Federal Liens and Priorities—Agenda for the Next Decade III*

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IV. Some Unresolved Federal Tax Collection Problems (*continued*)

C. *Conflicts Between Federal and State (and Local) Governments*

Although federal, state and local governments cooperate in the determination and collection of their taxes through exchange of tax information,¹ reciprocal withholding of income tax,² and other ways, they often become bitter competitors when the fund available for collection is inadequate to satisfy all their claims. A major part of the litigation over the priorities of federal taxes has involved conflict with state and local tax claims, since one who is delinquent in his federal taxes is likely to default other tax obligations as well. In fact, the priorities problem has sometimes been viewed as essentially a contest between "those who sought to maintain the supremacy of the National Government and those who were anxious to sustain undiminished power of the states."³

This is not as it should be. There may be legitimate differences of opinion concerning the proper scope of the functions of each level of government; but there can be no doubt in anyone's mind that the functions actually performed by each are of vital importance to the welfare of the nation, and that the nation has a stake in the financial soundness of all levels of government.⁴ Whether we shall ever come to

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1. INT. REV. CODE of 1954, § 6103(b). Some 41 States and the District of Columbia have entered into agreements with the Internal Revenue Service for the cooperative exchange of information on taxpayers.

2. See Plumb, *Federal Liens and Priorities—Agenda for the Next Decade II*, 77 YALE L.J. 605, 610 nn.35-37 (1968) [hereinafter cited as Second Installment].

3. Sarnet, *Correlation of Priority and Lien Rights in the Collection of Federal Taxes*, 95 U. PA. L. REV. 739 (1947), citing *Spokane County v. United States*, 279 U.S. 80 (1929), in which the Court reviewed a century of such conflict. In *United States v. Vermont*, 317 F.2d 446, 450 (2d Cir. 1963), *aff'd*, 377 U.S. 351 (1964), the Government argued, "[i]n the collection of its revenue the Federal Government must necessarily have supremacy over the states (and the numerous local tax authorities deriving their power from those states)."

4. In another, but not unrelated, connection, it has been well said that "the Committee [on Payments in Lieu of Taxes and Shared Revenues] proceeded from the compelling need to maintain robust local government. This is not merely in the sole interest of local

the actual sharing of revenues, efficiently collected by the federal government on behalf of the states, may be problematical because of fears of federal control over state expenditures. But no such problem impedes the adoption of rules for the fair and equitable distribution of a delinquent taxpayer's assets, which would remove a recurrent source of friction in sensitive intergovernmental relationships. And, as the Supreme Court conceded at the conclusion of an opinion sustaining federal priority, "nor would the Federal Treasury have been rendered bankrupt by a contrary result."⁵

1. *Revision of the Rules of Intergovernmental Priority*

A long-standing irritant in the relations between federal and state-local tax administrators was the federal government's argument for a double standard of "choateness" for their respective tax liens.⁶ Although the federal tax lien arises and becomes a "choate" lien on all property and rights to property belonging to the taxpayer as soon as the tax is assessed,⁷ the Government contended that a competing state or local tax lien was not "choate" until it was made specific by seizure under levy, transferring title or possession of particular property.⁸ It was not Congress but the Supreme Court, in *United States v. Vermont*,⁹ that finally repudiated that double standard and upheld the priority of an antecedent general lien for state withholding taxes which the state law, in terms tracking the federal statute, impressed at the time of assessment upon all the taxpayer's property. Thus, while the conflict between the federal and local governments was not eliminated,¹⁰ the combatants were at least armed with equal weapons.

In *Vermont* the state was armed with a lien that not only had attached to the property but also had been filed and perfected even

communities. The States and the Nation share in the general interest to maintain financially sound local governments The interest of the Federal Government in maintaining its financial strength mirrors the vital interest which citizens of local governments have in the same subject. The situation . . . is one calling for balanced judgment and reasonableness." COMMISSION ON INTERGOVERNMENTAL RELATIONS, A STUDY COMMITTEE REPORT ON PAYMENTS IN LIEU OF TAXES AND SHARED REVENUES 5 (1955).

