and sell the undivided interest of the taxpayer in the property, at least in the case of a tenancy in common or of the typical joint tenancy in which the rights of survivorship may be extinguished by severance.¹⁵⁶ But the market for undivided interests in property is limited, and such a sale almost inevitably will mean a sacrifice to either the taxpayer or the revenue or both, depending on who the purchaser may be. Moreover, a proceeding for partition will often have to follow such a sale.

The Government has sought, therefore, to shortcut the procedure by bringing suit to foreclose the tax lien, joining all the co-owners, and asking that the entire property be sold and the proceeds divided. One court has sustained that procedure, holding that the federal law authorizes the court to subject “any property” in which the taxpayer “has any right, title or interest” to the payment of his taxes, and empowers the court to order a sale “of such property” and a distribution of the proceeds according to the “interests of the parties and of the United States.”¹⁵⁷ Another court has held, however, that only the taxpayer’s interest in the property may be sold, whether by administrative levy or judicial foreclosure, and that the Government as a mere lienholder has no right to a partition of the property, by sale or otherwise.¹⁵⁸

Neither position affords a wholly satisfactory answer. The right of the non-indebted owners to have the property partitioned in kind, and not to have their interests sold against their will, ought to be respected “except in cases of imperious necessity.”¹⁵⁹ On the other hand, the reduction of the taxpayer’s interest to marketable form, by partition,

¹⁵⁶. Tenancies by the entirety, and any other forms of co-ownership in which the right of survivorship is indestructible, are considered in Section 11 of Part IV.A infra.
¹⁵⁷. United States v. Trilling, 328 F.2d 699, 702-03 (7th Cir. 1964), relying on Int. Rev. Code of 1954, § 7403. Trilling was approved in United States v. Mosolowitz, 269 F. Supp. 12 (D. Conn. 1967), although the court found that, even if state law controlled, the property (a residence) could not be divided in kind.
¹⁵⁸. Folsom v. United States, 306 F.2d 361 (5th Cir. 1962).
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ought to precede rather than follow the sale. Congress should provide, therefore, that the federal court may grant partition of the taxpayer's property interest, as an incident to foreclosure of a tax lien thereon, but that a sale of the interests of co-owners shall be ordered only when division in kind cannot be made equitably or without manifest prejudice or injury to any of the parties.\(^160\)

9. Joint Accounts and Savings Bonds

The interest of a taxpayer in a joint account in a bank or savings institution,\(^161\) or in co-owned United States savings bonds,\(^162\) is subject to levy for his taxes. The Service has stated:

Factors bearing on the question of the extent of the taxpayer’s interest in such an account include the nature of the tenancy created under State law; the source of the funds deposited; the intent of the person opening the joint account; and whether in actual practice the account was under the control of one party even though the other had authority to withdraw funds from the account.\(^163\)

It has been held that the Government, as the moving party, has the burden of proving the extent of the taxpayer’s interest.\(^164\) That, however, may well be an impossible burden to cast upon a party not privy to the confidential relationship normally existing between such co-owners. The problem involves one of the murkiest areas of property law,\(^165\) in which written evidence of “the intent of the person opening the joint account” may be contradicted by testimony that a mere agency for convenience was contemplated, and in which, if a gift was intended at all by the depositor of the funds, the transfer was in most cases revocable, since there is ordinarily no obligation to account to the other “owner” for withdrawals.\(^166\) Even the proof of such a

\(^{160}\) For a statute permitting lien creditors to obtain partition, see CODE OF VIRGINIA (1950) \(\S 8-690.\) The restriction on selling the whole when division in kind is feasible should be a uniform rule, but drafting assistance may be derived from state statutes, the various formulations of which are set out in 68 C.J.S. Partition \(\S 125\) (1950).


\(^{164}\) United States v. Stock Yards Bank, 231 F.2d 628 (6th Cir. 1956).

\(^{165}\) See Kepner, The Joint and Survivorship Bank Account—A Concept Without a Name, 41 CALIF. L. REV. 596 (1953).

\(^{166}\) Id. See also R. Brown, THE LAW OF PERSONAL PROPERTY \(\S 65\) (2d ed. 1955); Murray v. Gadsden, 197 F.2d 194 (D.C. Cir. 1922); and the authorities cited in Estate of Evan E. Eubanks, P-H TAX CR. MEM. 1967-189, 26 CCH TAX CR. MEM. 936.
seemingly objective fact as "the source of the funds deposited" is com-
plicated by

[t]he peculiar features of a joint bank account [which] . . . make it
difficult, if not impossible, in most cases, to determine what portion
belongs to each depositor. A long series of deposits which cannot
be traced to their source, and a similar series of withdrawals
which cannot be traced to their destination, are normally involved.
This defect is inherent in the severality feature of such bank ac-
counts wherein each depositor is allowed to treat joint property
as if it were entirely his own. Like any loose system of dealing
with money, joint bank accounts sacrifice precision to convenience
and becloud the respective rights of the depositors.167

Some state laws create rebuttable presumptions that the interests of
the co-owners are equal; the problem of proof is thereby eased but not
resolved, for the presumption may serve only to shelter from creditors
a portion of the interest of one whose actual portion is greater than his
presumed share of the account.168 At least one court, therefore, has
visited upon the co-owners the consequences of the difficulty they
created by permitting the creditors of either of them, in effect, to ex-
ercise their debtor's power to withdraw the entire account for applica-
tion on his debts.169 Such a solution, applied to federal tax collection,
might be consistent with the recommendation made earlier that the
federal tax collector should be permitted to reach any property which
the taxpayer had a legal right to take for his own benefit, whether the
power was created by himself or another.170 It may, however, be unduly
harsh if applied to more than the amount the taxpayer himself de-
posited in the account, since in the normal case it is doubtful that the
parties ever contemplated or intended that one of them would so
exercise the power with respect to deposits made by the other, or that
either of them acting in good faith would voluntarily have so exercised
it.

The basic problem is one of proof. The most equitable and practical
solution, which Congress should consider, would treat the taxpayer as
prima facie the contributor and owner, not of a portion but of the
entire account, subject to proof by the other co-owners that the tax-

167. Park Enterprises v. Trach, 233 Minn. 467, 471-72, 47 N.W.2d 194, 197 (1951),
noted in 36 Minn. L. Rev. 98 (1951).
168. Id. The presumption was applied against the Government in Bishop v. Warren,
67-1 U.S. Tax Cas. ¶ 9406 (E.D. Wash. 1967).
169. Park Enterprise v. Trach, 233 Minn. 467, 47 N.W.2d 194 (1951).
170. See p. 621 supra.
payer's interest is more limited.\textsuperscript{174} That would protect the rights of innocent parties, if they have preserved adequate records, but would properly place the burden of proof on the persons who are in possession of the facts (or whose neglect may have made such proof impossible).\textsuperscript{175} To require less is to invite evasion of tax responsibilities.

The most which should be free from the tax collector's grasp, however, in any case where withdrawal is permitted without accountability, should be the amount deposited (and not previously withdrawn) by the non-indebted cotenants, even if the evidence, or a presumption of state law, establishes that their fractional ownership in the account is greater; for, as to the difference, the taxpayer has in effect made a revocable gift.\textsuperscript{176} On the other hand, if state law permits the taxpayer's creditors to reach more than the amount he himself contributed, the Government as a creditor should be entitled to no less than others could take.\textsuperscript{177}

10. Surviving Joint Tenants

Joint bank accounts have been called the "poor man's will,"\textsuperscript{178} and joint tenancies in realty and other property are also used increasingly to avoid the expense and inconvenience of probate for small estates.\textsuperscript{179} Among other advantages, the survivor takes free of the debts of the deceased co-owner.\textsuperscript{177} Even if the probate estate, if any, is insolvent, the survivor is ordinarily not considered to have acquired any property from the decedent at his death, since in legal theory his interest vested when the estate was created.\textsuperscript{178} In the absence of proof, normally impossible to produce, that the tenancy was originally created with


\textsuperscript{172} Cf. Morrison v. California, 291 U.S. 82, 88 (1934); Casey v. United States, 276 U.S. 415, 418 (1929).

\textsuperscript{173} Notes 99-101, 118 supra.

\textsuperscript{174} E.g., in states where the entire account can be reached by creditors generally (note 169 supra), or where the proportionate interest of one who is a donee can be reached. American Oil Co. v. Falconer, 136 Pa. Super. 598, 8 A.2d 418 (1939).

\textsuperscript{175} In re Edwards' Estate, 140 Ore. 431, 436, 14 P.2d 274, 276 (1932). See Kepner, supra note 165, at 634.

\textsuperscript{176} Swenson & Degnan, Severance of Joint Tenancies, 38 Minn. L. Rev. 465, 469 (1954); Casner, Estate Planning—Avoidance of Probate, 60 Colum. L. Rev. 103, 116 (1960).


\textsuperscript{178} For some dissent (on policy) with respect to joint bank accounts, see Imirie v. Imirie, 266 F.2d 652 (D.C. Cir. 1957):

We need add only that the dangers inherent in situations of this sort are indeed serious. If a wife can take by survivorship the funds of the commercial checking accounts of a business conducted by her husband, in disregard of the claims of creditors or other interested persons, a ready means of producing fraud and injustice has been created. . . . Much the same is to be said of personal accounts, though here the risks are less, and the wife's claims may perhaps be viewed with a more favorable eye.

\textit{Id.} at 693-94.
an intent to injure those future creditors who might exist at death, the creditors are without remedy.\footnote{179}

As we have seen, the Government's power to collect unassessed taxes from the successors in interest of a deceased taxpayer is, under present statutes, circumscribed by state law.\footnote{180} If unsecured creditors have no right under state law to pursue the survivor as a transferee of the decedent, the Government has no remedy against the survivor to collect taxes for the year of death, or any additional taxes which may have been incurred for earlier periods but which had not been assessed before death.\footnote{181}

Furthermore, it is doubtful that even a federal tax which was assessed and became a lien before death can be collected from the joint property after the taxpayer dies. The usual rule of state law is that nothing less than an execution sale consummated before death will sever the joint tenancy and defeat the non-indebted survivor's right to the entire property free of lien. A mere judgment lien, to which the tax lien is analogous, does not sever the tenancy, and the lien creditor faces the risk the debtor's interest in the property will be extinguished if he predeceases.\footnote{182} We have seen, with respect to life insurance, that the existence of an \textit{inter vivos} federal tax lien makes federal collection law applicable, still subject to state rules of property rights but not to state characterizations thereof nor to state remedial rights.\footnote{183} The Supreme Court accordingly has rejected the state concept that the cash surrender value (to which the lien had attached) was extinguished at death, and that the right to the proceeds was a distinct property right free of any \textit{inter vivos} lien. Rather, the cash surrender value, which the taxpayer could have taken for his own benefit while he lived, was held as a

\footnote{179. Since the joint tenant's retained interest would ordinarily be reachable by his creditors during his lifetime, he would probably not be rendered insolvent by the creation of the tenancy, so it would be necessary to prove a then-existing intent to injure those who may be creditors at his death. Splaine v. Morrissey, 282 Mass. 217, 184 N.E. 670 (1933); cf. Irvine v. Helvering, 99 F.2d 265, 268 (8th Cir. 1938).}
\footnote{180. See p. 611 supra.}
\footnote{181. Tooley v. Commissioner, 121 F.2d 350, 354-56 (9th Cir. 1941); Irvine v. Helvering, 99 F.2d 265 (8th Cir. 1938). However, if the surviving joint tenant is a spouse who joined in a joint income tax return, he or she would be liable, not as a transferee of property but as a co-obligor. \textit{Int. Rev. Code of 1954}, § 6015(6)(b).}
\footnote{182. Musa v. Segelke & Kohlhaus Co., 224 Wis. 432, 272 N.W. 657 (1937), 111 A.L.R. 165 (1937). Even a levy (Van Antwerp v. Horan, 390 Ill. 446, 61 N.E.2d 358 (1945), 151 A.L.R. 1133 (1946)), or an execution sale until consummated by deed after the redemption period expires (Jackson v. Lacey, 408 Ill. 539, 97 N.E.2d 839 (1951)), has been held ineffective to prevent extinguishment of the right if death of the debtor then intervenes. A mortgage given by the deceased joint tenant, on the other hand, is protected, although the theoretical basis for the distinction has been undermined by the substitution of the lien for the title theory of mortgages. See Swenson & Degnan, \textit{supra} note 176, at 488-92.}
\footnote{183. See pp. 611, 618 supra.}
matter of "economic reality" to be a part of the fund passing to the
beneficiary which remained subject to lien.\textsuperscript{184} Comparable reasoning
might lead to the conclusion that as a matter of "economic reality" the
decedent's share of property held in joint tenancy, which he or his
creditors could have severed while he lived (thereby cutting off the
right of survivorship), passes to the survivor subject to existing federal
tax liens. But the absence of any litigation on the point suggests the
hopelessness of that argument under the present statutory scheme.

Congress should, therefore, consider amending the law expressly
to impose upon a surviving joint tenant liability for the federal taxes
of a deceased co-owner (whether assessed before or after his death),
to the extent of the share which the decedent could properly have
taken for his own benefit by severing the tenancy in his lifetime.\textsuperscript{185} The
power of Congress so to provide seems beyond question for, regardless
of the "refinements of title," there is at the taxpayer's death "a distinct
shifting of economic interest"\textsuperscript{186} and "definite accessions to the sur-
vivor's property rights,"\textsuperscript{187} which may be made the occasion for im-
posing liability upon the survivor\textsuperscript{188} under the general federal standard
of transferee liability proposed earlier.\textsuperscript{189} In fairness to the survivor,
however, such liability should be imposed only if the decedent lacked
sufficient other assets to meet his tax liabilities at the time of his
death.\textsuperscript{190}

\textsuperscript{185.} In rejecting such a rule under present law, one court drew an analogy to the
expiration of a life estate. Tooley v. Commissioner, 121 F.2d 350, 356 (9th Cir. 1941). The
vital distinction, however, is that the remainderman's right could not have been extin-
guished by any act of the life tenant, while the joint tenant had the right at any time
to take his share in fee. Joint tenancies in which the survivorship right is not extin-
guished are discussed in Section 11 infra.

\textsuperscript{187.} Gwinn v. Commissioner, 237 U.S. 224, 229 (1915).
\textsuperscript{188.} See concurring and dissenting opinion in Tooley v. Commissioner, 121 F.2d 350,
359 (9th Cir. 1941): "Had it seen fit to do so, Congress could by definition have declared
a surviving joint tenant a transferee of his deceased co-tenant for the purpose of collecting
\textsuperscript{189.} See supra note 165. The Special Committee on Federal Liens "suggested" such a
solution, but made no firm recommendation. 84 A.B.A. Rep. 692 (1959). It is of interest
that Wisconsin has provided by statute that a long list of contractual and statutory liens
(including certain state tax liens but excluding, of course, federal tax liens) shall continue
to attach to property in the hands of a surviving joint tenant, to the extent of the interest
See also id. § 49-26(5) (1937). An earlier version of the latter statute had been construed
to work a severance of the joint tenancy when the lien arose, thus defeating the survivor's
right even in the equity remaining in the decedent's interest (Estate of Feierisen, 263
Wis. 53, 56 N.W.2d 515 (1955)), but the present Wisconsin law expressly negatives such a
severance. See Swenson & Degnan, supra note 176, at 491-92, 497-98. The proposal made
herein, not being dependent upon the existence or effect of a lien, raises no problem of
severance.

\textsuperscript{190.} The non-indebted joint tenant risks his entire unencumbered interest on the
11. Tenancies by the Entirety and Similar Interests

About half the states recognize a special form of co-ownership between husband and wife known as tenancy by the entirety, which presents unique problems because neither spouse alone nor his or her creditors may force a partition which would destroy the right of survivorship. That feature of a right of survivorship indestructible by separate creditors is also present in an ordinary joint tenancy in Michigan, and can be created elsewhere by the device of setting up a joint life estate with contingent remainder to the survivor. In a few states, also, the homestead laws go beyond merely creating an exemption (ineffective against the federal tax collector) and are construed as vesting indestructible rights in the spouse.

In the case of the tenancy by the entirety, the collection problem is further complicated by the efforts of the state courts to harmonize the anachronistic but “amiable fiction of the common law” that the husband and wife were one person—that one being the husband—with the change of status wrought by the Married Women’s Acts. The result has been a variety of rules affecting separate creditors’ rights in such property, ranging from the common law rule still prevailing in Massachusetts (under which the husband’s creditors, like the husband himself, could take the entire profits and right to possession, and the fee if he contingencies of survivorship, while he would take the taxpayer’s share encumbered by the tax claim if the taxpayer predeceases him. Swenson & Degnan, supra note 176, at 491. That potential unfairness has been referred to in justification of the present rule, which in effect requires the creditor to choose between prompt enforcement during the joint lives (taking only the debtor’s share, and causing the other to obtain his share outright, by reason of the severance), or taking an all-or-nothing gamble by waiting to see which survives. Zeigler v. Bonnell, 52 Cal. App. 2d 217, 126 P.2d 118 (1942). The real remedy for that unfairness, however, would lie in denying survivorship rights, to a reciprocal extent, to the indebted joint tenant if the other dies while such a lien is outstanding. Swenson & Degnan, supra, at 502, a remedy that can be effected only by amendment of state law. So long as state law gives the taxpayer the whole upon his survival, the tax is properly enforceable against such enhanced property interest if he should be the survivor.


Swenson & Degnan, supra note 176, at 469.

United States v. Helfron, 158 F.2d 657 (9th Cir.), cert. denied, 331 U.S. 881 (1947).


survived, but remained subject to the wife's right of survivorship) to virtual complete immunity from separate creditors in the majority of those states that still recognize the estate. A substantial minority, including New York, take an intermediate position, permitting the creditors of one spouse to reach a half share in the possession and profits, as well as (except in New Jersey) his or her right of survivorship, subject, however, to the contingency of survival of the other spouse.

The federal tax collector may, of course, claim such rights as the minority states accord to ordinary separate creditors. In the jurisdictions following the majority rule, however, the Government is not only denied the right to levy upon any interest in the entirety property for the separate taxes of either spouse, but it has been denied even the protection of a lien, which might prevent the co-owners from disposing of or encumbering the property while they live (unless they settle for the value of the Government's interest) and which might be enforced, with its chronological priority, when and if the taxpayer spouse survives. Furthermore, although the husband and wife are privileged, in general, each to report half the income from entirety property if separate tax returns are filed, such income is itself considered entirety property (at least in some jurisdictions) and is held

196. Raptes v. Pappas, 259 Mass. 37, 155 N.E. 787 (1927). As a corollary, however, the wife's creditors can reach no interest while the husband lives, not even her right of survivorship. Licker v. Glausin, 255 Mass. 403, 164 N.E. 613, 63 A.L.R. 231 (1929).


199. See note 197 supra.


202. United States v. American Nat'l Bank, 235 F.2d 504 (5th Cir.), cert. denied, 328 U.S. 835 (1958); United States v. Hutcherson, 188 F.2d 326 (6th Cir. 1951); Pettengill v. United States, 206 F. Supp. 10 (S.D. Va. 1962). The American National Bank opinion states that the tax lien would attach to the property only at the death of the non-indebted spouse, when the taxpayer first acquires an interest that is his alone. Under the rule in Pennsylvania, however, a lien does attach to the interest of the indebted spouse during the life of the other, for priority purposes, but the lien can be defeated not only by the prior death of the debtor, Fleek v. Zillhaver, 117 Pa. 218, 12 A. 420 (1887), but by a joint conveyance. Beilh v. Martin, 236 Pa. 519, 84 A. 593 (1912). Even a voluntary joint conveyance in anticipation of the death of the non-indebted spouse, under circumstances that would constitute a fraudulent transfer if any other form of property were involved, will defeat the lien. C.I.T. Corp. v. Flint, 333 Pa. 350, 5 A.2d 129, 121 A.L.R. 1222 (1959).

immune from levy for separate taxes.\textsuperscript{204} The immunity is said not to be based on a mere exemption law, but to reflect a property right of the non-indebted spouse to share the possession and income with no one but the other spouse, and to convey the property freely with the concurrence, not of a stranger, but of the other spouse.\textsuperscript{205}

The result is to create, in something over a quarter of the states, a privileged sanctuary from the collection of federal taxes, a fictional bicephalous non-tax-paying personality which is permitted to accumulate wealth free of the citizenship obligations of either of the individuals who comprise that unit and for whose exclusive benefit it exists.\textsuperscript{206} The immunity would be difficult enough to justify if it were confined to homestead property—a special exemption, unlimited in amount, available only to taxpayers in certain states, and discriminatory against the widowed, the unmarried and the apartment dweller, which Congress has never seen fit to grant to taxpayers generally. But the immunity is not so confined. It protects business real estate and the income therefrom,\textsuperscript{207} and in many states personal property as well.\textsuperscript{208} In a number of states bank accounts may be held by the entirety, thereby dedicating those current funds (even though either may draw on the account) to the exclusive benefit of the marital unit, to the exclusion of the separate debts and tax obligations of either spouse.\textsuperscript{209} Occasionally, fraudulent conveyance procedures may be invoked to reach such properties,\textsuperscript{210} but

\begin{thebibliography}{100}
\item Beihl v. Martin, 236 Pa. 519, 84 A. 933 (1912).
\item Cf. Draper v. United States, 249 F. Supp. 563, 565 (W.D. Wash. 1965), \textit{quoted p. 642 infra}. The "distinct legal entity, consisting of the unified personalities of the husband and wife," has been analogized to "a corporate body." C.I.T. Corp. v. Flint, 333 Pa. 350, 5 A.2d 126, 128 (1939). There is a vital distinction, however. Although the property of a corporation cannot be reached for the debts and taxes of its beneficial owners, \textit{their interests in the corporation can}. There is no comparable remedy, in the jurisdictions following the majority rule, against one spouse's beneficial interest in the property of the "unified personality" of which he or she is a part.
\item Note \textit{infra}.
\item \textit{2 American Law of Property} § 6.6c (A. J. Casner ed. 1952); Annot., 64 A.L.R.2d 8 (1959).
\item Raffaele v. Granger, 166 F.2d 620 (3d Cir. 1948). See Madden v. Gosstown Sav. & Tr. Co., 331 Pa. 476, 489; 200 A. 624, 631 (1938); \textit{In re Meyer's Estate (No. 1)}, 232 Pa. 89, 81 A. 145 (1911).
\end{thebibliography}
only if the creation of the tenancy was fraudulent; the remedy is thus rarely effective for collecting subsequent taxes incurred while the spouses are sharing the benefits of an existing tenancy by the entirety.211

The importance of the loophole may have diminished as a result of the “income splitting” provisions which, since 1948, have encouraged the filing of joint income tax returns;212 the joint and several liability on which213 is collectible from otherwise immune entirety and homestead property of the spouses.214 But one who is determined to take advantage of the immunity to avoid payment of his taxes (and there have been such) runs little risk in filing a separate return. If the tax is uncollectible, he is not concerned that the liability is larger than it would have been on a joint return; and if the tax collector should find available separate assets, the taxpayer still has the privilege, at least for a time, of switching to a joint return to reduce his liability.215 Furthermore, the problem is not confined to income taxes, but extends to employment taxes and other federal tax obligations of a separately conducted business, especially where business realty and bank accounts are held by the entirety.216

“The power of taxation is a fundamental and imperious necessity of all government, not to be restricted by mere legal fictions.”217 It is hardly debatable that some way should be found to apply to the tax liability the tangible property rights of the taxpayer spouse—the right to use and enjoy the property, to share in its income, and to take the whole if he or she survives.218 The perplexing problem, however, is that the legal fiction reflects in part the fact that the rights of the indebted spouse are “hedged about at all points by the equal rights”

212. INT. REV. CODE of 1954, § 2(a).
213. INT. REV. CODE of 1954, § 6013(d)(5).
215. The option remains open for three years or until a deficiency notice is mailed (or certain other events occur). INT. REV. CODE of 1954, § 6013(b).
216. See Imrie v. Imrie, 246 F.2d 652, 653-54 (D.C. Cir. 1957), quoted note 178 supra. Of course, to get business credit in such a case, the spouse would ordinarily have to agree to subject the entirety property to contract creditors of the business; but she is under no such compulsion with respect to federal taxes.
217. Tyler v. United States, 281 U.S. 497, 503 (1930), upholding a federal estate tax on entirety property upon the death of one spouse.
218. As the Fourth Circuit said in another connection, estates by the entirety “should not be allowed to escape necessarily incident and proper burdens of taxation.” Lang v. Commissioner, 61 F.2d 280, 283 (4th Cir. 1932), aff'd, 289 U.S. 109 (1933).

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of the other, which must be protected from impairment. The House of Representatives in 1954 made an abortive effort to remove the immunity by extending the tax lien expressly to "the interest of such person [the taxpayer] as tenant by the entirety," but the Senate deleted the language because it was "not clear what change in existing law would be made" thereby. The question which the House proposal left unanswered is: Having attached the lien to the taxpayer's "interest," then what? How do you enforce a lien on the husband's right to share the occupancy of a home with his wife? How do you take his rights in the income and profits of entirety property, or in a joint bank account, without impairing the wife's rights of survivorship in the fund and her right that the entire fund be used for mutual benefit? How do you sell a contingent right of survivorship except at great sacrifice?

It has been recommended above, with respect to future interests generally, that the tax lien, if and when it cannot be satisfied from other sources, should be fastened to the property by appropriate judicial proceedings within the period of limitations, with actual enforcement by sale deferred until the survivorship contingency is resolved. That procedure should be adapted to the present situation and, with respect to the contingent rights of the taxpayer spouse, should be applied even in those states where an immediate sale would be permissible. If necessary, a receiver could supervise the use of the property to protect the Government's interests without interfering with the rights of the non-indebted spouse. In those states where the right of one spouse to

220. That the property of one spouse cannot be taken for taxes of the other, see Hooper v. Tax Comm'n of Wisconsin, 284 U.S. 296 (1931); Cannon v. Nichols, 89 F.2d 694 (10th Cir. 1936); Sheridan v. Allen, 153 F. 568 (8th Cir. 1917). Since the exemption from creditors protects the non-indebted spouse in her (or his) right to untrammeled enjoyment of the whole property, it has been doubted that Congress could change the rule if it would. Ullman v. Rothensies, 59-1 U.S. Tax Cas. § 9333 (E.D. Pa. 1939), appeal dismissed, 110 F.2d 390 (3d Cir. 1940). Nevertheless, the present vitality of the Hooper rule has been seriously questioned, e.g., H.R. REP. No. 1040, 77th Cong., 1st Sess. 20-22 (1941), and the Supreme Court had no difficulty in upholding an estate tax lien which Congress impressed on entirety property (including the non-indebted survivor's interest therein). Detroit Bank v. United States, 317 U.S. 329 (1943).
223. Actually, the language might have been wholly ineffective, for a court that was wedded to the proposition that the husband's (or wife's) interest is "like the rainbow in the sky or the morning fog rising from the valley" (United States v. Hutcherson, 188 F.2d 326, 331 (8th Cir. 1951)) would have found little "interest" to which to attach the lien.
224. See Note, 23 CORNELL L.Q. 598 (1938).
225. The Special Committee on Federal Liens posed the problems for further study but made no explicit recommendation. 84 A.B.A. REP. 681-82 (1959).
226. See pp. 617-18 supra.
227. INT. REV. CODE of 1954, § 7403(d).
sell the whole property with the concurrence only of the other spouse
is protected as a property right, and where an entirety character is
impressed on the proceeds, the court order could permit sale free of the
lien, upon joint application, with supervision of the reinvestment of
the fund in entirety property, to which the lien would be transferred.223
In the case of unreinvested funds, and entirety bank accounts generally,
the problem of balancing the property interests is more difficult. To
prohibit withdrawals for consumption would obviously be undesirable,
and would intrude upon the rights of the non-indebted spouse. Perhaps
a withdrawal could be regarded as pro tanto severing the tenancy in the
fund, entitling the tax collector, in the shoes of the taxpayer spouse, to
demand an equal distribution.229 Strictly speaking, it is only a with-
drawal for separate benefit which would have that effect, and the non-
indebted spouse has the right to have the entire account applied for
their mutual benefit.230 But it does not seem to be beyond the power
of Congress to require that the tax obligations of one spouse rank at
least on a parity with family expenditures out of the common fund.
If there is a constitutional problem it should be a vanishing one, since
future accretions at least should validly be subject to the new rule.

The right to the income from entirety property, in those states
where the income is impressed with the entirety character, should be
handled in the same way as sale proceeds and bank accounts, with
investment permitted subject to the lien on the taxpayer spouse's
interest, but with consumption matched by application of an equal
amount on the tax. Sale of the life interest of the taxpayer spouse should
be precluded, even in those states which permit it to creditors generally,
since the survival contingency would make it unmarketable at a fair
price.

The right of possession of non-income producing property, such as a
residence, involves a more serious problem, particularly in the states
following the majority rule, where the non-indebted spouse has a
property right to use and occupy, not half, but the whole, and she
(or he, as the case may be) cannot be charged rent for permitting the
taxpayer spouse to continue to occupy the property as a licensee. Even

223. Compare the court orders entered where the minority rule prevails, In United
States v. Ragsdale, 206 F. Supp. 613 (W.D. Tenn. 1962), and In First Fed. Sav. & Loan
Ass'n v. Lewis, 14 App. Div. 2d 150, 218 N.Y.S.2d 857 (1961), in order to protect the tax
lien on the husband's right, without impairing the wife's right of survivorship. Like
protection against acts of the non-indebted spouse was denied under the majority rule,
in In re Meyer's Estate (No. 2), 232 Pa. 95, 81 A. 147 (1911).
230. Note 209 supra.

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in the minority states, where creditors of one spouse can convert the estate into a tenancy in common with right of survivorship, no obligation of the non-indebted tenant to pay rent arises in the absence of a formal ouster of possession.231 It may be that, with respect to existing tenancies, little can be done in that regard beyond affixing a lien and bringing the property under supervision.232

The suggested procedure is not a wholly satisfactory solution, of course, since it is cumbersome and may hold the tax liability open indefinitely. It would operate, however, only in situations where the tax goes uncollected under present law, so the Government might be satisfied with half a loaf. I venture to predict that the mere availability of the remedy will induce tax payment (or a reasonable settlement) in most cases, and that the need for actually implementing the procedure will rarely arise.

A more direct and effective approach might be considered by Congress with respect to tenancies by the entirety created and amounts added to entirety bank accounts after enactment of the legislation, except those which are traceable to entirety property previously held. Only the states, of course, can abolish the anachronistic tenancy or change its incidents generally,233 but it seems a reasonable constitutional hypothesis that, as to interests created after Congress speaks, state law cannot authorize the creation of property rights one of the incidents of which is that they cannot be severed in order to satisfy the federal taxes of a co-owner. In such cases, therefore, the lien might be made immediately enforceable, by physical division where appropriate,234 but otherwise by sale of the whole, thereby avoiding the sacrifice that would result if a contingent interest were sold. Division should probably be made according to actuarial interests, rather than equally, in order to reflect fairly the value of the respective rights.235


232. It might reasonably be provided, however, that (in states where an ouster would entitle the cotenant to rent) the exclusive possession of property not capable of being shared with a stranger amounts to a constructive ouster. See 20 AM. JUR. 2d Cotenancy § 42 (1955).


234. See Section 8 of Part IV.A supra.

235. Unless the tenancy was created in fraud of creditors (note 210 supra), division even of a bank account on the basis of each party's contribution seems inappropriate since, unlike joint bank accounts generally (Section 9 of Part IV.A supra), the spouse of the contributor acquires rights which cannot be defeated by withdrawal. See note 209 supra.
Federal Liens and Priorities

The remedies suggested above should be made applicable to indivisible homestead rights and indestructible rights of survivorship as well as to tenancies by the entirety.

12. Community Property

Comparable problems, although without the complication of an indestructible right of survivorship, may occasionally arise with respect to community property, a form of marital co-ownership existing in eight states and with traces in some of the half dozen others which adopted such systems to gain federal tax advantages in the 1940's and promptly repealed them when the occasion passed. Since the laws and the interpretations thereof vary widely in detail, generalizations are difficult and dangerous, especially for a mere Easterner not versed in the lore.

The common denominator, however, is that husband and wife are considered to have equal, vested present interests in the community property, subject usually to the husband’s power of management, and that most income from property or services realized during marriage (except profits from the disposition of separate property and, in some states, the income from such property) is divisible between the spouses for federal income tax purposes. Thus, in general, they can achieve on separate returns the “income splitting” effect which is permitted to spouses elsewhere only if they file joint returns and incur the burden of joint and several liability for the entire tax. The question when arises whether the separate tax liabilities incurred by husband and wife may be collected from the community property, since except for gifts and inheritances they would frequently have no way to accumulate separate property after marriage to meet such obligations.

Community property is subject to seizure for debts incurred for the benefit of the community, and in Arizona and Washington for no other debts. In California and the majority of community property states, however, the husband as manager has power to subject the entire property (except, usually, the wife’s earnings) even to his separate debts, although the wife lacks such power even with respect to her “vested”

238. See id. Part 7; de Funiak, Principles of Community Property (1949).
239. Poe v. Seaborn, 282 U.S. 101 (1930); cf. Commissioner v. Harmon, 323 U.S. 44 (1944), rejecting, for federal tax purposes, the permissive system initially adopted in Oklahoma.
240. INT. REV. CODE of 1954, § 2(6).
half interest. In the majority states, therefore, there would be no problem concerning the husband's tax, unless perhaps the wife's earnings (half of which would have given rise to separate tax on the husband) were the only available source for collection. In the latter circumstance, as well as in the case of the wife's tax in those states and the tax of each in Arizona and Washington, the question is whether the separate taxes are community debts.

A leading authority has expressed the view that, like a tax on the property itself, a tax on community income is a community obligation but the few decisions in point are divided.

In certain states, no portion of the community property can be taken for antenuptial debts of one spouse—a principle that has been labeled “marital bankruptcy,” since one who brought no separate property to the marriage (or who thereafter consumed it) may never be able to acquire separate funds, even from his or her own earnings, from which to pay such liabilities. That rule was applied against the federal tax collector in one case, but another judge of the same court declined to do so, saying:

242. 2 AMERICAN LAW OF PROPERTY §§ 7.29-7.32 (A. J. Casner ed. 1952). The various laws are reviewed in De la Torre v. National City Bank, 110 F.2d 976 (1st Cir. 1940).
244. The wife's earnings were held immune from the husband's antenuptial taxes in Bice v. Campbell, 231 F. Supp. 948 (N.D. Tex. 1964), and for postnuptial penalties incurred by him as an officer in Mulchay v. United States, 251 F. Supp. 783 (S.D. Tex. 1966), but no reported case has directly involved the question of collecting the husband's tax on half his wife's earnings from such earnings. See note 245 infra.
246. 1 De Funik, supra note 238, at § 241, disagreeing with the fears of a contrary result expressed in G. McKay, COMMUNITY PROPERTY § 840 (2d ed. 1925), and in Mitchell, Taxation and Community Property, 14 So. Cal. L. Rev. 300, 391 (1941). In accord with de Funik, see Anderson, Federal Tax Liens—Their Nature and Priority, 41 CALIF. L. REV. 241, 254-55 (1953).
247. The wife's tax was held collectible from community property under California law in In re Ryan, 51-2 U.S. Tax Cas. ¶ 9493 (S.D. Cal. 1949), and under Hawaiian law in Santos v. United States, 277 F.2d 868 (Cl. Ct.), cert. denied, 364 U.S. 313 (1959). But California law was otherwise construed in Gilmore v. United States, 250 F.2d 942, 949-50 (Cl. Ct. 1961), rev'd on other grounds, 372 U.S. 39 (1963). Significantly, California law provides with respect to state income taxes that the one who receives, spends or controls the disposition of community income is liable for the tax thereon, as well as the one to whom it is taxable. 61 CALIF. REV. & TAX. CODE § 18555 (1956).
248. De Funik, supra note 238, at § 158, responds to the "marital bankruptcy" criticism by stating that one whose debts exceed his property at the time of marriage could in any event have availed of ordinary bankruptcy in order to get a fresh start. In bankruptcy, however, discharge is subject to conditions; and in the case of taxes, the liabilities dischargeable are limited. 11 U.S.C. §§ 32, 35, as amended (Supp. II, 1965-66).
249. Stone v. United States, 225 F. Supp. 201 (W.D. Wash. 1963), immunizing the hus-
Permitting a "marital bankruptcy" to be operative against valid and admitted tax obligations would not only be unjust and unreasonable but violative of sound public policy.\textsuperscript{259}

Congress should remove whatever doubt there may be that the entire community property may be taken for the separate taxes of either husband or wife so far as they are attributable to community income, as well as for non-income taxes arising from activities undertaken for the benefit of the community. If the states can make the community a distinct entity, Congress surely has the power to subject it to appropriate liabilities for federal taxes. Whenever separate property is insufficient, antenuptial taxes and later taxes attributable to separate income and activities should be made collectible from a spouse's half interest in the community property (or perhaps from his or her actual contribution thereto), unless collectible under state law from the property as a whole.\textsuperscript{260} The argument for this position, set out in the preceding Section, need not be repeated here.

13. \textit{Partnerships and Subchapter S Corporations}

The taxation of partnerships presents a curious dichotomy, each aspect of which raises its own peculiar problems. A partnership is both a taxpaying entity and an aggregate of individual taxpayers. Certain taxes incurred by the business (withholding, social security and excise taxes) are liabilities of the partnership itself. But the federal income tax is not a partnership liability; it is imposed on the partner's salary from his own antenuptial taxes. The situation was not comparable in \textit{Bice v. Campbell}, 231 F. Supp. 949 (S.D. Tex. 1965), where only the wife's earnings were immunized from the husband's antenuptial taxes.

\textsuperscript{259} Draper \textit{v. United States}, 243 F. Supp. 563, 565 (W.D. Wash. 1965), pointing out that "public policy" had been relied upon to subject community property (the husband's earnings) to levy for alimony to a former wife (\textit{Fisch v. Marler}, 1 Wash. 2d 639, 97 P.2d 147 (1940); \textit{Greear v. Greear}, 203 F.2d 393 (9th Cir. 1953)), and holding that "the Federal income tax, the economic life-blood of our nation" is at least of equal dignity with an alimony claim. In a property tax case the legislative policy of protecting the family against separate debts was overridden by a higher public policy, in \textit{Oglesby v. Peake}, 45 Ariz. 23, 40 P.2d 90 (1935), which was relied on in support of the \textit{Draper} rule in \textit{Prater v. United States}, 268 F. Supp. 754 (D. Ariz. 1967).