5. *Massachusetts v. United States*, 333 U.S. 611, 635 (1948).

6. See Plumb, *The Priorities of Federal Taxes over State and Local Taxes*, 12 NAT'L TAX J. 204, 205 (1959).

7. *United States v. City of New Britain*, 347 U.S. 81, 84 (1954).

8. The Government relied on *United States v. Gilbert Associates*, 345 U.S. 361 (1953), which had imposed such requirement with respect to the federal insolvency priority. See Plumb, *Federal Liens and Priorities—Agenda for the Next Decade*, 77 YALE L.J. 223, pt. II.A (1967) [hereinafter cited as First Installment].

9. 377 U.S. 351 (1964).

10. As would occur under the "pooling" alternative, considered in Section 2 of Part IV.C *infra*.

against bona fide purchasers before the federal tax lien arose by assessment.¹¹ The Supreme Court did not even mention that fact, however, and filing was quite clearly not considered a prerequisite to the state's priority over the federal tax.¹² Similarly, the federal tax lien need not be perfected by filing in order to prevail over state and local tax liens attaching after the federal tax is assessed.¹³ It has sometimes been urged that state and local tax liens should be added to the categories which are protected against unfiled federal tax liens—which, if competitive equality is to be maintained, would require protection for federal tax liens against unfiled state or local liens. The American Bar Association recommended against imposing such requirements, on the premise that neither of the taxing authorities extends credit in reliance upon the taxpayer's apparent freedom from liens.¹⁴ Congress, however, has taken the opposite tack in requiring that purchasers, secured lenders, and mechanics' lienors perfect their interests in order to prevail against the federal lien, apparently on the premise that the tax collector becomes a "reliance" creditor when he has to decide what collection action to take.¹⁵ On that premise, a reciprocal provision that federal, state, and local taxes take priority from the time they are perfected in some manner might be appropriate.¹⁶

A further feature of certain state and local tax liens may prejudice these in competition with federal tax liens. If a state, for whatever reasons, chooses to provide for the enforcement of its tax liens by judicial process, the liens may be held not to be "choate" until such process is invoked, even though state law purports to make the tax a lien on all property from an earlier date.¹⁷ It is true that federal tax

11. See *United States v. Vermont*, 317 F.2d 446, 447 (2d Cir. 1963).

12. Perfection of a competing lien as against bona fide purchasers has sometimes been regarded as an element of "choateness." *United States v. Morrison*, 247 F.2d 285, 288 (5th Cir. 1957).

13. *United States v. City of New Britain*, 347 U.S. 81 (1954); *United States v. City of New York*, 132 F. Supp. 779, 783 (E.D.N.Y. 1955), *aff'd*, 233 F.2d 307 (2d Cir. 1956). Even if state law gives the state or local tax lien the force of a judgment, that does not make it a "judgment lien" against which the federal lien would be invalid without filing. *United States v. Gilbert Associates*, 345 U.S. 361, 363-65 (1953); *Treas. Reg. § 301.6323-1(a)(2)(i)(b)* (1956).

14. 84 A.B.A. REP. 707 (1959). See *Plumb*, *supra* note 6, at 210-11.

15. See *Second Installment*, 658 n.329, 673 n.409, 678 n.429.

16. In this respect, a state or local tax which is enforceable without obtaining judgment is comparable to a judgment, whether or not so labeled. See note 13 *supra*. *United States v. Vermont*, 377 U.S. 351, 358-59 (1964). It should not be necessary for the state or local authorities to go through the otherwise needless formality of obtaining a "judgment in a court of record" in order to permit them to rely on their debtor's apparent assets in the same manner that a judgment lienor or the federal tax collector may do.