\textsuperscript{260} It has been argued, as a reason for immunity, that there is no available mechanism for equalizing the community interests by setting aside a part for the non-indebted spouse to balance the share taken for the other's separate debts, there being no accounting between the spouses until dissolution of the community. \textit{I de Funiak, supra} note 238, at § 158; \textit{Stone v. United States}, 222 F. Supp. 201, 209 (W.D. Wash. 1963). But state courts that have mastered the difficulties of specially treating such forms of community property as the wife's earnings, and of administering the "public policy" exceptions cited in note \textsuperscript{250} \textit{supra}, are not incapable of dealing, immediately or at dissolution, with such inter-spousal accounting problems as may arise. The analogy to a partnership's immunity from individual partners' debts, relied on in \textit{Stone, supra}, is faulty, since a partner's interest in the partnership may be reached for his separate debts, while there is nothing comparable in the case of community property. \textit{Cf. note 206 supra, and Section 13 of Part IV. infra.}
as individuals even if the partnership earnings are accumulated as
firm assets and are not distributed to them.\textsuperscript{222}

It is now firmly established that, even though the individual partner
may have no funds from which to pay his income tax, the Government
ordinarily is not entitled to collect it by levy upon any portion of the
partnership's bank accounts\textsuperscript{252} or its other claims,\textsuperscript{254} or to sell partnership
property,\textsuperscript{256} but can enforce its lien only against the partner's interest in the partnership, subordinate even to unsecured creditors
thereof.\textsuperscript{256} Similarly, in bankruptcy or other insolvency proceedings,
the statutory priority of the Government\textsuperscript{257} reaches only that surplus,
subject to the claims of all partnership creditors.\textsuperscript{259}

Those consequences follow from the rule of partnership law that an
individual partner's interest in the assets of the partnership consists
only of his share of the surplus after all partnership debts are paid.
Although now expressed as a rule of property, at least in the Uniform
Partnership Act,\textsuperscript{259} that principle originated in the idea that each
partner had an "equitable lien" on partnership property to have it
applied to the payment of partnership debts, an equity to which
partnership creditors were subrogated.\textsuperscript{260} Perhaps because the issues,
as they affect federal tax collection, were litigated to a conclusion before

\textsuperscript{222} Int. Rev. Code of 1954, § 701.
\textsuperscript{252} I.T. 3356, 1940-I Cum. Bull. 72. The tax collector was permitted to reach partnership
bank accounts, on unique facts, where there were no partnership creditors to be prejudiced and each
\textsuperscript{254} Stuart v. Willis, 244 F.2d 925 (9th Cir. 1957), holding individual taxes not collectible from contract proceeds owed to a joint venture. Although a joint venture is treated like a partnership for federal tax purposes (Int. Rev. Code of 1954, § 7701(a)(2)), another court has questioned whether they are thereby brought within the rule stated in the text, which is based upon a principle of state partnership law. In re Bruce Constr. Corp., 217 F. Supp. 926 (S.D. Fla. 1963), rev'd on other grounds sub nom. United States v. Owens, 329 F.2d 678 (5th Cir. 1964).
\textsuperscript{255} Adler v. Nicholas, 166 F.2d 674, 676 (10th Cir. 1948).
\textsuperscript{257} See Part IIA in First Installment.
\textsuperscript{258} United States v. Kaufman, 267 U.S. 408 (1925); United States v. Hack, 33 U.S. (8 Pet.) 271 (1834). The Government's otherwise sweeping right of setoff is likewise subject to the limitation that an individual debt, raised as a counterclaim to a suit by a partnership against the United States, may not be "unfairly satisfied out of partnership assets," to the prejudice of other partners and partnership creditors. Scott v. United States, 854 F.2d 292, 297-98 (Ct. Cl. 1988) (by implication).
\textsuperscript{259} Uniform Partnership Act §§ 18(a) and 25.
the days when "equitable liens" were branded as not "choate," the principle was accepted by the federal courts as a rule of property, binding on the United States.\textsuperscript{261}

If property rights are involved, they are not those of the partnership's unsecured creditors, whose rights are derivative and defeasible by concerted action of the partners.\textsuperscript{262} We have, therefore, another instance, somewhat analogous to those heretofore discussed, in which it is in the interest of co-owners that their property not be subject to lien or seizure for the debts of either of them, and they bring about that immunity through a private arrangement, sanctioned by law.\textsuperscript{263} Therefore, an argument could be made that taxes, the universal obligation for the support of government, should not be subject to defeat by such arrangements, and that federal liens for an individual's taxes should be made applicable to and enforceable out of his share of partnership gross assets, subject only to prior encumbrances thereon.\textsuperscript{294}

The appropriateness of that solution may be questioned, however. Except in marginal cases where the "partnerships" are little more than co-ownerships (and ought to be treated as such, if the line can reasonably be drawn),\textsuperscript{265} the immunity of partnership assets from individual debts serves an important business function. Whatever philosophical distinctions might be drawn, that immunity is not qualitatively different from the principle which immunizes corporate assets from the individual debts of stockholders, making only their equity (subject to all corporate debts) amenable to individual creditors, including the tax collector.\textsuperscript{266}

There is, however, one important difference already adverted to. Whereas, in the case of a corporation, individual tax is ordinarily payable only on distributed income, which thus is at least momentarily available in his hands for satisfaction of the tax, a partner may be taxable on income which does not reach his hands. We have here another instance of the problems which may arise when the tax law imposes income tax liability on one other than the person or entity that received and retained the income. Therefore, while the desir-
ability of radical surgery is doubtful, there may be need for a poultice for this sore spot. A precedent for a possible solution may be found in an early district court case in which the partners had allowed their shares of income to accumulate for three years, and had failed to pay taxes thereon for those years. Although the statutory lien for the taxes admittedly did not reach the partnership assets, the court impressed an equitable lien on the retained earnings for the amount of individual taxes attributable thereto.\footnote{267} While the present force of that decision is unclear,\footnote{268} it might well be confirmed by statute.\footnote{269}

A comparable situation may arise in the case of a corporation which duly elects under Subchapter S of the Internal Revenue Code,\footnote{270} thereby being relieved of any federal tax on its income, which is taxed instead to its stockholders, whether or not they receive distribution thereof.\footnote{271} Perhaps corporate assets should be made amenable to seizure for the individual taxes attributable to the undistributed income in such cases.

To whatever extent it is determined that individual taxes should be collectible from partnership or corporate assets, some affirmative action by the tax collector (whether by assessment or by court proceeding)\footnote{272} should be required in order to fix a lien on such assets, with priority

\footnotesize{267. In re Brezin, 297 F. 300, 304-07 (D.N.J. 1924).}
\footnotesize{268. The Supreme Court in United States v. Kaufman, 267 U.S. 408, 415 (1925), distinguished the Brezin case, saying that "Whether or not this case was correctly decided on its peculiar facts," no such facts (accumulation of untaxed income) had been shown in Kaufman.}
\footnotesize{269. This solution was suggested, without recommendation, by the Special Committee on Federal Liens, §4 A.B.A. Rev. 682-83 (1959). The Report raised for consideration the following questions: (1) Whether the lien should secure other individual taxes (including income taxes not attributable to partnership profits), on the theory that the undistributed profits belong to the partner: I submit that there is no logical basis for such an intermediate position, between the "radical surgery" and the "poultice." There is as much, or as little, reason for making the partnership capital subject to the general tax liabilities of the partners as there is to reach the income they have elected to leave in the business. If the lien is to be confined to the income, its logical basis rests on the fact that the tax is attributable to such income. (2) What effect should be given to a partnership agreement restricting withdrawal of profits: There was no such restriction in Brezin. But I submit that, if the principle of impressing a lien on the undistributed earnings for the tax thereon is sound, no agreement of the parties should frustrate it. (3) What effect should be given to losses which reduce undistributed profits after the taxable year: Such losses were given no effect in Brezin, apparently on the theory that, if the taxpayer had exercised his right to withdraw the profits when earned, the loss would have fallen on the partnership capital. The problem may be relatively academic, since loss carrybacks may in that event have eliminated the individual tax liabilities for the accumulation years as well.}
\footnotesize{270. Int. Rev. Code of 1954, §§ 1371-78.}
\footnotesize{271. Int. Rev. Code of 1954, § 1373.}
\footnotesize{272. Because of the conflicting interests involved, and the desirability of limiting the procedure to cases of necessity, it may be advisable to require court action. See p. 621 supra.}
Federal Liens and Priorities

over purchasers and secured creditors. It should not be necessary for such other persons to identify and search for federal tax liens against every partner or stockholder before they deal with the business entity.273

A different kind of problem is created by those federal taxes which are imposed upon the partnership itself. Such taxes, of course, are liens upon the assets of the partnership.274 In addition, however, without further action by the tax collector, those taxes give rise to federal tax liens against each individual partner who is, under state partnership law,275 a “person liable to pay” such tax.276 In bankruptcy or insolvency, the partnership tax (whether it had become a valid lien or not) will enjoy the same priority in individual assets as would an individual tax liability, notwithstanding the principle of partnership law (embodied in the Bankruptcy Act)277 which marshals individual assets first against individual debts.278

The difficulty arises from the Government’s attempts to bind secured creditors of and purchasers from the individual partners by liens filed against the partnership. There is no problem, of course, if the partners are also named individually in the notice of lien,279 but one which names certain partners followed by “et al.” should not be (and has not been by the courts) considered fair warning to persons dealing with those unnamed.280 Sometimes the partnership name itself may suffice to disclose the identity of the partners, although a decision holding that

273. See p. 621 supra.
274. Adler v. Nicholas, 166 F.2d 674, 679 (10th Cir. 1948).
275. Limited partners would have no liability, and hence no lien against them (Rev. Rul. 54-215, 1954-1 Comp. Bull. 265), unless by active participation they have incurred liability under state law. Heller v. United States, 351 U.S. Tax Cas. § 49,884 (N.D. Cal. 1954). A member of a defective limited partnership, who has done what state law requires to rid himself of liability, is also free of lien. United States v. Coson, 286 F.2d 453 (9th Cir. 1961).
276. In re Crockett, 150 F. Supp. 352 (N.D. Cal. 1957); Underwood v. United States, 37 F. Supp. 824 (E.D. Tex. 1939), aff’d, 118 F.2d 760 (5th Cir. 1941). Although the individual partner is not the “taxpayer,” he is (by virtue of general partnership law) a “person liable to pay any tax,” and his property is thus subjected to lien by Int. Rev. Code of 1934, § 6321. A notice and demand served upon the partnership as such, and not satisfied, is considered a notice and demand upon each partner and thus (when not complied with) fixes the lien on all. American Sur. Co. v. Sundberg, 58 Wash. 2d 337, 363 P.2d 99 (1961), cert. denied, 368 U.S. 989 (1962); cf. United States v. Coson, 286 F.2d 453, 464 (9th Cir. 1961).
278. Lewis v. United States, 92 U.S. 618 (1876); In re Crockett, 150 F. Supp. 352 (N.D. Cal. 1957). As to partnership taxes, the Government stands as a creditor of both the partnership and the individuals; as to individual taxes, it is an individual creditor only. See United States v. Kaufman, 267 U.S. 408, 415-16 (1925) (reconciling the Lewis case).
279. In Underwood v. United States, 37 F. Supp. 824, 827 (E.D. Tex. 1939), priority in individual assets was based on a tax lien filed against A, B, and C, “doing business as Hanover Refining Company.”
a lien filed against "Oscar Sundberg and Sons" was notice to those dealing with the unnamed sons individually seems to go to the limit of the law. Carried to its extreme, the apparent position of the Government, that filing in the firm name will bind those dealing with the individuals, would require such third parties (with no help from the records) to ascertain all the partnerships, joint ventures and syndicates in which those individuals may be involved. The law should prescribe that, in order to bind those dealing with the property of individual partners, a filed lien against the partnership must specifically name them, in such manner that the filing officer will index the lien against their names.

B. Priorities of Federal Tax Liens

A primary concern of the Federal Tax Lien Act of 1966 was the relative priority of federal tax liens and other liens. Although the amendments did not go as far as some might have liked, the reforms accomplished were important and far reaching.

Having previously acknowledged the achievements of the Act, it is with some hesitation that I include priority questions in the "agenda for the next decade." Nevertheless, a recital of battles lost and causes abandoned or deferred may be helpful in laying the foundation for further study and for the development of necessary accommodations in the years to come.

1. Filing of Liens

The federal tax lien, although it arises automatically whenever an assessment is not paid after notice and demand, is "not valid" against purchasers, holders of security interests, mechanics' lienors and judgment lien creditors until notice of the lien has been filed in an office, usually designated by state law, in the state, county, or other governmental subdivision where the property subject to the lien is "situated." Until 1966 the law did not define the word "situated," and the decisions left much uncertainty as to where the tax collector should file and third parties should search for federal tax liens on tangible and intangible personal property. The Special Committee on Federal

282. See Part I in First Installment, and sources cited at 228 n.3.
284. INT. REV. CODE of 1954, § 6323(a) and (d). If for any reason the state designation goes beyond the power delegated by that provision, filing is to be in the federal district court. Id. § 6323(f)(1)(B). See United States v. Union Central Life Ins. Co., 368 U.S. 291 (1961).
285. See PLUMB & WRIGHT 55.
Liens, with the approval of the American Bar Association, had proposed to resolve the conflict by prescribing filing at the residence of the taxpayer in the case of intangibles and certain mobile tangibles, and at the physical location in other cases. The Treasury, however, while willing to seek out each jurisdiction where a taxpayer owned realty, was adamantly opposed to having the generality of its lien further limited by a requirement that it do the same with respect to his personal property. It persuaded Congress, therefore, to prescribe filing against all tangible and intangible personal property only in the jurisdiction where the taxpayer resides at the time of filing. Although a search at the residence may occasionally be burdensome to a lender on or a purchaser of personal property located at a distant place, we can be grateful for the certainty the law now provides. To reopen that question, I am satisfied, would serve no purpose.

Congress, accepting in principle although not in detail another Bar recommendation, provided in the 1966 Act that the filing of a notice of lien shall cease to be effective against intervening as well as subsequent purchasers and encumbrancers unless the notice is refiled after six years, thereby making it unnecessary for the searcher to be con-
cerned with older lien notices. While the purpose of the provision is sound, it seems in two respects to have gone beyond the necessities of the case, to the possible detriment of the revenue.

It is only those who become purchasers or secured creditors after expiration of the six-year period who can be injured by a failure to refile. If the notice of lien, originally properly filed, is invalidated also as against those who acquired their interests within the six-year period, with actual or constructive notice of the prior lien, it "places a quite arbitrary burden on the [federal revenue], while it bestows entirely undeserved benefit on [such purchasers and creditors]." Yet that is the apparent effect of the refile provision, which is said to nullify the effect of the original lien notice (in the absence of timely refileing) "as against any person without regard to when the interest in the property subject to the tax lien was acquired." The apparent purpose of so providing was to avoid the possibility of circular priority, which could arise, for example, if the federal tax lien remained superior to a first mortgage perfected within the six-year period yet was inferior to a second mortgage perfected after such period. But such circuity would be present in only a fraction of the cases in which the law now confers an undeserved benefit on those who lost nothing by the failure to refile. And when it does arise the circuity would be readily soluble, under familiar principles, without need to confer such a benefit.

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292. While a lien would normally have expired six years after the assessment (INT. REV. CODE of 1954, §§ 6322, 6502(a)(1)), many events may cause its life to be extended, and refile warning third parties that this has occurred. See PLUMB & WEXNER 46-48.

293. For the difficulties formerly encountered by searchers, see United States v. Hodes, 355 F.2d 740 (2d Cir. 1966), cert. dismissed, 386 U.S. 901 (1967); United States v. Herman, 186 F. Supp. 15 (E.D.N.Y. 1960).

294. Adapted from Lockhart v. Garden City Bank & Trust Co., 116 F.2d 658, 662 (2d Cir. 1940), which involved a chattel mortgage refile statute. See 1 GIMMLER, supra note 288, at § 21.2.

295. H.R. REP. No. 1884, 89th Cong., 2d Sess. 47 (1966), and Temp. Treas. Reg. § 400.1-1(b), construing INT. REV. CODE of 1954, § 6323(g)(1), a cryptic provision which ought to be rewritten even if its substance is not to be changed.

296. Concerning circular priority, in another context, see First Installment 231-32 n.31.

297. See In re Andrews, 172 F.2d 996, 1000 (7th Cir. 1949), involving chattel mortgage refile. The solution there adopted may be illustrated by assuming a $7,000 federal tax lien, a $15,000 first mortgage attaching while the federal lien remained valid, and a $3,000 second mortgage attaching after the federal lien should have been refiled. Assume the proceeds are $16,000. The amount of the first mortgage ($15,000) would be set aside, leaving the balance ($1,000) for the second mortgagee, who thus gets all he would have received if there were no federal lien. The $7,000 federal tax lien is then paid (as was the holder of the non-refiled chattel mortgage in the cited case) out of the $15,000 set aside for the first mortgage, leaving only $8,000 for the first mortgagee. That solution is unfair to the first mortgagee, however, as he gets less than the $9,000 he would have had if the federal lien (to which alone he is junior) and the first mortgage were the only claims. The burden of that differential should fall on the Government, whose failure to refile caused the loss. Therefore, the amount of the prior federal lien ($7,000) should first be set aside, leaving $9,000 for the first mortgagee; the second mortgagee, being superior to the federal lien, should then be satisfied from the amount set aside, but only to the...
Refiling of a stale tax lien would afford small protection to those purchasing or lending on the security of personal property if, as the House bill had initially prescribed, refiling occurred only in the jurisdiction of original filing of the notice of lien, at a residence perhaps long since abandoned by the taxpayer. A Senate amendment, therefore, provided that refiling should occur not merely in the original office but also in the jurisdiction of the most recent residence of the taxpayer of which the tax collector had received written information, such as might be given by a tax return. But the additional requirement was not confined, as it should have been, to liens on personal property. One searching for liens on real estate will be concerned only with the notices filed or refiled at the physical location of the property, and will be amply protected if the notice was refiled there; yet he may take advantage of the tax collector's failure to refile as well at the latest known residence of the taxpayer. On the other hand, an encumbrancer or purchaser of personal property would hardly be prejudiced by a failure to refile in some jurisdiction where the original notice may have been filed because the taxpayer once resided there; as to him, a refiling at the recent residence should, by itself, have the same effect as any original filing in that place.

The refiling provision should therefore be revised to state that refiling at the physical location will suffice to bind real estate, and that refiling at the most recent known residence will suffice as to personalty.

298. Section 9-403(2) of the Uniform Commercial Code states that, upon failure to timely file a continuation statement, the security interest "becomes unperfected." The Comment of the Commissioners on Uniform State Laws construes that provision in the same way that the House Report construes Section 6323(g) of the Internal Revenue Code, stating that the rule thus avoids circular priority. The Comment is criticized in 1 Giousos, supra note 288, at § 21.6, at 589, as being "wrong, not only in principle but as an explanation of the statutory text. It is no doubt desirable to avoid circular priority systems, but not at such a cost. Moreover, as the Andrews case shows, solutions to circular systems, when they do arise, are not hard to come by."


300. S. REP. No. 1708, 89th Cong., 2d Sess. 12-13 (1965). The information must have been received at least 90 days before refiling, and must have been imparted in the manner to be prescribed by regulations. Int. Rev. Code of 1954, § 6323(g)(2)(B). Not even a new address shown on a later tax return will bind the Treasury in the case of assessments made before January 1, 1967 (because such information had not theretofore been coordinated with the delinquent collection file). Inexcusably, however, the Treasury has declined to be bound even by information that is actually in the collection file, unless it was received in writing from the taxpayer himself or his representative and related to an unpaid tax liability. Temp. Treas. Reg. § 400.1-1(c)(2). The test should be the one adopted, with respect to third parties' "actual notice or knowledge," in Int. Rev. Code of 1954, § 6323(b)(1), namely whether the fact has been brought to the attention of the individual acting in the transaction, or would have been brought to his attention if the organization had used due diligence.
Moreover, only one who acquired an interest after the required refiling period should be entitled to benefit from the failure to refile.

The six-year refiling requirement has ameliorated, but not eliminated, the problem of the prospective encumbrancer or purchaser of personal property who, to be safe, must ascertain the present and former residences of his debtor or seller (and any prior owner) and make a search in each place. In this mobile age, many people may change their county of residence one or more times in any six-year period. The Bar, therefore, also proposed a requirement for refiling in the new jurisdiction within one year after a change of residence.\(^8\) The Treasury successfully opposed that provision, maintaining that the tax collector is in no position to keep close track of the residences of all delinquent taxpayers. That, however, should not be the sole consideration. Congress has in other circumstances accepted some diminution of its security (despite the impossibility of protective action) by subordinating duly filed federal tax liens to innocent parties who, for various reasons, could not reasonably be expected to discover them.\(^3\) It might well do the same for the sake of lenders on and purchasers of personalty who are justifiably ignorant of a lien filed in a jurisdiction other than that of the present residence of the borrower or seller.\(^0\)

If that proposal still proves unacceptable, it might be a reasonable accommodation of the interests involved to prescribe that the tax collector must refile within a specified time after he does in fact learn, through his collection efforts, of a change in residence to another jurisdiction.\(^2\) While that would not protect everyone, it would at least reduce the chance of entrapment without imposing a significant burden on tax administration.

The focus for legislative activity with respect to federal tax lien filing, however, has now shifted to the state level. The privilege which Congress long ago granted to the states to regulate the filing of federal

\(^{301}\) 84 A.B.A. REP. 688, 710 (1959); cf. Uniform Commercial Code § 9-103(2), requiring refiling of financing statements within four months after the state of situs of personalty changes, and the alternative form of § 9-401(3), providing similarly with respect to the county of situs. See 1 Gilmore, supra note 288, ch. 22.


\(^{303}\) A test of reasonableness might well be applied to determine the extent of the inquiry that would be required, in the light of the size of the transaction and other circumstances.

\(^{304}\) Cf. Uniform Conditional Sales Act, § 14. Consideration should be given to whether knowledge obtained from a subsequent tax return (unless and until the information is actually associated with the collection case for prior years) should suffice to require refiling at the new address. While such information is required to be availed of in refile six-year-old liens (note 300 supra), the reasonableness of requiring the addresses on all delinquent accounts to be checked against new returns would depend on the feasibility of using computers for the purpose.
tax liens is subject to conditions which were materially tightened by the Federal Tax Lien Act of 1966. Any state law which requires filing at the location of personal property rather than at the residence of the owner is now invalid, as is any law which prescribes more than one office for filing against the personalty of any one taxpayer.\textsuperscript{205} Any Torrens Act or similar law that prescribes a different office for filing federal tax liens against registered realty than for other realty in the same county is likewise invalid.\textsuperscript{206} Failure promptly to conform such state laws to the new requirement will put local lenders and purchasers to the inconvenience of searching for federal tax liens at the office of the clerk of the federal district court,\textsuperscript{207} not merely during the period of invalidity but for years afterward.\textsuperscript{208}

New York in 1966 led the way in conforming its law in anticipation of the new federal requirements.\textsuperscript{209} In addition to eliminating location-filing and dual-filing requirements, however, it went a long way toward the goal of coordinating federal tax lien filing provisions with the Uniform Commercial Code. The New York law has become the model for the 1966 version of the Revised Uniform Federal Tax Lien Registration Act, and should be considered for general adoption.\textsuperscript{210}

\textsuperscript{205} Int. Rev. Code of 1954, §§ 6323(f)(1)(A)(ii) and (2)(B). For example, Va. Code § 55-189.1 (1950), requiring filing federal tax liens against personal property at its location, and Ariz. Rev. Stat. § 11-464 (Supp. 1967), requiring filing of federal tax liens on motor vehicles with the Motor Vehicle Bureau, while such liens on other personalty are filed in county offices, is clearly invalid now, even assuming (as held in K-R-K Inv. Co. v. United States, 66-2 U. S. Tax Cas. § 9668 (D. Ariz. 1960)) that it was valid before. It is unclear whether such special filing provisions, if not repealed, would cause the entire state law on federal tax liens to be invalid, or whether the special requirement can simply be disregarded as surplusage. The Senate Report on the 1966 Act seems to take the former view, saying that, “where the State designates more than one office, notice of lien is to be filed with the appropriate Federal district court.” S. Rep. No. 1783, 89th Cong., 2d Sess. 11 (1966). But Int. Rev. Code of 1954, § 6323(f)(1)(B) provides for federal court filing only “whenever the State has not by law designated one office which meets the requirements” (emphasis added). Here, the state has designated one office, and only one, which meets the requirements. See generally Plumb & Wright 59-61.


\textsuperscript{207} Note 284 supra. While the Government’s practice in such situations has been to file copies of tax lien notices in county offices even when a state law is considered invalid, such copies are filed “solely as a matter of convenience, and not as a matter of legal effectiveness,” and the risk of any slip-up rests on the searcher who fails to check the official filings in the district court. Rev. Proc. 67-15, supra note 285.

\textsuperscript{208} A lien once properly filed in the federal court need not be refiled in a state-designated office after the state law is changed. In re Dartmont Coal Co., 46 F.2d 455 (4th Cir. 1931). Furthermore, in the absence of a change of residence, the only required place for refileing after six years will be the same federal court, even if the state law has meanwhile been conformed. Temp. Treas. Reg. § 403.1-1(c)(3), example (7).


\textsuperscript{210} Unlike the ill-starred 1962 version of the Revised Uniform Federal Tax Lien Registration Act (note 286 supra), which sought complete coordination, the New York law was cleared with the Treasury before enactment.
The New York version of the Commercial Code, like that of most states, provides for central filing against some types of personal property, and local filing against others; in some circumstances, both are required. Any attempt to require filing of federal tax liens in the same places would be invalid under the "one office" rule of the new federal law, if for no other reason. The next best thing is to require filing against all personal property of a taxpayer at the one place where most Commercial Code searches would be made in connection with the particular taxpayer. Since most purchases and secured transactions involving personal property of individuals would relate to consumer goods or farm personal property, with respect to which Commercial Code filings would be at the local level, the New York law requires federal tax liens against individuals to be filed in county offices. Since most such transactions involving personal property of corporations, associations and partnerships would be commercial transactions, in which (despite the requirement of both central and local filing in some circumstances) most Commercial Code searches would be made at the state level, federal tax liens against these business entities must be filed with the Secretary of State. Thus, with relatively few exceptions, prospective purchasers or lenders may search for federal tax liens in the same office where they would normally search for security interests.

2. Effect of Actual Knowledge of Unfiled Lien

A question that has long been troublesome is whether a third party's actual knowledge of an unfiled federal tax lien has the same effect as the constructive notice that would have been imparted if the lien had been filed. Most of the decided cases have protected purchasers and secured creditors in such circumstances, on the ground that the law makes the lien "not . . . valid" against them unless it was filed, and imposes no condition respecting their lack of knowledge of the unfiled lien. But the Government, with some dubious support in the cases, has maintained that actual knowledge was as effective as filing.

312. See notes 266 & 305 supra.
314. The Comptroller General ruled even a bona fide bank loan to be subordinate to a known but unfiled lien. 37 Comp. Gen. 817, 819 (1958). But the only supporting cases involved transfers to controlled corporations for stock consideration (Hayward v. United States, 2 F.2d 467 (6th Cir. 1924); United States v. Woodside, 40-2 U.S. Tax Cas. ¶ 9402
at one time sought to have that position confirmed by the statute.\footnote{315}{The Federal Tax Lien Act of 1966 does not clearly adopt either view, although it arguably supports the former majority view that made actual knowledge immaterial if notice of the lien had not been filed.\footnote{310}{There is much to be said for freeing third parties from the effect of known but unfiled liens, at least if they act in good faith and give new value. The usual reason for the District Director's failure to file notice of a lien for a delinquent tax assessment is that the taxpayer is faithfully meeting agreed payments and appears to have a good chance to get back on his feet if his credit is not impaired by the filing of a lien. It would be inconsistent with that purpose to take the position that the taxpayer is precluded from obtaining secured credit from anyone who, by careful credit investigation or otherwise, becomes familiar with his tax situation.\footnote{317}{The cogency of this argument has been lessened, however, by the availability of the new procedure for subordination of the lien by agreement.\footnote{318}{If the premise of the argument is sound, that the District Director wants the delinquent taxpayer to operate normally, a prospective lender or purchaser in the normal course who knows of the lien should have no trouble obtaining such a subordination—but on terms tailored to protect the revenue in the circumstances of the case.\footnote{319}{Hence, there may now be something to be said for making an unfiled lien, unless subordinated, binding on those with actual knowledge of it. In any event, it is difficult to justify the extreme position taken in some of the decisions, which accorded priority to related parties who, with knowledge of an unfiled lien, acquired their interests as security for or in satisfaction of antecedent debts.\footnote{320}{And surely, even one who...}


\footnote{315}{The House version of the 1954 Code bill so provided (see H.R. REP. No. 1337, 83d Cong., 2d Sess., A407 (1954)), but the Senate preferred to "continue to rely upon judicial interpretation" (S. REP. No. 1622, 83d Cong., 2d Sess. 575 (1954)), and the Senate view prevailed.\footnote{316}{This view is based on new Section 6323(d) of the Internal Revenue Code, protecting the priority of the security for disbursements made within 45 days \emph{after} the filing of notice of the lien \emph{or} (if earlier) before the person making such disbursements had actual notice or knowledge of tax lien filing" (emphasis added). While the security for disbursements made \emph{before} filing is not expressly dealt with, it would be anomalous if such security were subordinated to known but unfiled liens, while post-filing advances are protected unless not only the lien but also the filing thereof is known.\footnote{317}{\textsuperscript{84} A.B.A. REP. 699 (1959).}\footnote{318}{Int. Rev. Code of 1954, § 6326(d)(9).}\footnote{319}{Ordinarily, because of confidentiality requirements (Int. Rev. Code of 1954, §§ 6323(g)(9), 7215), it is impossible to get revenue employees even to admit the existence of a federal tax liability that has not been placed on public record. But, if the taxpayer joins in the request for subordination, that difficulty should be eliminated.\footnote{320}{Runyan Mach. & Boiler Works v. Oil Screw "Captain Pete," 60-1 U.S. Tax Cas. 655}}
gives new value with knowledge of the lien should not be protected if he participates with the taxpayer in a scheme to convert the taxpayer’s property into spendable, concealable cash in order to hinder or defeat collection of the tax. The American Bar Association took an intermediate position and would deny protection only in those two special circumstances, but the provision was omitted from the bill as enacted.

Any rule which bases the priority of a purchaser or a secured creditor on such a subjective fact as knowledge of an unfiled lien—either generally or in the special cases last mentioned—may involve dangers to an innocent subsequent transferee of the purchased property or assignee of the security interest. It would obviously create havoc in the secondary market for secured obligations if a security interest which on its face is superior to the tax lien were in fact subject to a hidden infirmity because of the original creditor’s knowledge of the lien before it was filed. The Bar proposal would have met that problem by removing the infirmity when an innocent party thus entered the picture.

The proposal also sought to resolve the circuity problem which may result where, for example, a first mortgage is taken with knowledge of the lien and is invalidated against the federal lien (under one or another of the rules considered above), but there is an innocent second mortgagee or bona fide purchaser who is behind the first mortgagee but ahead of the federal tax collector, who is superior to the first mortgagee. Unfortunately, the complexity of the remedies recommended for resolving those peripheral problems contributed to the demise of the entire proposal. Perhaps, if it is revived, the lien should be viewed only as the triggering circumstance, and the remedy should be framed in terms of a personal liability of the person enjoying the preference or participating (even for new value) in the fraudulent transfer, so that innocent parties’ rights would be in no way involved.

9179 (N.D. Fla. 1955) (transfer to controlling stockholder with knowledge of lien, as indemnity for past endorsements); Schmitz v. Stockman, 151 Kan. 891, 101 P.2d 662 (1940) (transfer to grandmother to secure past advances with intent to defeat a known tax lien that was filed the next day). When a lien is neither filed nor known, however, an antecedent consideration should, and apparently does, suffice. H.R. REP. No. 1884, 89th Cong., 2d Sess. 11n. (1966).

322. Id. at 669, 689-90, 717.
323. Id. at 669, 713-18. The federally oriented circuity solution adopted in United States v. City of New Britain, 347 U.S. 81 (1954), in First Installment 231-32 n.31, would produce a result unjust to the innocent second mortgagee if applied in a case where the circuity arises from the Government’s failure to file notice of its lien; hence, it was proposed to protect the innocent party at the expense of the federal lien. See generally 4 AMERICAN LAW OF PROPERTY § 17.33 (A. J. Casner ed. 1952).
3. Secured Financing

A major contribution of the Federal Tax Lien Act of 1966 was the removal or amelioration of the threats to the security of financing transactions which had resulted from the “choateness” doctrine developed by the courts.234 Under the previous decisions, a security interest was not deemed “choate,” and was not protected against intervening federal tax liens, until the identity of the lienor, the property subject to the lien and the amount payable became fixed and certain. Lenders, therefore, could not safely make additional advances under an existing financing arrangement, or permit the substitution of security, without again searching for federal tax liens.235

Nowhere was the problem more acute than in the field of commercial finance, where loans and collateral may turn over daily. If Congress failed to resolve the problem in this area, it was not for lack of good intentions. In explaining the new provision protecting commercial loans or purchases of obligations made in ignorance of a filed tax lien within 45 days after such filing,236 both committee reports state categorically that:

The provision added by the bill is designed to keep this obligation [to search before each advance] within practical bounds by giving the interests arising under the agreements providing for these loans or purchases priority over a filed tax lien if the loans or purchases are made not later than 45 days after the tax lien filing and before the lender or purchaser had actual notice of the filing. This generally gives an inventory or accounts receivable, etc., financier assurance that his loans or purchases are not inferior to some recently filed tax lien as long as he searches the records at least once every 45 days.237

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234. See Part I in First Installment. The Act failed to provide relief for lenders in cases of insolvency of the debtor (see First Installment 235), but lenders may take heart from a recent decision holding an assignment of present and future accounts to secure present and future debts to be “choate,” even under the stringent standards applicable in Rev. Stat. § 3465 cases. It does not appear, however, that any of the indebtedness or the accounts arose after the event of insolvency. Creditors Exch. Serv. Inc. v. United States, 67-2 U.S. Tax Cas. ¶ 9745 (S.D. Tex. 1967).
235. See First Installment 231, n.27-28.
237. H.R. Rep. No. 1884, 89th Cong., 2d Sess. 8 (1966); S. Rep. No. 1708, 89th Cong., 2d Sess. 8 (1965). It has been objected that 45 days is not enough time to work out a distress situation. Coogan, supra note 326. Actually, the timing is tighter than that comment suggests. The lender can safely permit substitution of collateral until 45 days after filing of the tax lien, but that may be much less than 45 days after its discovery. And if new loans are needed to complete pending contracts or otherwise keep the debtor afloat, they will enjoy no priority under Section 6323(c)(2) if made at any time after discovery of the filed lien, although protection may in some circumstances be achieved under the purchase money security principle (note 380 infra) or perhaps under In re Halprin, 280
The possibility exists, however, that the intended relief may have been nullified, at least for optional future advances against existing collateral, by the unanticipated effect of one of the conditions which Congress attached thereto.

The Treasury was insistent that some standard of perfection be imposed upon security interests, since those that had not achieved such dignity that they would be protected under local law were not thought worthy of protection against federal tax liens. But against whom must the interest be “protected”? In whose hypothetical shoes is the tax collector to stand? For certain purposes of the Act, he is (somewhat anomalously) treated as if he were a “subsequent purchaser without actual notice,” but that standard would not do in the case of security interests, at least in inventory and obligations, which in some circumstances can be sold free of existing commercial security interests. Therefore, following substantially the pattern of the Bankruptcy Act, the federal tax collector was, with respect to security interests, placed in the shoes of a holder of “a subsequent judgment lien arising out of an unsecured obligation.”

Until quite late in the legislative process, however, it was recognized that security for future advances involved special problems, in terms of

F.2d 407, 410 (3d Cir. 1960), which extended that principle to cover other contract financing. Essentially, the 45-day rule merely spares the lender from constant searching of the files; but to work out a distress situation, once a lien is discovered, he must bring the District Director to the conference table and negotiate a subordination or discharge of the lien. Plume & Wright 87-88.

328. The American Bar proposal, reasoning that the tax collector was not a “reliance” creditor (see United States v. Lebanon Woolen Mills Corp., 241 F. Supp. 328, 339 (D.N.J. 1965); and United States v. R. F. Ball Constr. Co., 335 U.S. 597, 608 (1959) (dissenting opinion)), had taken the opposite approach, making such interests “effective” against the tax lien if local law preferred them over third parties “acquiring liens upon or interest in the property for value, with or without notice, either generally or subject to such limitations or exceptions as may be provided by law” (84 A.B.A. Rptr. 692, 694 (1959)); failure to record or file would merely have affected the burden of proof (id. at 686, 705).

329. Int. Rev. Code of 1954, §§ 6323(h)(2) and (6) (as against mechanics’ lienors and purchasers). The Treasury and Congress evidently were influenced by the view, reflected in the Bankruptcy Act (11 U.S.C. § 107(0)(1)(B) (Supp. II, 1965-66)), that the holder of “a lien which is so tenuous that it can be defeated by transfer to a bona fide purchaser” has “reason to know that [his] security is extremely vulnerable.” H.R. Rep. No. 686, 89th Cong., 1st Sess. 6 (1965). In bankruptcy, nevertheless, Congress permitted belated perfection against bona fide purchasers if the lien was valid against other lien creditors on the fatal day. No such locus poenitentiae was allowed as against a tax lien. See pp. 675, 677 infra.


perfection as well as in other respects. The Treasury-drafted bill on which hearings were held in March 1966 conditioned the relief for future advance security upon "all requisite actions under local law to protect the priority of such security interest [having been] taken."332 That broad, if imprecise, language might have supported the inference that filing of a commercial security interest (or any alternative method of perfection provided by the Uniform Commercial Code)333 would suffice to protect the security for future advances against the tax lien, as it would against intervening security interests.334 In the final stages, however, the draftsmen's instinct for symmetry and precision prevailed, and the "judgment lien" test of perfection, applicable to security interest generally, was extended to security for future advances.335 Those outside the Treasury who knew commercial finance law awoke too late to the possible effect of what had been done.

The chosen point of reference to local law, namely, protection against "judgment liens," was particularly unfortunate because the Uniform Commercial Code, now enacted in 49 states, the District of Columbia, and the Virgin Islands, does not deal expressly with the subject and there are no pertinent judicial interpretations under the Code. The leading commentators on the Code cannot agree on whether a judgment creditor, obtaining a lien by levying upon commercial collateral, would prevail over the security for optional advances yet to be made against existing collateral pursuant to a previously filed financing statement.336 The problem arises from the fact that a security interest is not

332. Section 6323(f)(4) of H.R. 11256, 89th Cong., 2d Sess., as introduced (set out in Hearings before the House Comm. on Ways and Means on H.R. 11256 and H.R. 11290, 89th Cong. 2d Sess. 3, 6 (1966)) (emphasis added).


334. UNIFORM COMMERCIAL CODE § 9-312(5).

335. INT. REV. CODE OF 1954, § 6323(c)(1)(B) ("protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation") (emphasis added). Additional conditions that must be met, in the case of commercial financing, are that the transaction must be covered by a written agreement entered into before tax lien filing, and that the collateral must be "commercial financing security" acquired before the 46th day after tax lien filing. Id. §§ 6323(c)(1)(A) and (2)(B). It seems that the required "agreement" need not be a firm commitment to make loans, but the matter is not free from doubt. See Young, Priority of the Federal Tax Lien, 54 U. of Chi. L. Rev. 729, 732-33 (1967).

deemed perfected, as against competing liens, until (1) it has "attached" and (2) the applicable steps (filing or otherwise) required for perfection have been taken.\(^{337}\) It does not "attach" until, among other things, "value" has been given.\(^{338}\)

Professor Grant Gilmore argues that, if a series of optional loans are to be made on existing collateral (e.g., a contract right), the lender acquires a single security interest, of fluctuating amount, which attaches once and for all by the giving of "value" when the first loan is made,\(^{339}\) and which, having been filed, is then fully protected against intervening judgment liens with respect to all future advances covered by the agreement.\(^{340}\) On the other hand, Peter Coogan argues, or at least warns of the possibility, that each optional loan gives rise to a separate security interest, which attaches and hence is perfected only when the particular advance is made, and is vulnerable to intervening liens arising from levies by judgment creditors.\(^{342}\) If the latter view is correct, one making a series of optional commercial loans on existing collateral remains as vulnerable to federal tax liens as before, and cannot, as Congress plainly contemplated, protect himself if he merely "searches the records at least once every 45 days."\(^{342}\)

In his latest article, soon to be published, Coogan suggests an intermediate position, that the commercial lender who makes future optional advances may be protected against intervening judgment liens of which he lacks actual knowledge, just as he was in the majority of States before the Commercial Code.\(^{343}\) Although the Commercial Code rejected that line of distinction as applied to intervening security interests,\(^{344}\) it may perhaps survive with respect to judgment liens.\(^{345}\) But

\(^{337}\) UNIFORM COMMERCIAL CODE § 9-309(1).

\(^{338}\) UNIFORM COMMERCIAL CODE § 9-204(1).

\(^{339}\) The "single security interest" view is in line with the traditional (although not unanimously held) concept of a real estate mortgage covering future advances. J. Pomeroy, EQUITY JURISPRUDENCE § 1195 (5th ed. 1941); G. Osborne, MORTGAGES, §§ 114, 117 (1931). "Value" includes "any consideration sufficient to support a simple contract," and the first loan would be such. UNIFORM COMMERCIAL CODE § 1-201(44)(a). Of course, the lender who is bound by a commitment has no trouble with the perfection requirement, because the commitment itself constitutes "value" and causes the security interest to attach at once to existing collateral. Id. § 1-201(44)(c). Whether the committed lender enjoys any greater protection than Int. Rev. Code of 1954, § 6323(c) gives the voluntary lender is discussed note 399 infra.