17. *In re Lehigh Valley Mills, Inc.*, 341 F.2d 398, 401 (3d Cir. 1965); *Ersa Inc. v. Dudley*, 234 F.2d 178 (3d Cir. 1956). While those cases may be explained as turning on an adverse interpretation of the state law by a state court, it is nevertheless true that the

liens are summarily enforceable without need to resort to the courts. But equality, not identity, is the goal to be sought, and the manner provided for *enforcement* of a lien is no proper part of the test of its priority.¹⁸ The American Bar Association proposal would have protected the lien when it became effective against third parties (either generally or subject to exceptions), without regard to the manner of enforcement.¹⁹

So much for equality; what of superiority? It is not uncommon for the states to make their taxes paramount liens on the taxpayer's property, or to "relate back" their liens to a date prior to the time of actual administrative determination of the amount of the liability, in either case displacing earlier liens and encumbrances upon the property.²⁰ So far as such rules reflect an exertion of naked sovereign power over competing claimants, it should not be surprising that they are ineffective against the federal tax lien.²¹ In some circumstances, however, such superiority of the state or local lien may be justified.

The Federal Tax Lien Act of 1966, accordingly, made a significant concession to the priority of state and local claims by subordinating federal tax liens even to *after-arising* liens for real property taxes, special assessments, and certain charges for public services.²² Congress thus recognized the superpriority which state laws almost universally pro-

need for judicial process for enforcement has generally been fatal to "choateness." In *United States v. Vermont*, 377 U.S. 351, 358-59 (1964), the Court said:

Moreover, unlike those cases in which the *Security Trust* [340 U.S. 47 (1950)] rationale was applied to subordinate liens on the ground that judgment had not been obtained prior to the time the federal lien arose, it is as true of Vermont's lien here as it was of the federal [sic] lien in *New Britain* [347 U.S. 81 (1954)] that "[t]he assessment is given the force of a judgment, and if the amount assessed is not paid when due, administrative officials may seize the debtor's property to satisfy the debt [emphasis added]."

18. In his dissenting opinion in *Illinois ex rel. Gordon v. Campbell*, 329 U.S. 362, 377-78 (1946), Mr. Justice Reed said:

I deem the recorded notice as the incident that consummates the lien upon the specific and ascertainable property. The enforcement proceedings after that recordation are only an enforcement of a lien already fixed upon the specific property adequately described in the recorded notice.

19. 84 A.B.A. REP. 686, 692, 701, 707 (1959).

20. 4 AMERICAN LAW OF PROPERTY § 16.106I (A. J. Casner ed. 1952). If a quotation from Plumb, *supra* note 6, at 208, may be pardoned:

When we criticize the strong-arm priorities of the federal government we must not forget that the States have led the way in granting themselves priority over the antecedent interests of third parties, and we should not be surprised that, when the play is rough, the bigger boy takes the marbles.

21. *United States v. City of New Britain*, 347 U.S. 81 (1954); *United States v. First Nat'l Bank & Trust Co.*, 386 F.2d 646 (8th Cir. 1967); *City of Dallas v. United States*, 369 F.2d 645 (5th Cir. 1966); *Massachusetts Bonding & Ins. Co. v. New York*, 259 F.2d 33, 38-39 (2d Cir. 1958); see Plumb, *supra* note 6, at 208, 211.

22. INT. REV. CODE OF 1954, § 6323(b)(6). This had been recommended, with respect to real property taxes and special assessments, by the American Bar Association. 84 A.B.A. REP. 691, 720 (1959).

vide for such obligations on the theory that they reflect benefits conferred by the state or local government upon the specific property taxed and subjected to the lien. A real property tax is imposed upon the entire property, regardless of the number and nature of the interests into which it may be divided (although it is in fact borne by the equity owner or, if his equity is insufficient, by the most junior of the lienors); a special assessment reflects improvements theoretically enhancing the value of the property and thus benefiting the pre-existing liens.²³

Further study might lead to the conclusion that additional superpriorities may deserve federal recognition. It is doubtful that this will be the case with personal property taxes, which seem more appropriately to be regarded as "personal" levies, rather than as impositions in rem upon the specific assets which measure the tax.²⁴