\(^{340}\) UNIFORM COMMERCIAL CODE § 9-204(5).

\(^{341}\) He also refers to UNIFORM COMMERCIAL CODE § 9-311, exposing a debtor's rights in collateral to involuntary transfer by levy, etc., "notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default." Note 327 supra.

\(^{342}\) Coogan, supra note 326. The prior law is described in 2 G. Gilmore, supra note 336, at § 354. See also note 350 infra.

\(^{343}\) See Comments to UNIFORM COMMERCIAL CODE § 9-312.

\(^{344}\) While the lien creditor's knowledge of an earlier but unperfected (not nonexistent)
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it would be easier to see the knowledge test as a limitation on Gilmore's theory than as an escape from Coogan's general thesis that each advance gives rise to a new security interest which, it seems, should be subject to judgments which had theretofore become liens, whether known or unknown to the lender. In any event, the new Coogan theory may not resolve the question under federal law, which neglects to say whether the hypothetical judgment lienor against whom the security must be protected is one who is known or unknown to the lender.

A related problem arises in the case of optional loans for the construction or improvement of real property, which enjoy limited protection against intervening federal tax liens, without reference to the 45-day limitation otherwise applicable, but still subject to the requirement that the security be protected under local law against a judgment lien arising as of the time of tax lien filing. Whatever the rule may be for commercial loans, most states do hold that the maker of optional real estate loans is subject to intervening judgment liens actually known to him, but not those of which he is ignorant. Logic would suggest that, if the tax collector stands in the shoes of a judgment lienor, the lender should be protected against intervening federal tax liens of which he had only constructive notice, and subject to those of which he had actual knowledge. But whatever merit that solution might have as a possible amendment to the statute, the language of the present law affords no clear basis for drawing such a distinction.

security interest is relevant to his priority (Uniform Commercial Code § 9-301(1)(b)), the Code is silent concerning the effect of the secured lender's knowledge of the intervening lien. Cf. Creedon, supra note 336, at 35 n.114.

346. 2 G. GILMOR, supra note 336, at § 35.6, however, apparently regards a "perfected" security interest covering future advances as good against intervening liens, known or unknown.

347. 4 J. FOMER, EQUITY JURISPRUDENCE § 1199 (5th ed. 1941).


349. Int. Rev. Code of 1954, §§ 6323(c)(1)(B) and 6323(c)(3). See PLUM & WILCOX, 85-86. The security for cash disbursements for such construction or improvement, even though made more than 45 days after tax lien filing and with knowledge thereof, is protected if they are made pursuant to a written agreement entered into before such filing and are duly protected against judgment liens. The protection of post-filing advances, however, extends only to the security consisting of the real property itself or (in the case of loans to a contractor) the contract proceeds. With respect to loans secured by contract proceeds, as well as crop and livestock loans (which anomalously are included in "real property construction or improvement financing"), the preceding discussion of Commercial Code chattel security would be applicable, so far as the perfection requirement is concerned.

In retrospect, it seems that the statutory point of reference to local law should have been protection against, not a judgment lien, but “a security interest subsequently perfected by filing or recording, of which the holder of the prior security interest does not have actual notice or knowledge.” A commercial security interest, expressly covering future advances, would be protected in that sense as soon as a financing statement is filed or an appropriate alternative step is taken, with no need for concern about whether the security interest technically had “attached” when the federal tax lien was filed. Such a solution seems preferable to amending the Commercial Code to resolve what appears to have been a relatively academic question in the states until the Federal Government undertook to make itself, without need for a levy, a universal judgment lienor.

Short of amending the federal law, or taking the long and painful course of amending or litigating the effect of the Commercial Code in every state, I submit that there is a fair construction of the present statute which, if written into the regulations, would resolve the issue in harmony with the intention of Congress as expressed in the committee reports. That construction is that the federal perfection requirement is satisfied when the lender (or factor) has taken the only action (by filing or otherwise) which state law provides for protection of his federally defined “security interest” (i.e., “an interest in property acquired by contract [the financing agreement] for the purpose of securing payment . . . of an obligation . . . .”) against judgment liens. If the protection provided by state law is incomplete, in that it does not extend to future advances, that is irrelevant, because—once the prescribed action under state law has been taken—it is federal law that prescribes in detail the extent to which the protection, as against federal tax liens, is broadened to embrace additional advances. The semantics of that construction may be debatable, but to reject it is to say to

351. The 1950 Bankruptcy Act amendments (note 331 supra) were not a reliable precedent for Congress, once the “judgment lien” test was extended, by amendment of the tax lien bill, to security for future advances. Security for future advances was not a problem under 11 U.S.C. § 96(a) (1964), since the giving of new consideration would negative a preference. See id. § 96(a)(6). And the trustee’s status as a hypothetical judgment creditor under 11 U.S.C. § 110(c) (1964) raised no problem in this regard because the notorious fact of bankruptcy would ordinarily terminate a line of credit.

Congress, "We see what you are driving at, but you have not said it, and therefore we shall go on as before."\(^{355}\)

If the suggested interpretation of the present federal law, or the amendment thereof proposed above, were applied to construction and improvement loans, the recording of the mortgage would fully satisfy the perfection requirement and, if the other conditions were met, the security for optional future advances would be protected against intervening federal tax liens known or unknown to the lender, since the federal law itself does not cut off the protection of construction loans when knowledge of the lien is obtained (as it does in the case of commercial loans).\(^{356}\) That is not necessarily an undesirable, or even an unintended, result, however, since the construction loans presumably enhance the value of the property, and completion would ordinarily be beneficial to the Government.\(^{357}\)

A number of problems arise where after-acquired property is to serve as security for either present or future loans. Congress was understandably reluctant to permit taxpayers to pledge their future earning power, to the exclusion of intervening liens for federal taxes. Therefore, the Federal Tax Lien Act of 1966, with severely limited exceptions, denies protection to security interests so far as they embrace property not yet owned by the debtor at the time the federal tax lien is filed.\(^{358}\)

\(^{355}\) Johnson v. United States, 163 Fed. 50, 52 (1st Cir. 1908) (Holmes, J., sitting on circuit). For further development of the distinction between the concepts of "protected" under the Federal Tax Lien Act and "perfected" under the Commercial Code, see Young, supra note 335, at 735-39.

\(^{356}\) The 45-day leeway allowed for making additional commercial loans, note 326 supra, is cut short immediately when actual, rather than constructive, notice of a federal tax lien is obtained. In contrast, presumably because many construction loans are made pursuant to commitments, Section 6323(c)(2) imposes no restriction with respect to either the time of making the advance or the lender's knowledge of the tax lien. If any restraint is to be imposed on optional construction loans, it must be found in the perfection provision (Section 6323(c)(1)(B)).

\(^{357}\) One writer has noted "some legislative tendency to provide that a mortgage for optional future advances shall have priority even though the mortgagee has actual notice of intervening claims. The main reasons for giving the mortgage such a continuing priority seem to be . . . the need, in some cases, to make further advances to protect those already made. . . . Similarly, a loan for the construction of a building may require a later loan to complete the construction, since only a completed building can earn the income to pay back the first loan." Perry, Priority of Liens against Real Property, in CURRENT TRENDS IN STATE LEGISLATION 1953-1954, at 351, 351 (1954). The American Bar Association proposal adopted that philosophy, imposing no conditions on the protection of construction or improvement loans except that the money be used for the intended purposes. 84 A.B.A. REP. 694, 702 (1959). The Treasury, as late as the March 1966 hearings (when the perfection requirement in the bill was admittedly worded differently), was apparently not averse to protection of nonobligatory construction and improvement loans. 1966 Hearings, supra note 332, at 48.

\(^{358}\) Int. Rev. Code of 1954, § 6323(b)(1)(A). See Plum & Wight 89-96. It is argued in Creedon, supra note 336, at 47, that the effect of Section 6323(b)(1)(A) is only to make the security interest attach to the property simultaneously with the federal lien, and that it does not follow that the federal lien will prevail. Under prior law, however, it was
One of the exceptions, already noted, permits commercial financing security to embrace collateral acquired by the debtor within 45 days after the filing of a federal tax lien, thus permitting some leeway for the turnover of inventory and accounts. Surprisingly, the "judgment lien" question which cast a cloud on the similar leeway which Congress intended to provide for future advances against existing collateral does not appear to affect the permitted acquisition or substitution of new collateral. Although all the experts would agree, in this instance, that the security interest cannot "attach" to the new collateral, and hence cannot be "perfected" with respect thereto, until "the debtor has rights in the collateral," that concession does not lead to the conclusion that a federal tax lien filed before the attachment of the security interest to new collateral must prevail (no matter which interpretation of federal law is adopted). On the contrary, since a hypothetical intervening judgment creditor likewise could not attach a lien to the collateral until it is acquired by the debtor, and then could do so in most states only by making a levy, it would seem that the security interest—which, under the Code, ordinarily attaches automatically to new collateral the moment it is acquired—would be "protected" against a judgment lien with respect to such property.

held that "the federal tax lien is superior to any simultaneously attaching interest" in after-acquired property (United States v. Graham, 96 F. Supp. 318, 321 (S.D. Cal. 1951), aff'd sub nom. California v. United States, 195 F.2d 550 (9th Cir.), cert. denied, 344 U.S. 831 (1952)), even if the nonfederal lien was earlier in date and attached automatically, Berkowitz v. Maxwell House Hotel Corp., 64-2 U.S. Tax Cas. ¶ 9824 (N.Y. Sup. Ct. 1964), But cf. United States v. Blackett, 220 F.2d 21 (9th Cir. 1955) (holding, at least where the federal lien arose first, that liens attach to after-acquired property in order of priority of time). The rule applied as between private liens in such circumstances is discussed in note 362 infra.

359. INT. REV. CODE of 1954, § 6323(c)(2)(B). The American Bar proposal would have permitted substitutions of collateral, without time limit, to the extent necessary to maintain unimpaired the value of the creditor's security as of the time of tax lien filing. 84 A.B.A. REP. 655, 704 (1959).

360. UNIFORM COMMERCIAL CODE § 9-204(1). Although there is some suggestion that future earnings and inventory of a business may be viewed as a present asset in the nature of a "general intangible" in which "the debtor has rights" and to which a security interest, therefore, may "attach" before actual acquisition of the claims and goods (2 G. Gilmore, supra note 356, at § 45.5), that would have no bearing on the present question, as the House Report on the 1966 Act expressly excludes "general intangibles" from the qualified category of commercial financing security. H.R. REP. No. 1884, 89th Cong., 2d Sess. 42 (1966). Cases involving the question of preference under 11 U.S.C. § 96 view a floating mass of inventory or receivables as an "entity," the "transfer" of which occurs when the security interest in the entity is created. Rosenberg v. Rudnick, 262 F. Supp. 635, 639 (D. Mass. 1967); In re Portland Newspaper Pub. Co., 271 F. Supp. 395, 399-400 (D. Ore. 1967). But those courts did not deny that the substituted items are after-acquired property (see Rosenberg v. Rudnick, supra at 638-39). The test under 11 U.S.C. § 96 is one of perfection against judicial lien creditors (see note 362 infra), whereas the Federal Tax Lien Act has added a further restriction concerning the time when the collateral may be "acquired." See generally Young, supra note 355, at 746-47.

361. UNIFORM COMMERCIAL CODE § 9-303(1), and Comment 1.

362. See Gordon, The Security Interest in Inventory under Article 9 of the Uniform
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The limitation of the protection to commercial security "acquired" within 45 days after tax lien filing does, however, raise problems of interpretation which, if not resolved favorably by the regulations, may have to be re-examined by Congress.363 Commercial security goes through a normal cycle, from inventory or contract rights to accounts or chattel paper to cash. The ultimate collateral for most commercial financing is the cash proceeds expected at the end of the cycle, and under the Commercial Code the security interest normally follows through each mutation in the collateral.360 It would be unthinkable if collections (or conversions into non-cash proceeds) after the 45th day were deemed to result in an acquisition of new and different property against which the intervening federal tax lien had priority. Similarly, the conversion of accounts into returned or repossessed goods, or of materials into a product or mass, or of a contract into a modified or substituted contract, all of which under the Commercial Code may (in some circumstances) result in a shifting of the security interest, should not be treated as involving after-acquired security for purposes of the federal tax lien law, unless possibly to the extent of any value

Commercial Code and the Preference Problem, 62 COLUM. L. REV. 49, 51 (1962). In United States v. Strollo, 67-1 U.S. Tax Cas. ¶ 9142 (Fla. Dist. Ct. App. 1966), involving the pre-Code Florida law, the attachment of the security interest to the after-acquired contract right was not automatic, so there was an interval during which a hypothetical judgment creditor could have levied. Therefore, a federal tax lien arising within 45 days before the new collateral was acquired and assigned to secure new advances was preferred, in reliance on INT. REV. CODE of 1954, § 6323(c)(1)(B). That situation might arise under the Code if the agreement does not contemplate automatic attachment. UNIFORM COMMERCIAL CODE § 9-204(1); Creedon, supra note 336, at 34. In some states, also, a judgment may become a lien on personality prior to levy (e.g., N.Y. CIV. PRAC. LAW & RULES § 5202(6) (McKinney 1963); Miss. CODE § 1555), and thus may attach automatically to after-acquired property (see Baker v. Hull, 250 N.Y. 484, 166 N.E. 175, 176 (1929)), simultaneously with the U.C.C. security interest. Perhaps in such a case a judgment lienor and the holder of a security interest would share ratably in the after-acquired property (Annot., 67 A.L.R. 1901 (1930); Note, Nonconsensual Liens Under Article 9, 76 YALE L.J. 1649, 1656-68 (1967)), and the security interest would be deemed "protected under local law against a judgment lien" only pro tanto. See Creedon, supra note 336, at 35-34.

363. See PLUMB & WRIGHT 93-95.
364. 2 G. GILMORE, supra note 336, at 1317, 1336.
365. UNIFORM COMMERCIAL CODE § 9-306. See 2 G. GILMORE, supra note 336, at ch. 27. Incredibly, the Government has contended, unsuccessfully, that a security interest in the proceeds of goods (pre-U.C.C. trust receipt) was not "choate" because it was uncertain how much the proceeds would be. The 1956 Act, although applicable, was not cited. Creditors Exch. Serv., Inc. v. United States, 67-2 U.S. Tax Cas. ¶ 9745 (S.D. Tex. 1967).
366. UNIFORM COMMERCIAL CODE § 9-306(5). See 2 G. GILMORE, supra note 336, at § 27.5. But cf. 3 W. COLLIER, BANKRUPTCY ¶ 60.51A(9) (14th ed. 1967). The problem under the Federal Tax Lien Act is discussed in Young, supra note 335, at 740-43.
367. UNIFORM COMMERCIAL CODE § 9-315. See 2 G. GILMORE, supra note 336, at §§ 31.4-5. When materials acquired before or within the 45-day period are combined with others which were not owned or were not subject to the security interest within that time, an apportionment (cf. UNIFORM COMMERCIAL CODE § 9-315(5)) of the product would be appropriate. See Coogan, supra note 326.
368. UNIFORM COMMERCIAL CODE § 9-318(2). See 2 G. GILMORE, supra note 336, at § 41.10.
added after the 45-day period. Again, the future payments to be earned under contract rights or chattel leases assigned as collateral should be regarded as existing property and not as property "acquired" only when the payments are earned. If the law is otherwise construed in those respects, commercial necessity would seem to compel its early amendment.

A security interest in the rents or royalties from real estate stands in a much more doubtful position. So far as the rent assignment may secure construction or improvement loans made after tax lien filing, priority over the tax lien is clearly denied. In other cases, even as security for present advances, its protection depends upon establishing that the right to future rents was property in existence at the time the tax lien was filed. Rents under a net lease, not conditional upon future performance by the owner, might qualify as present property, but otherwise the security seems vulnerable. Significantly, Congress had before it, but ignored, requests from the American Bankers Association and others that the law make clear that rents under existing leases are not after-acquired property for this purpose. Remedial legislation seems unlikely in the future because of the Government's fear of abuse where realty is held through corporations with no means to pay taxes on their net income from rentals if the rents are subject to a prior security interest.

369. The comparable bankruptcy problem is discussed in 2 G. Gilmore, supra note 336, at § 456.

370. "Contract rights" (which, by definition are "not yet earned by performance" (Uniform Commercial Code § 9-106) and in which the "debtor has rights") when the contract has been made (id. § 9-204(2)(c)) and "chattel paper" (which includes chattel leases (id. § 9-105(1)(b)) are expressly mentioned as qualified "commercial financing security," in H.R. REP No. 1884, 89th Cong., 2d Sess. 42 (1966). It must be contemplated that "contract rights," at least, are "acquired" when the contract is entered into, since when thereafter earned they would no longer be "contract rights" but "accounts." Uniform Commercial Code § 9-106. In a bankruptcy context, see 2 G. Gilmore, supra note 336, at § 42:5; Rockmore v. Lehman, 129 F.2d 892 (2d Cir. 1942). Under the Federal Tax Lien Act, see Young, supra note 335, at 743-48.


372. See p. 661 supra.


374. A provision added to the American Bar Association bill, H.R. 4925, 88th Cong., 1st Sess. (1963), at the instance of the American Bankers Association, provided broadly: A security interest in contractual rights to future payments or performance, whether such rights are fixed or conditional, shall not be deemed a security interest covering after-acquired property. Efforts to incorporate that provision in the bill which was finally enacted (H.R. 11256, 89th Cong., 2d Sess. (1965)) were unsuccessful.

375. By forcing the creditor to foreclose on the property itself, the Treasury would hope to put the rental income in the hands of one with taxpaying capacity.
A variation of the "proceeds" problem arises when the property securing an obligation is stolen or destroyed by fire. Although the insurance proceeds have sometimes been held to stand in the place of the security, subject to the same priorities, one court has held under prior law that the proceeds (despite a "loss payable" clause) constitute after-acquired property of the debtor, to which an intervening federal tax lien attaches in preference to the secured party. While proper drafting of the policy provision might avoid the problem, it would be hard to justify the Government's taking the proceeds of the security under any conditions, whether such proceeds result from a sale or from loss or destruction.

Among the noteworthy omissions in the 1966 legislation is a specific provision recognizing the superpriority of purchase money security interests, which the American Bar Association had urged. Congress chose instead to deal with the matter in the committee reports, which state:

Although so-called purchase money mortgages are not specifically referred to under present law, it has generally been held that these interests are protected whenever they arise. This is based upon the concept that the taxpayer has acquired property or a right to property only to the extent that the value of the whole property or right exceeds the amount of the purchase money mortgage. This concept is not affected by the bill.

At least under state law, that "concept" is not dependent upon retention of title in the vendor, or upon the application of the title theory of mortgages. A mortgage (to the vendor or to a financing party) which is deemed a lien, or a "purchase money security interest" under the Commercial Code, is equally effective for the purpose, at least if it

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377. Home Ins. Co. v. B. B. Rider Corp., 212 F. Supp. 457, 461-63 (D.N.J. 1965). The case is weakened as authority since the terms of the loss payable clause were not placed in evidence.
383. See Rev. Rul. 68-57, 1968 INT. REV. BUL. NO. 6, 24, 66-7 CCH STAND. FED. TAX REP. ¶ 5524. The Commercial Code has obliterated the distinctions based upon retention of title and, in effect, treats either a conditional vendor or a third party financer as
attaches simultaneously with the purchase so that only an encumbered title is acquired. That much of the concept, at least, is incorporated in federal law. So far, however, as state law may give "purchase money" priority to a security interest which is not taken simultaneously but is viewed as a part of the same transaction, it may possibly go beyond the concept stated in the committee report and may be vulnerable to the argument that, once the taxpayer has acquired a property right, the question of priority of liens thereon is to be determined solely by federal law. One might wish that Congress had stated its own definition of a purchase money mortgage, or had adopted state definitions, rather than referring vaguely to a concept that may or may not set the limits under state law.

A further consequence of the failure of the statute to deal expressly with purchase money security interests is that the status of those which are unperfected under state law is left in doubt. Most of the decisions under prior law held perfection unnecessary as against the federal tax lien, whether the vendor's interest was a retained title or a commercial security interest, and whether the federal lien arose before or after the transaction. The courts generally adopted the view that,

holding a security interest. Uniform Commercial Code §§ 9-107, 9-202, 9-312(3) and (4), and the Comments to those sections and to Section 9-507; In re Yale Express Sys., Inc. 370 F.2d 433 (2d Cir. 1965).

See Plum & Weaver 71-72. For a unique, and perhaps unreliable, application of the purchase money concept to protect a Commercial Code loan to finance the manufacture of goods, made after the filing of a tax lien, see In re Halprin, 280 F.2d 407, 410 (3d Cir. 1960).


See Aquilino v. United States, 363 U.S. 509, 512-14 (1960); Rev. Rul. 66-47, 1968 INT. REV. BULL. No. 10, 24, 68-47 CCH STAND. FED. TAX REP. ¶ 6524, states that "a purchase money security interest or mortgage valid under local law is protected even though it may arise after a notice of federal tax lien has been filed." If "valid" is intended to mean "enjoying the priority status of purchase money security," local law in this regard may control.

The American Bar proposal, note 374 supra, included a definition substantially in the language of the Commercial Code (but embracing purchase money security in real as well as personal property, and extending also to an equitable or statutory vendor's lien), and then, as against the tax lien, accorded the interest so defined the priority which it would enjoy over the pre-existing liens under state law.


There were tax liens arising both before and after the unrecorded conditional sales in the Anders, G.M.A.C. and Planters Bank cases, but no distinction was drawn. The tax lien arose subsequent to the conditional sale in Gauvey and Lebanon Mills. In Diamond T the tax lien arose first but was filed after.
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since tax liability is not a matter of voluntary contract, the federal tax collector is not the kind of reliance creditor the recording acts were designed to protect. As a general proposition, however, Congress rejected that viewpoint in the 1966 Act, apparently on the ground that, while the Government does not voluntarily extend credit, it may rely upon the record in deciding what collection action to take. Accordingly, a requirement of perfection against subsequent judgment liens was incorporated in the federal statutory definition of a “security interest.”

It seems safe to say that a commercial purchase money security interest which is perfected by filing any time within the ten days of grace allowed by Section 9-301(2) of the Uniform Commercial Code will be protected from either antecedent or intervening federal tax liens, since there is never a time when the security interest, although yet unfiled, is not “protected under local law against a subsequent judgment lien.” But it is possible to go further and argue for the protection of a commercial or other purchase money security interest that is never filed or recorded at all, on the theory that the general federal definition of “security interest,” including its express requirement of perfection, has no relevance to the priority of such interests. Since Congress elected to view purchase money interests, not as “security interests” enjoying superpriority by federal law, but as encumbrances limiting the property right which the taxpayer acquires and to which the federal tax lien may attach, there may still be vitality in the earlier decisions holding that a purchase money security interest which is good against the taxpayer purchaser himself is good against the federal tax lien, whether the latter attaches before or after the purchase. If, as a matter of policy,
Congress believes the federal tax collector should always be treated as a reliance creditor, then this gap in the statute should be closed by requiring that purchase money security interests be perfected within the period prescribed by state law, in order to prevail over either an antecedent or an intervening federal tax lien.\(^\text{395}\)

One provision which was sought by the Bar, in order to remove a gross judicial inequity, would have protected the security for disbursements which one is required to make, after federal tax lien has been filed, by reason of a binding obligation undertaken in good faith before the lien was filed.\(^\text{396}\) Congress was willing, however, to go only part way, by protecting the security taken, before tax lien filing, to indemnify sureties, endorsers, issuers of letters of credit and others who are bound to make later disbursements "by reason of the intervention of the rights of a person other than the taxpayer."\(^\text{397}\) The protection of a lender who is committed only to the borrower is subjected to the same conditions as the maker of optional advances (although he may perhaps have less trouble meeting the requirement of perfection against judgment lienors).\(^\text{398}\) Such a lender, unless he can qualify for the special protec-

\(^{395}\) If the tax collector is a reliance creditor at all, he is such whether the tax lien arose before or after the purchase money security interest, since collection efforts with respect to antecedent tax liabilities may be influenced by the taxpayer's later apparent ownership of property.

\(^{396}\) The decisions are well analyzed in Sullivan, supra note 378, at 162-65 (1964).

\(^{397}\) Note 339 supra. Section 6323(c)(4) would apparently protect the security of one who makes a commitment for the permanent financing of a building (even though he does not qualify as a construction lender), if that take-out commitment is relied upon not only by the owner but by the maker of the short-term construction loan.
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tion accorded real property construction and improvement loans or crop and livestock loans, must search for intervening federal tax liens at 45-day intervals and provide appropriate escape clauses in his loan commitments. 399

Furthermore, even as applied to those who become bound to third parties, Congress attached a condition, making the protection available only if the “obligatory disbursement agreement” was entered into in the course of the trade or business of the person who is bound. That, in my opinion, is one of the most indefensible terms in the entire Act. One who endorses a note or signs a bail bond for a friend, and takes a security interest in property of the friend before there is any federal tax lien on file, is surely as much entitled to protection against subsequent federal tax liens as the business endorser or the surety company. 400

Moreover, the restriction is not merely inequitable but is irrational as well, because it gives undue weight to the formal manner in which the security is held. For if the security is held by the obligee on the note or bond, the accommodation party will always get the benefit of it, either by being relieved pro tanto if the security is enforced by the obligee,

399. See Young, supra note 335, at 739. INT. REV. CODE of 1954, § 6323(h)(1) provides as a general rule that a security interest, properly perfected, “exists” when the collateral is “in existence,” but only “to the extent that, at such time, the holder has parted with money or money’s worth.” That seems to be a carefully constructed scheme to exclude both after-acquired collateral and future advances, except to the extent provided in Section 6323(c), which protects certain security interests which “came into existence” after the federal tax lien was filed. Regrettably, I must disagree with Peter Coogan, supra note 336, who argues that the security for loans made after tax lien filing, pursuant to a pre-filing commitment made only to the borrower, is protected by Section 6323(b) without need to refer to Section 6323(c). He contends that the lender in making the commitment has not merely given “value” (UNIFORM COMMERCIAL CODE § 1-202(44)(a)) but has met the more stringent federal test of having “parted with money or money’s worth” even before the loans are made. In the tax laws, however, the phrase “money or money’s worth” means something “reducible to a money value,” and is narrower than the common law or statutory concept of contractual consideration. Commissioner v. Wemass, 324 U.S. 303, 305 (1945); Treas. Reg. § 301.6323-1(b)(1). Congress underscored its restrictive intention in this instance by adding the words “to the extent that” and “parted with.” (Contrast the language of Section 6323(h)(6), relating to purchasers, which was construed in H.R. REP. No. 1884, 89th Cong., 2d Sess. 12 (1966), to embrace an unpaid obligation.) When the lender has “parted with” only his commitment, it cannot be said that the commitment itself is reducible to a money value equal to the amount to be loaned. 2 G. GLMORE, supra note 336, at § 35.4. Under Coogan’s view, Section 6323(c)(4) would add nothing to the protection already more freely available under Section 6323(b)(1), except in the very limited circumstances in which the security is to embrace certain after-acquired property (principally that which is “directly traceable” to the loans). It is more reasonable to suppose that Congress was unwilling (except in the meritorious cases covered by Section 6323(c)) to permit a taxpayer to tie up his property indefinitely as security for advances that he might draw upon at will, than that Congress was concerned merely with precluding one category of committed lenders from enjoying priority in after-acquired property “directly traceable” to their loans.

400. The discrimination was no mere oversight. When attention was called to it, Congress made doubly sure by spelling out the exclusion of accommodation endorsers in the committee reports. H.R. REP. No. 1884, 89th Cong., 2d Sess. 5, 44 (1966); S. REP. NO. 1708, 89th Cong., 2d Sess. 9 (1966).
or by subrogation if it is not.\footnote{Subrogation rights are recognized in Int. Rev. Code of 1954, § 6323(i)(2).} Ordinarily, only those unsophisticated in the strange ways of the tax law will be trapped.\footnote{In some circumstances, however, the obligee may be unwilling or not permitted to hold the security, so that even the wise may be endangered.}

An important reform accomplished by the 1966 Act was the protection of an otherwise prior mortgagee with respect to his outlays for such items as real property taxes and insurance premiums.\footnote{Int. Rev. Code of 1954, § 6323(e), aided by Section 6323(b)(6).} But that protection was extended only to his lien on the mortgaged property itself. Left in uncertainty was the status of cash deposits which the mortgagor may be required to make in escrow, in anticipation of property taxes and insurance premiums that are not yet due. The federal tax collector asserts the right to levy upon such escrows as property of the taxpayer, thereby diverting them from their intended purpose. The mortgagee’s interest in the deposit, even if it is denominated a “trust,” is probably no more than a security interest to indemnify the mortgagee against loss, and none of the special rules protecting the security for future disbursements appear to protect it against intervening federal tax liens.\footnote{See proposal by the United States Savings and Loan League in Hearings on H.R. 11256 and H.R. 11290 Before the House Comm. on Ways and Means, 89th Cong., 2d Sess. 234 (1966).} That matter should be expressly dealt with.\footnote{See United States v. Scovil, 348 U.S. 218, 221 (1955) (dictum).}

4. Purchasers

Secret, unfiled federal tax liens have, since 1918, been subordinated to purchasers of property from the taxpayer. But before the 1966 amendments that protection was held to be effective only if the purchaser had obtained a deed.\footnote{Leipert v. R.C. Williams & Co., 161 F. Supp. 355 (S.D.N.Y. 1957).} Therefore, families who had entered into executory contracts for the purchase of homes and had taken possession, but whose payments were insufficient to have entitled them to deeds, were subordinated to liens for federal taxes subsequently assessed against the seller; they not only lost their homes, but their equitable lien for recovery of their payments was held not to be “choate” enough to prevail over the later federal liens.\footnote{See United States v. Scovil, 348 U.S. 218, 221 (1955) (dictum).} The purchaser of all the assets of a business, who had received deeds which erroneously omitted a portion of the real estate intended to be sold, was similarly subordinated, provoking a dissenting judge to declare that

the morality of the Government’s taking property which . . . was sold to, paid for by, and in equitable conscience and law be-
longed to a stranger, is so disturbing to me that before the heavy hand of the tax gatherer falls, it is for Congress to speak clearly to declare that this is the conscience of the country.\textsuperscript{408}

Congress spoke, in the 1966 Act. It declared that one who has entered into a written executory contract or option to purchase property shall have all the protection of a purchaser with title. But what Congress gave with one hand, it took away with the other, for it prescribed that even a purchaser with title should enjoy protection only if his interest was “valid under local law against subsequent purchasers without actual notice.”\textsuperscript{409} Since sellers customarily will not permit contract purchasers or optionees to record their interests because of the potential cloud on title if the deal should fall through and because of the publicity which would be given to the contract price, their new “protection” is probably illusory—although the home buyer \textit{in possession} presumably meets the condition.\textsuperscript{410}

Normally, at least where real estate is involved, an intervening federal tax lien would be discovered when the title is searched at the time of closing. The perfection requirement at least serves the salutary purpose of inducing the parties to invite the tax collector to the settlement table (for which there would be no incentive if the buyer were protected unconditionally from the date of the contract or option), thereby enabling the seller’s tax liability to be collected from the proceeds. But it goes too far in bringing the tax collector to the table in the undeserved role of a hypothetical subsequent bona fide purchaser, having no obligation to give the contract purchaser or optionee the benefit of his bargain (which can be particularly important in long-term lease options, or in cases where large sums have been expended in assembling land or preparing for construction), or even to recognize a lien for the recovery of payments already made by the purchaser or optionee.\textsuperscript{411} In good

\textsuperscript{408} United States v. Creamer Indus. Inc., 349 F.2d 625, 629-30 (5th Cir. 1965).
\textsuperscript{409} \textit{Int. Rev. Code} of 1954, § 6323(h)(6). The \textit{Leipert} case, 101 F. Supp. at 538, had at least gone so far as to protect those who had received deeds, even though unrecorded. Cf. notes 389-90 supra.
\textsuperscript{411} Although many state recording acts deny “purchaser” status to those who have not taken title (45 \textit{Am. Jur., Records and Recording Laws} § 147 (1943)), the effect is mitigated by giving a lien for payments made under the contract. \textit{American Law of Property} § 11.76, 4 id. § 17.10 (A. J. Casner ed. 1952). That lien, at least in some states, prevails over subsequent judgment liens although not over bona fide purchasers. See
conscience, those rights should be recognized, at least unless some action or inaction of the tax collector has demonstrably—not merely hypothetically—been based upon his reliance on the apparent title of the seller.

It may be responded that the holder of an unrecorded contract or option takes a calculated risk that the rights of others will intervene, and that to accord him a greater equity against the federal tax lien than state law would give him against private third parties would result in circular priority, which—while not insoluble—would divert the benefit of the Government's self-abnegation to the holders of otherwise junior liens. A solution which would be fair in all circumstances is elusive. But we would be much closer to such a solution if the contract purchaser or optionee—as well as the purchaser with an unrecorded deed—were given at least such rights as state law would give him if the Government were (as it is in fact) an intervening lien creditor, not a bona fide purchaser.

The law has long protected purchasers of stocks, bonds and negotiable instruments against duly filed but unknown federal tax liens thereon, in recognition of the practical impossibility of searching for such liens, or even of tracing the chain of ownership, when such properties are purchased. Similar practical problems exist with respect to negotiable warehouse receipts and bills of lading, to which the American Bar Association vainly recommended that the protection be extended.

Since 1964 purchasers of motor vehicles have also been protected against unknown federal tax liens. The provision, while it incidentally protected retail purchaser of vehicles, was primarily intended for

Notes, 37 Mich. L. Rev. 165 (1938); 33 Cornell L.Q. 301, 305 (1947). The vendee's lien in Leipert, 161 F. Supp. at 358, was good against judgment creditors but lost out to the federal lien.

412 If the federal tax lien were subordinated to a vendee's lien, which was not effective against certain third parties under state law, the circular priority principle (See First Installment 231-32 n.31), would award the Government the amount left after the vendee's equitable share, but would give the vendee's share to the third party. The Special Committee struggled with a proposed preventive, but found it too complicated for adoption. See 83 A.B.A. Rep. 519-21 (1958); 84 A.B.A. Rep. 710-13 (1959).

413 Int. Rev. Code of 1954, § 6323(b)(1). The provision also protects security interests in such properties.

414 84 A.B.A. Rep. 698, 719 (1959). The proposal was not clear concerning whether a federal tax lien already attached to the goods before they were delivered to the carrier or warehouseman would continue valid against a purchaser of (or lender on) the negotiable document, as would a previously perfected security interest in the goods. See Uniform Commercial Code § 7-503, and Comment. Commercial convenience would seem to call for a liberal position. The question may be academic if the proposal next discussed is adopted.

415 Int. Rev. Code of 1954, § 6323(b)(2). This provision does not apply to security interests.
the convenience of the "automobile or truck dealer buying hundreds of used cars or trucks each year [who] finds it difficult to follow the normal procedures" of searching for federal tax liens.\footnote{416} The American Bar Association, believing that the practical problem was not confined to any one product, had recommended that a purchaser of any tangible personal property in the ordinary course of business of the seller should not be required to search for, or be subject to, federal tax liens on file against the seller.\footnote{417} Congress in 1966 accepted the proposal, but inexplicably confined the relief to the retail level.\footnote{418} Therefore, a wholesale purchaser (of property other than motor vehicles) may find himself subordinated to federal tax liens on file against the distributor, the manufacturer, or even the producer of the raw materials that went into the product, and a purchaser on a commodities market remains subject to the risk of liens against the unknown producer of the goods.\footnote{419}

A further 1966 amendment makes a search of the files unnecessary in the case of one who without actual notice or knowledge of a lien buys, in a "casual sale" for less than §250, household or personal effects or "other tangible personal property described in § 6334(a)—i.e., property exempt from levy.\footnote{420} The exception is supposed to cover purchases from neighbors or through the classified columns. But the purchaser at a household auction, or the purchaser of one or more of several items offered in the same classified advertisement, still buys at his peril, because the protection is expressly denied to one who knows that the sale is "one of a series of sales"—the stated premise of the limitation being that "the series of sales itself may be an indication that the seller is having credit problems" and thus may be subject to tax liens.\footnote{421}

A more reasonable inference may be that someone has died, retired from

\footnote{416} S. REP. No. 830, 88th Cong., 2d Sess. 155-56 (1964).
\footnote{417} A.B.A. REP. 690, 718 (1959); cf. UNIFORM COMMERCIAL CODE § 9-207.
\footnote{418} INT. REV. CODE of 1954, § 6323(b)(3). In order that one who had read of a store's tax difficulties need not cease dealing with it, both the Bar proposal and the law as enacted made the buyer's actual knowledge of the lien immaterial, unless he participated in a scheme to hinder or defeat collection of the tax.
\footnote{419} See Schmitz v. Stockman, 151 Kan. 891, 896-97, 101 P.2d 952, 966 (1940), in which wheat was pursued into the hands of a purchaser from a purchaser from a farmer-taxpayer.
\footnote{420} INT. REV. CODE of 1954, § 6323(b)(4). Regarding exemptions from levy, see Part IV.A.1 supra. The technique of cross-reference to a provision passed for another purpose is unfortunate, as it is unclear how many of the qualifications of § 6334(a) are incorporated by the words "described in." For example, to be exempt from levy, livestock and poultry must belong to a taxpayer who is a head of a family; must the casual purchaser of a horse inquire into the owner's family status? Tools and books (unless they are schoolbooks or qualify as household or personal effects) are exempt from levy only if they are "necessary for the trade, business or profession of the taxpayer"; must the purchaser ascertain at his peril whether they were "necessary"? And what of sales by a widow (herself subject to tax liens) who never used the items in any trade, business or profession of her own?\footnote{421} H.R. REP. No. 1884, 89th Cong., 2d Sess. 5 (1966).
his trade, been transferred overseas or remodeled his kitchen. But *caveat emptor* applies nevertheless in such cases, with respect to federal tax liens.

As a practical matter, because of the administrative burdens of pursuing the purchasers in most such cases, it will probably be a rare case in which anyone suffers from the petty and irrational restrictions imposed on the relief for sales in the ordinary course of business and casual sales.\(^{421a}\) But if that is the case, it underscores the unimportance of those restrictions to the revenue. They should be removed.

5. *Tracing the Proceeds of a Subordinated Loan or Purchase*

From time to time, because of ignorance, neglect or the practical difficulties of making a search in the circumstances, a purchaser or secured lender may fail to discover a prior federal tax lien on the property involved.\(^{422}\) The Government will be unjustly enriched if it is entitled to take both the property and its proceeds to satisfy the tax debt in preference to the purchaser or lender. Consideration might be given to allowing such a person a prior right to recover the proceeds mistakenly paid by him, if they can be traced.\(^{423}\)

6. *Mechanics' Liens*

The statutes of every state recognize the justice of impressing a lien on real property for the protection of those by whose services or materials the property is improved. A number of states go so far as to prefer the lien, subject to various conditions, even over pre-existing encumbrances on the property, on the theory (analogous to that underlying the priority accorded purchase money mortgages) that the encumbrancers should not enjoy a windfall from the enhancement of the

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\(^{421a}\) “Your committee has been informed that, as a practical matter, the Internal Revenue Service rarely proceeds against the purchaser unless the item involved has substantial value.” H.R. Rep. No. 1884, 89th Cong., 2d Sess. 4-5 (1966).

\(^{422}\) See, e.g., Pipola v. Chicco, 274 F.2d 909 (2d Cir. 1960) and United States v. Stutsman County Implement Co., 274 F.2d 733 (8th Cir. 1960), where little sympathy was shown to the victims of the errors. Regarding the procedural rights of such persons, see Part V.F, in the third installment of this article.

\(^{423}\) The Special Committee considered, but did not adopt, the following language:

A person who purchases property or acquires a security interest, without actual notice or knowledge of a lien under section 6321 which has priority over his interest, shall be entitled to enforce a constructive trust upon the consideration given by him, if such consideration can be traced, whether or not such constructive trust would exist under local law.