The most likely area where such a superpriority may be justified relates to sales, gasoline, and other taxes collected from the consumer, as well as withholding taxes. In theory, the collecting agent should set such taxes aside in trust for the state or local government. As a practical matter, if delinquency occurs there is frequently no trust fund that can be traced,²⁵ and the taxing power will be dependent upon its lien. If a federal tax lien exists before the state or local tax is collected from the public or withheld from the employees, or before the formal assessment of the liability, the Federal Government will profit from the resulting enhancement of the net assets of the collecting agent. It would be more equitable to recognize a superpriority for that type of liability as a sort of rough-hewn substitute for tracing the actual collections as trust funds into the specific accounts that were enhanced thereby.²⁶ But however supportable that view may be as applied to current working

23. The justification is not so readily discernible in the case of water and other service charges, which were a late addition to the bill. It is also not clear why the federal government, as junior lienor, should consent to bear the entire burden of property taxes the superpriority of which is justified on the theory of benefit to *all* interests in the property. The Special Committee on Federal Liens originally considered recommending that the federal lien be charged only with its pro rata share of the burden of after-assessed property taxes. 83 A.B.A. REP. 507, 528 (1958). That limitation was ultimately abandoned in the interest of simplicity and the avoidance of circular priorities injurious to mortgagees.

24. Plumb, *supra* note 6, at 213. Congress, in consenting to taxation of federal property or to the priority of property taxes, has rarely included personal property taxes in the scope of the consent, although it did so with respect to the security for Small Business Administration loans. See First Installment, 290 n.383 (1967).

25. Cf. First Installment, 275-76 nn.295-303. An actually identifiable trust fund would be protected against federal liens. Cf. *Aquilino v. United States*, 363 U.S. 509 (1960).

26. Plumb, *supra* note 6, at 213. Equality should be provided, of course, where the federal claim too relates to collected or withheld taxes.

capital, from which it may be argued that the collecting agent would have expended his own funds before invading the trust,²⁷ it seems to break down when the superpriority is extended to plant and equipment to which federal tax liens had previously attached.²⁸

This may be an area where cooperative effort of the kind that, in the private sector, produced the Federal Tax Lien Act of 1966 could result in some further accommodations. Actually, private mortgagees have as great a stake in obtaining federal recognition of such superpriorities as the states and municipalities themselves. Except in the unlikely event that the delinquent's property is otherwise unencumbered, a state or local government, when armed with a state law superpriority (lacking federal recognition), can satisfy its claims, at least in part, at the expense of the holder of a prior security interest or judgment lien under the circular priority principle.²⁹ Private creditors, therefore, are the primary beneficiaries of federal recognition of such state and local superpriorities and should share the burden of justifying additional cases. Such relief should be justified, however, on the merits of the tax claim; any appeal for relief based merely on the inequity which the non-federally-recognized superpriority causes to the mortgagee is more properly addressed to the state legislatures.³⁰

So much for superiority; what of inferiority? The really serious cause for state and local discontent with federal priorities relates to the situation arising when a taxpayer dies insolvent, makes an assignment for creditors, or suffers a receivership or a reorganization under the Bankruptcy Act. In that event, the ancient and unreformed absolute priority of the Federal Government, discussed at length in Part II.A in the First Installment, becomes operative. An antecedent state or local tax lien that was "choate" in every sense required for perfection against later federal tax liens (and even against bona fide purchasers) will then be subordinated not only to federal taxes but to all federal claims,

27. 5 A. SCOTT, TRUSTS § 517 (3d ed. 1967).

28. *E.g.*, the gasoline tax lien involved in *United States v. Texas*, 314 U.S. 480, 484 n.3 (1941), which was "first and prior to any and all other existing liens, upon all of the property of any distributor, devoted to or used in his business as a distributor, which property shall include refinery, blending plants, storage tanks, warehouses, office buildings and equipment, tank trucks or other motor vehicles, and any other property devoted to such use, and each tract of land on which such refinery, blending plant, tanks or other property is located, or which is used in carrying on such business."