The American Bar Association did make a general recommendation for the protection of constructive trusts, since they are equitable interests vulnerable to bona fide purchasers and hence may not be “choate” by present judicial standards. 84 A.B.A. Rep. 664, 691 (1959). See section 11 of Part IV.B infra. Congress, however, ignored that recommendation.
value of their security when that enhancement has not been paid for.\(^{424}\)

The majority, however, reject that approach, presumably concluding that the prospective lienor is in a position to discover the encumbrance from the records and, if he wishes, to negotiate with the encumbrancer for a subordination agreement before conferring an unsought and perhaps unwanted “benefit” upon him. The majority states differ among themselves concerning the point at which the prospective lienor may be expected to consult the records and beyond which he will be protected against any later encumbrances, or against bona fide purchasers of the property. Some look to the date when the particular lienor began his services, but a larger number fix the priority of all liens on the project at the time of visible commencement of work on the entire improvement, while others look to the contract date. A few deny protection against encumbrances or purchases intervening before actual filing of notice of the mechanics’ lien, but most view such filing only as a condition subsequent, not affecting the priority of the lien.\(^{425}\)

Until the 1966 Act, however, a federal tax lien might deprive the mechanics’ lienor of the product of his work and materials, even if the federal lien first arose after the project had been completed, the mechanic’s lien had been filed and suit had been begun to enforce it.\(^{426}\) A major accomplishment of the Federal Tax Lien Act of 1966 was the elimination of that inequity.\(^{427}\)

The new law protects a mechanics’ lienor\(^{428}\) against any federal tax lien which is not duly filed by the date as of which the mechanics’ lien

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425. Id. § 16.106F. The laws currently in force are digested in the Mechanics’ Lien Laws chapter of the annual CREDIT MANUAL OF COMMERCIAL LAWS, published by the National Association of Credit Management.
427. See PLUMB & WRIGLEY 127-33.
428. A “mechanic’s lienor” is defined as one who has a lien for “services, labor or materials.” INT. REV. CODE of 1954, § 6323(h)(2). Unless liberally interpreted, that language may exclude the liens which some state laws extend to lessors of equipment and suppliers of power, whose contribution to the lien structure the American Bar Association thought equally worthy of protection. 84 A.B.A. REP. 692, 705 (1959). One who for any reason does not have a mechanic’s lien under state law, or who falls outside the federal definition, is powerless to obtain equivalent protection against federal tax liens by contracting for a security interest, because of an inexplicable and unwarranted restriction of the protection of construction financing (p. 661 supra) to those making cash disbursements. INT. REV. CODE of 1954, § 6323(c)(8)(A). The protection of the new law is extended to liens on contract proceeds as well as on the property improved; but claimants to contract proceeds may frequently enjoy a higher priority (in fact a superpriority) over tax liens against the general contractor, independently of that provision. See PLUMB & WRIGLEY 130-33. Since only liens on real property and contract proceeds are covered, a materialman’s statutory right to repossess materials not incorporated in the work is left unprotected. Bethlehem Steel Corp. v. Foley, 67-2 U.S. Tax Cas. ¶ 9729 (W.D.N.Y. 1967) (under N.Y. Lien Law § 39-c).
"becomes valid under local law against subsequent purchasers without actual notice." But a restriction is imposed: The priority can be fixed no earlier than the time when the particular lienor begins to furnish services, labor or materials, even if state law sets an earlier date. Congress should consider whether that arbitrary restriction, apparently imposed in the interest of uniformity, or in the belief that the facts would be more readily susceptible of proof, serves a sufficient purpose to warrant the trouble it may cause. It requires prospective mechanics' lienors to check for federal tax liens at a different point of time than they may be accustomed, under local law and practice, to search for other encumbrances. It may frequently result in circular priorities, and inequities even to those who have made a search at the proper time, in cases where some mechanics' lienors are superior to and others inferior to the federal tax lien yet are equal among themselves under state law, or where a mortgage intervenes between the state law priority date and the date recognized by federal law. On the other hand, the restriction apparently will be ineffective in any case where there is a general contractor who is himself unpaid, since the others may claim through him and with his priority.

Congress did not, nor did the Bar recommend that it should, give

429. INT. REV. CODE of 1954, §§ 6323(a) and (h)(2). That the tax collector would more appropriately be equated to a lien creditor than to a bona fide purchaser, see Section 4 of Part IV.B supra. 430. On the other hand, if the state law sets a later date as of which the priority is fixed, that date controls for purposes of the federal law. Since mechanics' liens are creatures of state policy, it was felt that they should enjoy no greater rights than they had under local law, even though some lack of uniformity among the states results. 431. The view has been expressed, however, that the difficulties of determining the commencement date are "considerably greater" under such statutes than under those that look to commencement of the work as a whole. 4 AMERICAN LAW OF PROPERTY § 16.100F, at 231 (A. J. Casner ed. 1952). The American Bar proposal, which would have recognized the priority date under state law (unless state law prescribed superpriority), placed the burdens of proving such date on the mechanics' lienor. 84 A.B.A. REP. 666, 702 (1959). There is no comparable provision in the law as enacted. 432. Some of the states which, like the federal law, date the priority of a mechanics' lienor against other encumbrances from the commencement of his own contribution also provide, inconsistently it seems, for equality among the mechanics' lienors themselves. Decisions in such states permit the intervening encumbrance to create two different classes of mechanics' liens, thereby destroying their statutory equality. An alternative solution, consistent with the federal circular priority rule (First Installment 231-32 n.31) would be to set aside an amount equal to the mechanics' liens having priority over the federal lien, plus whatever remains after satisfying the federal lien, and to divide that sum proportionately among all the mechanics' liens—thereby preserving their equality, but penalizing the earlier lienors who could not have discovered the federal lien by searching when they commenced their participation. 433. Although the mortgage may have been perfected before the federal lien, the mortgagee, rather than the later mechanics' lienor, would be the one to suffer. See First Installment 231-32 n.31, 233 n.29. 434. Subrogation rights are recognized against the federal tax lien. INT. REV. CODE of 1954, § 6323(i)(2). 435. 84 A.B.A. REP. 705 (1959).
consideration to recognizing the superpriority over pre-existing encum-
brances and liens which some states grant to mechanics' lienors to the 
extent that they add value to the liened property. The mechanics’ 
lienor can prevent unjust enrichment at his expense of the federal fisc 
by searching for tax liens at the prescribed time and, if it is important 
to him in the circumstances, by asking the tax collector to subordinate 
any lien which may be on file—thereby letting the tax collector 
decide whether the proposed improvement would really be beneficial to 
the lien. If there is real inequity, as distinguished from mere incon-
venience, in not recognizing such superpriority, it is the injustice suf-
f ered by a mortgagor, antedating the federal tax lien, who is subordi-
nated to the later mechanics’ lien while the federal lien absorbs the 
value added to the property by the improvement. But there is a limit 
to how far Congress can be asked to go in bowing to state rules of 
superpriority in order to prevent injury to innocent parties in isolated 
cases.

Congress did, however, recognize a superpriority for mechanics’ 
lienors in a very limited class of cases—where the contract with the 
property owner provides for a price for repairs and improvements of 
not more than $1,000. Although the committee reports justify the 
superpriority on the broad grounds that “it is unreasonable to expect 
construction workers and contractors to search for filed tax liens prior 
to undertaking small repair and improvement work,” and that “the 
work is likely to add to the value of the property and, therefore, in-
crease the Government’s chances of collection,” the law proceeds to 
add some of the kind of petty and irrational restrictions that we have 
noted in other connections. The property must be a personal residence, 
occupied by the owner and containing not more than four dwelling 
units. The “construction workers and contractors” must make their 
search, however small the job, if the resident owner holds the title 
through a corporation, or if the owner lives off the premises, or if the

436. Note 424 supra.
437. A subordination agreement may be entered by the federal tax collector where he 
finds that the chance of ultimate collection of the tax will be enhanced thereby—as 
where the work arrests deterioration of the property or puts it in condition for a more 
favorable sale. Int. Rev. Code of 1954, § 6325(c)(4). The procedure is described in Tempo-
rary Treas. Reg. § 40.2-1(c) and Rev. Proc. 68-8, 1968-8 INT. REV. BULL. No. 8. —
438. First Installment 232 n.31, 233 n.39.
439. Congress removed the most frequent source of circular priority inequities by 
bowing to state rules of superpriority for real property taxes. Int. Rev. Code of 1954, 
§ 6323(b)(6).
441. H.R. REP. No. 1884, 89th Cong., 2d Sess. 6 (1966); S. REP. No. 1708, 89th Cong., 
2d Sess. 6 (1966).
property is a larger rooming house or apartment house, and, of course, if it is a nonresidential property. Furthermore, the worker or material-man whose part in the job is $1,000 or less is unprotected if the total price under the general contract exceeds $1,000. And, while the rule, when applicable, eliminates the circular priority problem in those states which give mechanics' lienors a superpriority, it can give rise to new circular priority situations in those which do not.442

7. Landlords' Security Interests and Liens

A landlord who takes security for rent is particularly vulnerable to application of the "choateness" doctrine,443 since the debt secured is constantly changing and the collateral may also be subject to change.444 The best any landlord could do under prior law, in competition with federal tax liens, was to sustain his priority to the extent of rent accrued before the federal tax lien was filed.445 But, like a commercial lender,446 a landlord is in effect extending credit on a day-to-day basis, and cannot feasibly keep searching for federal tax liens against his tenants in order to protect his rent as it accrues.

The American Bar Association recommended, therefore, that landlords' security interests be protected with respect to rent accruing before or within three months after the filing of a federal tax lien, thereby making it unnecessary for a landlord to search the records unless he let the rent go delinquent for a longer period.447 In the case of farm tenancies, where it may be reasonable or necessary to let the rent go until a crop is harvested, the recommended limit was one year's rent. There

442. Suppose a $1,000 federal tax lien is ahead of a $10,000 mortgage, which state law prefers over a later $900 mechanics' lien, which federal law prefers over the federal tax lien. A federally oriented solution to the dilemma might place the mechanics' lien ahead of both the federal tax lien and the mortgage, in effect causing the mechanics' lien to be satisfied at the expense of the mortgagee. Cf. In re Quaker City Uniform Co., 238 F.2d 155 (3d Cir. 1956). However, since the circuity results from a subordination provided by federal law, the equitable solution would be to take the mechanics' share out of the amount otherwise payable on the federal lien, leaving the mortgagee with the proceeds in excess of the prior federal tax. Jordan v. Hamlett, 312 F.2d 121 (5th Cir. 1963).
443. See Part I in First Installment.
444. In cases involving the insolvency priority under Rev. Stat. § 8466 (Part I of First Installment), the landlord's contractual security was held "inchoate" in United States v. Menier Hardware No. 1, Inc., 219 F. Supp. 448 (W.D. Tex. 1963); Terry v. Title & Trust Co., 207 Ore. 356, 295 P.2d 161 (1956). The Government argued that such security was also not "choate" as against a federal tax lien, in Hoare v. United States, 294 F.2d 823 (9th Cir. 1961), but prevailed in that view only as to post-filing rents. Cf. Evans v. Stewart, 245 Iowa 1299, 66 N.W.2d 442 (1954), which antedated the full flowering of the "choateness" doctrine.
446. See Section 3 of Part IV.B supra.
would have been no time limit in the case of deposits or other security in the actual possession of the landlord.\footnote{448} Congress declined, in the 1966 Act, to deal directly with landlords' security interests. Arguably, however, they now enjoy limited priority under the general catch-all provision which protects the security for "disbursements made" within 45 days after a tax lien is filed and without notice thereof.\footnote{449} The word "disbursements," being used in contradistinction to "cash disbursements" in a related provision,\footnote{450} clearly embraces disbursements in \textit{kind}, and it may not place too great strain on the language to extend it to the furnishing of value in the form of the right to occupy the premises.\footnote{451} Nevertheless, it would be better to remove the doubt, and to tailor the time limits on the protection to the practicalities of the landlord's situation.\footnote{452}

If the landlord elects to rely on a statutory landlords' lien rather than taking a formal security interest, it is clear that he will be subordinated to federal tax liens arising either before or after the accrual of the rent obligation.\footnote{453} While state laws vary greatly in the terms of the protection accorded landlords' liens, even the strongest of them can be struck down under the "choateness" doctrine.\footnote{454} Whenever state law provides a landlords' lien of sufficient dignity to serve the practical function of a protection against third parties,\footnote{455} that lien should be recognized by

\footnote{448} When a deposit is made to cover the rent for the final period of a lease, the Government asserts the right to levy on it as property of the tenant. In Maryland Nat'l Bank v. United States, 227 F. Supp. 504 (D. Md. 1964), that contention failed only because the amount was found to be a \textit{payment} of advance rent, rather than security therefor.\footnote{449} \textsc{Int. Rev. Code} of 1954, § 6323(d). The security interest would be protected thereunder only in property owned by the tenant and covered by the security interest on the date of tax lien filing, and only if the interest is perfected against judgment creditors as of that date. Failure to record a lease containing a chattel mortgage clause would be as fatal as under prior law. Mason City & Clear Lake R.R. v. Imperial Seed Co., 132 F. Supp. 145, 156 (N.D. Iowa. 1957). See \textsc{Plumb \& Wachtr} 142-44.\footnote{450} \textsc{Int. Rev. Code} of 1954, § 6323(g)(3).

\footnote{451} \textsc{Hoare v. United States}, 294 F.2d 823, 828 (9th Cir. 1961) ("As each month under the lease went by, the lessees' use of the premises represented in effect the acceptance and use of value advanced by the lessors.").\footnote{452} See pp. 68-81 \textit{supra}. After 45 days, rent would normally be only 15 days delinquent, if at all, and the landlord could not reasonably be expected to begin searching for liens.\footnote{453} United States v. Scovil, 346 U.S. 218 (1955); United States v. Leventhal, 316 F.2d 341 (D.C. Cir. 1963); United States v. Weissman, 135 So. 2d 235 (Fla. App. 1961). United States v. Lawler, 201 Va. 666, 113 S.E.2d 921 (1960), \textsc{Int. Rev. Code} of 1954, § 6323(d), relied on in note 449 \textit{supra}, is confined to "security interests," which must be contractual, not statutory. Id. § 6323(b)(1).

\footnote{454} \textsc{See Plumb \& Wachtr} 141-42. The landlords' lien held not to be "choate" in United States v. Leventhal, 316 F.2d 341 (D.C. Cir. 1963), was valid against chattel mortgages given after the property was placed on the premises, although not against purchasers of goods in the ordinary course of business. See dissent in United States v. Saidman, 231 F.2d 503, 513 (D.C. Cir. 1955).

\footnote{455} A "bona fide purchaser" test of perfection would be too stringent, for the same
federal law as on a parity with a landlord's security interest, enjoying protection with respect to rent accrued before or within a limited period after the filing of a federal tax lien.  

8. Liens on Causes of Action

In many states an attorney has a top-priority "charging" lien by common law or by statute against any fund his efforts create, by suit or settlement, for the benefit of his client. In some circumstances, also, an attorney may protect himself by taking an assignment of a portion of the claim, or otherwise contracting for a lien on the recovery. Until the 1966 amendments, however, the attorney in either case risked having the product of his efforts taken to satisfy his client's federal taxes, whether the lien arose before or after the suit, because his lien was considered not to be "choate" until the suit was finally disposed of and the lien was confirmed by court order.  

At best, and then only if his right was in the nature of a contractual security interest, the attorney might be preferred to the extent of the value of his services performed before the federal tax lien arose.  

The new law, however, subordinates even a pre-existing federal tax lien to the right of an attorney to share in the fund he created, if it is "a judgment or other amount in settlement of a claim or of a cause of action," whether his lien is founded on local law or on "a contract enforceable against such judgment or amount." The law embraces liens on administrative claims, such as workmen's compensation or fire insurance as well as on claims pursued in court.  

But if an insurance adjuster, accountant, or other non-lawyer prosecutes such a claim, in reli-
ance on a contractual interest therein, he remains subject to the full
grigors of the "choateness" doctrine. 461

The defense lawyer who protects the taxpayer's right to a fund
already in his hands, or the lawyer who assists in the sale of prop-
erty, 462 in reliance upon a contractual right to a share of the funds in-
volved, may be defeated by intervening federal tax liens under the
"choateness" rule. While a superpriority relieving the lawyer of the
necessity to search for tax liens at the inception of his services might be
inappropriate in such cases, 463 some protection against tax liens filed
after that time should be provided. 464

There is one limitation on the relief granted by the new Act which,
while it may sometimes operate unfairly, is unlikely ever to be undone.
When the Government itself is sued, it may (with a limited exception)
offset any tax or other claim it may have against the plaintiff, and
that right of offset is not subordinated to the attorney's lien. 

The winning counsel may thus find himself with no fund from which to
satisfy his claim for compensation because of some entirely unrelated
matter arising during the litigation. 465

Numerous states give hospitals, and some give doctors, dentists and
nurses, a lien on a cause of action for personal injury. It makes sense
that the part of the recovery that reflects hospital and medical bills of
the injured person should go to pay those bills. Yet if he happens to owe
federal taxes, the recovery will be applied thereto in preference to the

1963); Home Ins. Co. v. B. B. Rider Corp., 212 F. Supp. 457 (D.N.J. 1963); United States
462. United States v. Beaver, 57-1 U.S. Tax Cas. ¶ 9281 (W.D. Pa. 1956), aff'd, 222
464. In those instances where loss of the case would deplete the funds otherwise subject to
the tax lien, or where the sale is more advantageous than any the tax collector could
arrange, the attorney, having discovered the tax lien by checking the files at the inception
of his services, can protect himself by obtaining a subordination agreement under Int.
Rev. Code of 1954, § 6325(d). See also Freitag v. The Strand of Atlantic City, Inc., 205
F.2d 778 (3d Cir. 1953).
465. A provision requiring periodic searches for liens (as provided in Section 6323(b)(2)
for commercial finance, and as above proposed for landlords) would not be appropriate.
Once the attorney has invested substantial time in the case, he cannot make himself whole
by withdrawing from the case, if the tax collector should decline to agree to subordination.
(1965).
468. Madden v. United States, 371 F.2d 469 (Ct. Cl. 1967); Brooks v. United States, 271
The provision for judicial award of attorneys' fees in cases under the Federal Tort Claims
Act (28 U.S.C. § 2675) does not override the Government's superior right of setoff. United
hospital and other claims.\textsuperscript{469} Congress in 1966 failed to adopt a Bar recommendation for protection of those liens,\textsuperscript{470} but the matter merits further consideration.

9. \textit{Attachment and Garnishment}

Under state law an attachment or garnishment before judgment gives the plaintiff rights in specific property to the exclusion of subsequent lien creditors, encumbrancers and even purchasers.\textsuperscript{471} In some states the attachment or garnishment prevails even over pre-existing interests which are not duly recorded.\textsuperscript{472} The Supreme Court has held, nevertheless, that an attachment or garnishment lien is not “choate,” as a matter of federal law, until the \textit{amount} recoverable is finally fixed by judgment, and hence that a federal tax lien arising after the attachment or garnishment and filed at any time before judgment will prevail.\textsuperscript{473}

Since attaching creditors\textsuperscript{474} were initially unsecured, their position does not have the same equitable appeal as that of the purchasers, secured lenders and mechanics’ liensors who act in reliance on the seller’s or debtor’s apparently clear title to his property. Therefore, the Bar made no recommendation for their relief.\textsuperscript{475} Yet it seems a persuasive case could be made therefor. Their equitable position is at least as strong as that of the creditor who persuades his debtor voluntarily to give security for an antecedent unsecured debt—a creditor for whom the Bar urged\textsuperscript{476} and Congress apparently granted\textsuperscript{477} relief.