29. See First Installment 231-32; Creedon, *On Mortgage Foreclosures and Federal Tax Liens*, 18 BUS. LAW. 117 (1963).

30. Plumb, *supra* note 6, at 211. An intermediate position that might have some equitable appeal to a state court, in the absence of a change in the law, is outlined in Creedon, *supra* note 29, at 1147-48 (1963).

secured or unsecured by lien.³¹ Even a real property tax lien, despite some lower court authority to the contrary, may be vulnerable in insolvency.³² Enactment of the reform of the insolvency priority proposed by the American Bar Association (whereby lien priorities would be recognized and unsecured federal, state and local taxes would stand on a parity, ahead of federal non-tax claims, as in bankruptcy) would do much to promote intergovernmental harmony.³³

2. *The "Pooling" Alternative*

In 1957 the National Association of Tax Administrators (NATA) presented to the Congressional staff two alternative proposals for achieving greater equity in cases involving conflicting federal, state and local tax claims. The second alternative was to apply the same rules of "choateness" to the claims of all taxing authorities. The substantial achievement of that objective by Supreme Court decision, except in the area of insolvency, appears to have stilled the clamor for the first alternative, which to me has the greater appeal.

The first alternative, rather than arming the combatants with equal weapons, would have seated them at the conference table in true equality, by pooling all assets available for federal, state and local tax claims, on the basis of the priorities of any such governments over private claims, and dividing such assets pro rata among the governments concerned. Congress has already moved in that direction, by providing for proportionate sharing among tax claims in bankruptcy, in the absence of valid liens. The NATA proposal would go a step further and call upon the several governments, *as between themselves*, to surrender the advantages of pre-existing liens,³⁴ and to share the benefits thereof with each other, not only when the taxpayer's assets are administered in bankruptcy or insolvency but also whenever a tax lien is enforced on property on which another taxing authority has a lien.³⁵ In order to preclude a race to gain an advantage, it seems that

31. *United States v. Gilbert Associates*, 345 U.S. 361 (1953); *Illinois ex rel. Gordon v. Campbell*, 329 U.S. 362 (1946). See *United States v. Vermont*, 377 U.S. 351 (1964).

32. See First Installment, 234-35 nn.52-53.

33. 84 A.B.A. REP. 732, 734 (1959). See First Installment, 251 n.152, 253 n.167.

34. Whether special exceptions should be made for property taxes or for collected and withheld taxes, see notes 22-23, 25-26 *supra*, would be a question of policy. Special assessments should in any event be separately treated, as under INT. REV. CODE of 1954, § 6323(b)(6)(B).

35. This is analogous to the provision permitting a bankruptcy trustee to preserve invalidated liens and preferences for the benefit of the entire body of creditors, 11 U.S.C. §§ 96(b), 107(b)(2), except that only the taxing authorities would share the benefit. Administrative procedure could be developed for such sharing where a lien is enforced without judicial action.

preferential payments received at a time when the taxpayer is unable to pay all his tax liabilities should be contributed to the pool.

The premise of that proposal is that all tax claims are equally meritorious, and that possession of a prior lien signifies only that the holder has permitted its claim to go delinquent for a longer period of time.³⁶ Governments "second in time" are not voluntary creditors and cannot be accused of having unwisely extended credit without regard for prior liens. During the sometimes extended period that the holder of a prior lien permits the delinquent taxpayer to operate and attempt to pay off his taxes, the taxpayer enjoys the benefit of the services of all three levels of government, each of which contributes in some degree to the earning of his income; yet only those governments holding the most stale claims may be satisfied.³⁷

Adoption of the proposal may have beneficial side effects. The existing priority system has no doubt encouraged the state legislatures, in self-defense, to give superpriority to their tax claims, in order that they may recoup from mortgagees and others under the circular priority principle what they lose to the federal priority.³⁸ While the proposal would not, of itself, relieve those inequities, since superpriorities would be preserved for the benefit of the common pool, there would be less inducement to the states to enact or retain such provisions where they cannot equitably be justified. Further, relief from competitive pressure to gain priority over the rival government may make it more often possible for the taxing authorities to be lenient with taxpayers who may have a chance to work out of their difficulties if they are not forced into liquidation or bankruptcy.

Since the proposal would require the state and local governments to surrender part of the benefit of their prior liens, superpriorities, and preferences, legislation would be necessary at the state as well as the federal level.³⁹ Congress could enact the legislation, to go into effect in any state when reciprocal legislation was adopted by its legislature.⁴⁰

36. 3 W. COLLIER, *BANKRUPTCY* ¶ 64.403 (1961); Kennedy, *Statutory Liens in Bankruptcy*, 39 MINN. L. REV. 697, 729 (1955). Interest and penalties might well be excluded in determining the ratio of division of the fund, if it is inadequate to satisfy the principal of all claims.

37. Cf. *Borock v. City of New York*, 268 F.2d 412, 416 (2d Cir. 1959) (receivership operation).

38. See note 20 *supra* (Plumb quotation).

39. In some cases, there may be difficulties in bringing local governments into the pool.

40. Cf. *Steward Machine Co. v. Davis*, 301 U.S. 548, 593 (1937). In the absence of state legislation, the existing priority rules could be continued—or they might be toughened up, as an "inducement" to adoption of the alternative system. If the Government correctly

3. *Unemployment Taxes*

The interrelationship between federal and state unemployment taxes gives rise to unique problems of priorities. The federal unemployment tax was enacted, not as a means of raising federal revenue, but in order to encourage and assist the states to establish tax-supported unemployment compensation systems. Payments by employers into approved state systems may be applied as credits against, in general, 90 per cent of the federal tax (or 81 per cent if the payment to the State is untimely).⁴¹ Yet payment to the state fund may be prevented if the federal tax has priority, and the credit is not earned unless the state contribution is actually *paid*. This can lead to some odd results.

Let us first take the situation of the financially embarrassed employer who is unable to meet his unemployment tax obligations but whose assets are not under administration. If the federal tax is the superior lien (either because it happened to be assessed sooner than the state liability or because the lien provided by state law lacks the essential quality of "choateness"),⁴² 100 per cent of the federal tax may be satisfied from the proceeds of sale of the employer's assets, with no offsetting credit for the state tax, which remains unpaid. But if a single dollar is left over (and is not absorbed by other prior claims), the payment of that dollar to the state will entitle the employer to a federal refund, which in turn may be applied on the state tax, and so on until the entire line of dominoes has fallen and the employer has earned the maximum 81 per cent credit for late payment,⁴³ and the state has received a large tax payment.

Now let us suppose that the employer dies insolvent, makes an

represented the situation when it argued in the *Vermont* case (as quoted in the Court of Appeals opinion, 317 F.2d 446, 450) that "the Federal Government is not in a position . . . to match the timing of the innumerable state and local tax liabilities," the states may need some such inducement to give up the advantage they have gained through the *Vermont* decision.

41. In applying these percentages, the gross federal tax is taken to be three per cent, although in fact it has for some years been higher. Additional credits, above actual payments to the State, are allowed under certain conditions. The maximum credit may be reduced if the state fund is indebted to the federal fund. *INT. REV. CODE OF 1954*, §§ 3302-03. For purposes of illustration, these variations will be ignored.

42. The unemployment tax in Pennsylvania, for example, does not give rise to a "choate" lien until judicial process is invoked for its enforcement. *Ersa, Inc. v. Dudley*, 234 F.2d 178 (3d Cir. 1956). Other States have liens which, while formerly held not to be "choate," *Consumers Power Co. v. Rubiner*, 225 F. Supp. 926 (E.D. Mich. 1963), would appear to meet the standard established by *United States v. Vermont*, 377 U.S. 351 (1964)—provided the State happened to be first to make its assessment.