Furthermore, attaching creditors are “reliance” creditors at least in the sense that they may incur considerable expense in obtaining and maintaining the attachment, and the further expenses of suit, in the belief that their “execution in advance” (as an attachment has been called)\textsuperscript{478} will assure collection of the ultimate judgment. If the court

\textsuperscript{470} 84 A.B.A. REP. 691, 720 (1959).
\textsuperscript{471} 7 C.J.S., \textit{Attachments} §§ 272-73 (1937).
\textsuperscript{472} Id. § 276.
\textsuperscript{474} For convenience, this term will be used to include also those who obtain garnishments before judgment.
\textsuperscript{475} 84 A.B.A. REP. 692, 701 (1959).
\textsuperscript{476} 84 A.B.A. REP. 659-60 (1959).
\textsuperscript{477} Although the 1966 Act was silent on the subject, the committee reports state that the term “money or money’s worth” (the parting with which is a prerequisite to protection of a security interest) “is intended to include money previously parted with if, under local law, past consideration is sufficient to support an agreement giving rise to a security interest.” H.R. REP. No. 1884, 89th Cong., 2d Sess. 11 (n.3 (1966); S. REP. No. 1708, 89th Cong., 2d Sess. 13 n.4 (1966).
has only in rem jurisdiction, as is frequently the case where attachment is obtained against a nonresident or absconding defendant, the intervention of a federal tax lien of sufficient magnitude may leave the plaintiff with nothing, not even an empty personal judgment, in return for his expenditures.

Congress as long ago as 1913 determined to protect judgment lien creditors, not merely against subsequently arising federal tax liens but also against those already existing but unfiled. Yet ordinary judgment creditors cannot make as appealing a case of reliance on the debtor's apparent title as those who commence their suit by attachment. Even though the non-attaching plaintiff may have decided to incur the expense of suit on the strength of the debtor's apparent capacity to satisfy a judgment when obtained, he consciously took the risk that the property he relied upon might be encumbered or dissipated pending the suit.

Perhaps the most cogent argument against extending that protection to attaching creditors is that the collection of taxes should not be delayed to await the outcome of private litigation. Yet the argument loses force upon analysis. If Jones and Smith dispute the title to a piece of property, the Government cannot seize it for Smith's taxes and cut off Jones with the argument that tax collection cannot be delayed while the ownership is litigated. The situation is not markedly different where a creditor acquires an interest in the debtor's property, by attachment, which is fully perfected against other third parties, subject to litigation over its amount. Furthermore, Congress was not deterred by any such practical considerations from recognizing the equities of mechanics' lienors and certain contingent security interests. The real issue is

479. Act of March 4, 1913, ch. 166, 37 Stat. 1016. Until the 1955 amendment, the words used were "judgment creditor" rather than "judgment lien creditor," but the courts interpolated the requirement that the judgment must have become a lien. Fore v. United States, 339 F.2d 76 (5th Cir. 1964), cert. denied, 381 U.S. 912 (1965). It appears that judgment liens remain subject to the full rigors of the "choateness" test (United States v. Cohen, 271 F. Supp. 709 (S.D. Fla. 1967); H.R. Rep. No. 1884, 89th Cong., 2d Sess. 35 (1965)); Congress having declined to adopt the more liberal standard of perfection proposed by the Bar. 84 A.B.A. Rep. 690-61 (1959). See PLUMB & WRIGHT 113-15.


481. Many states decline to extend the protection of their recording acts to judgment creditors, although the modern tendency has been to protect them. 2 A. FREEMAN, JUDGMENTS § 970 (5th ed. 1952); 5 H. TIFFANY, REAL PROPERTY § 1282 (3d ed. 1939). Congress itself has been ambivalent in its treatment of judgment creditors, excluding them from the benefit of certain collateral protections which are accorded the other favored classes. INT. REV. CODE of 1954, §§ 6323(b)(1) (protection against previously filed but unknown liens on securities), and § 6324 (protection against the secret special liens for estate and gift tax).

482. See INT. REV. CODE of 1954, §§ 6323(a), (c), (h)(2).
whether the equities involved have sufficient weight to justify bearing
the attendant costs.

Paradoxically, if the defendant lifts the attachment by giving bond,
and indemnifies the surety by giving the same or other property as
security, the surety's contingent security interest is protected against
intervening as well as existing but unfiled federal tax liens, even though
some delay in collection will result.\footnote{483}{ INT. REV. CODE of 1954, § 6323(c)(4). “In such a case an amount sufficient to cover
the potential obligations usually is set aside and used for these obligations. Only after
these obligations have been met is any remainder available to satisfy the liability secured
by the Federal tax lien.” H.R. REP. No. 1884, 89th Cong., 2d Sess. 9 (1966); S. REP. No.
1708, 89th Cong., 2d Sess. 9 (1966). \footnote{484}{ INT. REV. CODE of 1954, § 6323(b)(5). So far as local law may grant the lien but
deny it superpriority as against earlier security interests (see the limitations in Uniform
Commercial Code § 9-310), the circuity of liens envisioned, note 442 supra, may arise.
Cf. Note, Nonconsensual Liens Under Article 9, 76 YALE L.J. 1649, 1659-61 (1967).}

\footnote{485}{ United States v. Toys of the World Club, Inc., 288 F.2d 89 (2d Cir. 1961). It appears that most possessory liens today are enforceable without resort to judicial proceedings. Restatement, Security § 72, Comment b (1941); cf. id. § 48.}

Are the practical difficulties, then, sufficient justification for discrimination against the plaintiff
whose attachment is not thus lifted?

10. Miscellaneous Liens

State laws provide a great variety of other liens—for innkeepers and
garagekeepers; for carriers and warehousemen; for agisters and owners
of breeding animals; for artisans and repairmen; for laborers on farms,
railroads, oil wells, mines and forests; for seamen, musicians and book-
keepers; as well as for the reimbursement of the state for old age assis-
tance, to name a few.

Congress in 1966 carved out one category of such liens for special
protection. In recognition of the fact that it would be most unusual for
a repairman or artisan to search for federal tax liens before performing
the services for which local law gives him a possessory lien, and of the
fact that such services normally result in an increase in or restoration
of the value of the liened property, federal law now provides that even
a previously filed federal tax lien shall be subordinate to a possessory
lien “securing the reasonable price of the repair or improvement” of
tangible personal property.\footnote{484}{ Other possessory liens, however, while
they may be sufficiently “choate” to prevail over after-arising federal
tax liens, remain vulnerable to those which arose earlier, whether filed
or unfiled.\footnote{485}{ The American Bar Association recommended, but Congress did not
grant, a like superpriority for liens for the care, safekeeping, preserva-}
tion or carriage of personal property, innkeepers’ liens, liens on female animals and their young for services of a breeding animal, and liens upon animals, vehicles or vessels for damage done thereby.\textsuperscript{480} The factor of enhancement of value of the liened property is present in some of those cases, although it is less tangible than in the situations Congress chose to favor: business property, at least, ordinarily gains value when transported to another place, or when safeguarded from the elements, else the owner would not incur the cost of such services.\textsuperscript{487}

But there is a more persuasive reason for recognition of the superpriority of those additional liens. The tax collector, by not enforcing the tax lien, clothes the owner with power to make normal use of the property and with apparent authority to incur liens for the cost of normal services thereto by persons who could not be expected to make a search for federal tax liens.\textsuperscript{488} To enforce a prior tax lien at their expense compels them to bear another’s tax burdens, from which they could not reasonably protect themselves even by normal diligence. That ground alone, without reference to enhancement of value of the liened property, has sufficed to motivate the grant of superpriorities to purchasers of and lenders upon securities, purchasers of motor vehicles, retail and casual purchasers, and life insurance and passbook lenders.\textsuperscript{489}

That still leaves a mixed bag of other statutory liens, mostly nonpossessory, which for want of specific recognition by Congress would generally be subordinated under the “choateness” doctrine to both existing and subsequently arising federal tax liens.\textsuperscript{490} Some of them, although labeled “liens,” represent no protected interest in the debtor’s property, but rather are equivalent to rules of priority in the distribution of whatever the debtor may have at the time of insolvency or liquidation; such “liens” deserve no consideration as against the federal tax lien, unless perhaps on a selective basis it is found that federal policy coincides with that of the state.\textsuperscript{491}

Others, however, by reason of filing or other form of perfection, are attached so firmly to the debtor’s property that they will bind a pur-

\textsuperscript{486} 84 A.B.A. REP. 645, 691, 719-20 (1959). The superpriority would have applied whether the lien arose from local law or by contract.

\textsuperscript{487} And the service of a breeding animal adds value comparable to “repair or improvement.”

\textsuperscript{488} Concerning the priority of such liens under state laws, see 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY, ch. 33 (1965).

\textsuperscript{489} INT. REV. CODE OF 1954, § 6323(b).

\textsuperscript{490} See Part I in First Installment.

chaser without knowledge of the lien. A lien of that dignity should be regarded as a property right, which the lienor is as much entitled to rely upon as if he had taken contractual security for his claim, and which federal law ought to respect. The judicial doctrine of "choate-ness," so far as it holds that a federal tax lien prevails over an earlier private lien thus perfected *merely* because the private lien is not enforceable without judicial proceedings—a condition that has never been thought requisite to the priority of mortgages—should be overturned by Congress.

11. Victims of Crime

Money which is borrowed and must be repaid is, of course, not taxable income. Nevertheless, it is now established that the avails of embezzlement, extortion, swindling and sales of stolen goods are taxable despite the existence of an unquestionable obligation to make restitution to the victims. Even amounts expressly denominated

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492. Cf. Note, *Nonconsensual Liens Under Article 9, 76 Yale L.J. 1649, 1656 (1967)*, discussing the requirement of *Uniform Commercial Code § 9-310* that artisans' liens be perfected by possession in order to enjoy the protection thereof. The Note suggests that the restriction may have been motivated by the thought that, if bankruptcy should occur, any priority over secured creditors which the law might give a nonpossessionary lien would inure to the benefit not of the artisan but of the unsecured creditors represented by the trustee (11 U.S.C. § 107(c)(2) (1964), before the 1966 amendment), and points out that such reason would no longer be valid since liens on personally perfected otherwise than by possession are now recognized in bankruptcy. 11 U.S.C. § 107(c)(1)(B) (Supp. II, 1965-66), as amended, 80 Stat. 264. That may be a good reason for liberalizing the Federal Tax Lien Act as well as the Commercial Code in this respect.

493. Cf. United States v. White Bear Brewing Co., 390 U.S. 1010 (1959); *In re Lehigh Valley Mills, Inc.*, 341 F.2d 398, 401 (3d Cir. 1965). Priorities of state and local tax liens, which often are enforceable without judicial proceedings, are separately discussed in Part IV.C, in the third installment of this article.

494. The failure of the conventional mortgage to satisfy the standard test of "choate-ness" is demonstrated in Kennedy, *From Spokane County to Vermont: The Campaign of the Federal Government Against the Inchoate Lien*, 50 Iowa L. Rev. 724, 729-42 (1965).

495. The Special Committee on Federal Liens, in its Preliminary Report, considered recommending a general catch-all provision, that a lien not otherwise specifically dealt with should be protected against after-arising federal tax liens (but not against pre-existing unified tax liens) if it "has been so perfected that it would continue to attach to the property subject thereto in the hands of a bona fide purchaser (or of any bona fide purchaser other than a purchaser in the ordinary course of trade)." 83 A.B.A. Rptr. 449, 471-72, 501, 518 (1958). The Committee ultimately determined, however, that, "rather than jeopardize the chance of obtaining relief in the more serious situations expressly dealt with, it should not recommend a broad catch-all provision, but should leave the problem of broadening the relief to be dealt with in the light of future experience." 84 A.B.A. Rev. 645, 707 (1959).


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as loans have been held taxable when obtained by a confidence man who did not mean to repay if he could avoid it.\footnote{501} There is, of course, a certain equitable appeal to the view that the criminal should not be permitted to live “lavishly”\footnote{502} on untaxed ill-gotten gains while honest citizens pay taxes on their earnings.\footnote{503} But the problem has another facet that is too easily overlooked.

Unless the criminal has independent wealth, the primary source from which his tax liability must be satisfied is the very money or property to which his innocent victims must look for restitution,\footnote{504} and the natural result is an unseemly scramble by the United States to obtain a share of the loot in preference to its rightful owners.\footnote{505} Of course, in those situations where the victim’s title to the misappropriated property remains complete and unimpaired, a tax lien running against the wrongdoer cannot attach to that property.\footnote{506} But if under local law the criminal obtained even a voidable title, or one subject to a constructive trust, the victim’s equitable interest is ordinarily subject to defeat by a bona fide purchaser from the wrongdoer; and such vulnerability may be enough, under the “choateness” doctrine, to subordinate the victim’s equitable interest to a federal tax lien against the holder of the voidable legal title,\footnote{507} or to the absolute federal priority

\footnote{501} United States v. Rochelle, 584 F.2d 748 (5th Cir. 1978).
\footnote{502} Id.
\footnote{504} “[T]here are probably few instances of independently wealthy embezzlers who have not nonstolen assets available for payment of taxes.” James v. United States, 366 U.S. 213, 228 (1961) (dissenting opinion of Black, J.).
\footnote{505} See Commissioner v. Wilcox, 327 U.S. 404, 410 (1946); McKnight v. Commissioner, 172 F.2d 572, 574 (5th Cir. 1949); and the dissent of Mr. Justice Black in James v. United States, 366 U.S. 213, 227 (1961), in which Wilcox and McKnight were overruled.
\footnote{507} Cf. United States v. Morrison, 247 F.2d 285, 288 (9th Cir. 1957), in which a “lien, equitable in nature,” which “arises only because equity in good conscience requires it to accomplish right and justice” but which “is, or may be, outranked by many liens of innocent purchasers and others” and which can be enforced only by suit, was held subordinate to a federal tax lien. That description, applied to a vendor’s lien, fits a constructive trust as well, unless a distinction is made that if the property is divested of the trust by transfer to a bona fide purchaser, the trust attaches to the proceeds. Cf. United States v. Dunn, 268 U.S. 121 (1925). That possibility of substitution of property subject to the trust may, however, itself be evidence of absence of “choateness.” Cf. United States v. Sovi, 348 U.S. 218, 220 (1955); First Installment 251 n.27. Perhaps the position of a constructive trust, as a “property right” of the creditor-beneficiaries rather than a mere lien, has been strengthened by Aquilino v. United States, 363 U.S. 509, 515 (1960), on remand, 10 N.Y.2d 271, 176 N.E.2d 826 (1961) (see Libin & Haydon, supra note 497, at 458-462), which preferred over a federal tax lien a statutory trust which state law imposed on contract proceeds for the benefit of subcontractors and others; but the proceeds there were still in the hands of the owner and the trust fund may not yet have become vulnerable to bona fide purchasers. Cf. Mass. Bonding & Ins. Co. v. New York, 259 F.2d 33, 37 (2d Cir. 1958). The Government apparently argued the bona fide purchaser test of “choateness” of a trust in commingled but traceable funds in Dallas Airmotive, Inc. v. Schmidt, 66-2 U.S.
if an insolvency proceeding ensues.508 Furthermore, if the victim is unable to trace the money or property taken from him, as is commonly the case, he will stand as a mere general creditor in competition with the Government’s all-embracing lien or priority.510 His plight is dramatized by a recent bankruptcy case in which the available fund was exhausted by the Government’s priority claim for taxes incurred by a confidence man on sums he had “borrowed,” leaving nothing from which the victims could be repaid.511

The search for a complete solution requires consideration of questions of substantive tax law and policy, both criminal and civil, that would carry us well beyond the scope of this study. The unqualified taxability of unlawful receipts has, since the days of Al Capone,512 enabled the Federal Government to punish wrongdoers who would otherwise escape when local law enforcement breaks down; but the appropriateness of federal involvement in prosecutions for essentially local crimes—or rather, for failure to share the fruits of the crimes with Uncle Sam—is open to question, particularly since they are frequently in addition to, rather than in lieu of, state prosecutions for the underlying crimes.513 On the civil side, while there no doubt are instances in which the victim’s failure to seek restitution may leave the criminal with a net benefit on which he should pay a tax,514 the justice which is due even to a wrongdoer seems to require that some form of netting be provided for when restitution is made.515

Tax Cas. ¶ 9578 (S.D. Fla. 1966), but its position was rejected on the ground that as a pre-existing creditor it was not there in the position of a bona fide purchaser. The Government conceded priority so far as embezzled funds could be traced into specific property, in Springfield Brewing Co. v. First Nat’l Bank, 64-1 U.S. Tax Cas. ¶ 9430 (Ill. Cir. Ct. 1963) (Finding 20). See Plum & Wurz 155-57.


511. United States v. Rochelle, 364 F.2d 748 (5th Cir. 1966).


514. Kann v. Commissioner, 210 F.2d 247, 250 (3d Cir. 1953). See Commissioner v. Wilcox, 327 U.S. 404, 409-10 (1946). The suggestion that taxability be deferred until the statute of limitations expires or the victim releases his claim (see dissent of Mr. Justice Whittaker in James v. United States, 366 U.S. 213, 223 (1961)) may be unrealistic in the light of the policy of the tax law to affix the tax at the time when the money may still be available for its payment.

515. Congress has recognized the inequity of imposing tax on amounts received “under
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Assuming, however, that no substantive reform in this regard is found acceptable, attention should then be focused on the collection aspect, with a view to protecting the victim's right to restitution out of whatever assets the wrongdoer may have. The victim's right to reimbursement is surely an equity superior to the Government's claim to so much of the tax as is attributable to inclusion in the criminal's income of the amount unlawfully taken, without regard to whether the victim can trace his money or property into the available fund; to that extent, the victim should enjoy an unconditional statutory preference over the federal tax lien and over the federal priority in bankruptcy or other insolvency proceedings. To the extent that the tax liability arises from *other income* of the wrongdoer, the victim should be given priority with respect to money or property into which he is able to *trace* what he lost, but the Government should enjoy its usual lien or priority position in the wrongdoer's other assets.

a claim of right" and then allowing a deduction for the repayment in a later year when the taxpayer may have insufficient income to offset it. Accordingly, Section 1341 of the 1954 Code allows a form of netting of the repayment against the income (in a complex manner that need not be here detailed). But in the case of the embezzler, who had no "claim of right" in the first place, the Service denies him the benefit of Section 1341 and insists on taxing the receipt even though repayment has been made (for which a probably wasted deduction will be allowed in the later year). Rev. Rul. 65-254, 1955-2 Cust. Bult. 50. Even if Section 1341 were made applicable it would not help the victim, because the wrongdoer (if on the cash basis) still could not avail of Section 1341 unless he had first made repayment (Treas. Reg. § 1.1341-1(c)), and repayment may be impossible until the tax has been refunded or has been removed as a lien on the property from which repayment might be effected. That "vicious circle," which results from the mechanics of Section 1341, should be corrected by making an adjudicated or acknowledged liability to repay sufficient to trigger the relief, regardless of the taxpayer's accounting method.

516. *See* dissent of Mr. Justice Burton in Commissioner v. Wilcox, 327 U.S. 404, 414 (1946) ("This priority of the tax lien is hardly an adequate argument to eliminate the tax itself. At most it is an argument for Congress to modify the tax lien in favor of the victim.") *See also* United States v. Rochelle, 384 F.2d 748, 752 n.5 (9th Cir. 1967) ("Since Congress decided that income shall be taxable, and that a properly obtained lien for taxes shall have first priority in Bankruptcy, it is their decision and not ours that the United States shall take all and the other claimants nothing.")

517. Whether the federal lien arose before or after the wrongful taking, the Government should not "be so zealous in keeping money or property which is known to belong to a citizen of this country and which has been seized and wrongfully withheld." Machinery Center, Inc. v. Kelly, 65-1 U.S. Tax Cas. ¶ 9187 (E.D. Mo. 1965) (in which the tax collector had seized a bank account into which a third party's funds were traceable). The American Bar Association proposed recognizing the priority of constructive trusts (84 A.B.A. Rev. 664, 691 (1969)), but did not deal with the other aspects of the priority problem arising in cases of this type.

518. Circular priority may result where, for example, a bona fide purchaser from or secured lender to the wrongdoer has priority under local law over the victim's claim, but is inferior to a federal tax lien that had been filed. As such cases will probably be rare, the solution might best be left to the good sense of the courts, rather than adding a complexity to the statute. Cf. p. 656 *supra*. I suggest that the equitable solution would be to set aside an amount equal to the prior federal tax and award the balance to the third party, who thus gets all he had a right to expect; the amount set aside should then be paid to the victim to the extent that his equity superior to federal claim is recognized under the principles stated in the text.