43. *Kush v. Convair*, 58-2 U.S. Tax Cas. ¶ 9827 (N.D. Tex. 1958). See *Massachusetts v. United States*, 333 U.S. 611, 624 (1948) (rejecting the applicability of that principle in an insolvency case, which is next considered). See also Note, *Priority and Effect of Liens on Distribution of Insolvent Estates Between Federal and State Claims for Unpaid Taxes*, 31 MINN. L. REV. 479, 484 (1947).

assignment for creditors, suffers a receivership, or undergoes a Chapter X reorganization. The federal insolvency priority statute,⁴⁴ overriding any prior lien that the State may have obtained,⁴⁵ then requires that 100 per cent of the federal unemployment tax (as well as all other federal claims) must be paid before anything can be applied on state unemployment contributions.⁴⁶ Furthermore, even if there is money left over after paying priority claims so that all or part of the state unemployment contributions can be paid out of the estate, no credit will be allowed against the federal tax for such payment. Although the tax law expressly allows partial credit for late payment, the Supreme Court holds that such provision must yield to the insolvency priority statute, which gives absolute, not conditional or defeasible, priority to federal claims *as they exist on the date when the priority attaches*.⁴⁷ The four dissenting Justices, referring to the decision as an "unnecessarily ruthless interpretation of a statute that at best is an arbitrary one," pointed out that it could result in the federal government taking 100 per cent of the tax and the state taking 90 per cent *in addition*, in preference to general creditors.⁴⁸

Finally, let us consider the situation if the employer goes into bankruptcy, and if neither the federal nor the state claim for unemployment tax had previously become a "choate" lien.⁴⁹ In such circumstances, the two claims rank equally.⁵⁰ But that does not mean they will be paid proportionately. Rather, an algebraic formula must be resorted to, since the amount available for the state's claim depends on the amount allowed on other tax claims, including the federal unemployment tax

44. REV. STAT. § 3466 (1875), 31 U.S.C. § 191 (1964). See First Installment, pt. II.A.

45. *Illinois ex rel. Gordon v. Campbell*, 329 U.S. 362 (1946) (involving a lien as "choate" as that which was accorded priority, in the absence of insolvency, in *United States v. Vermont*, 377 U.S. 351 (1964)).

46. *Massachusetts v. United States*, 333 U.S. 611 (1948); *Illinois ex rel. Gordon v. Campbell*, 329 U.S. 362 (1946); *Illinois ex rel. Gordon v. United States*, 328 U.S. 8 (1946).

47. *Massachusetts v. United States*, 333 U.S. 611, 624-29 (1948). At that time, the credit was wholly forfeited if the state tax was not paid by a certain date, whereas now only 10 per cent of the credit is lost, no matter how late the payment is made. However, the assignee there had, at the risk of surcharge, paid the state tax within the time allowed by Section 902(a) of the Social Security Amendments of 1939, 53 Stat. 1399. Therefore, the decision remains authoritative today, inasmuch as it was not the tax law but the insolvency statute that prevented the allowance of the credit.

48. *Massachusetts v. United States*, 333 U.S. 611, 635, 638 (1948).

49. If the Government had a lien antedating bankruptcy and superior to the State's lien (if any), the situation would be the same as outlined at p. 1112 *supra*, since lien priorities are respected in bankruptcy. See Note, 31 MINN. L. REV. 479 (1947), *supra* note 43.

50. Although state laws generally refer to unemployment "contributions" rather than "taxes," it seems to be established that they rank as taxes in bankruptcy, under 11 U.S.C. § 104(a)(4) (1964). *In re William Akers, Jr., Co.*, 121 F.2d 846 (3d Cir. 1941); *cf. Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495 (1937).

which, in turn, cannot be determined until the amount paid on the state's claim is known.⁵¹ At times the result of applying the formula will be that, the smaller the available fund, the greater the *dollar share* (not merely the percentage) which the Federal Government will take.

The solution to these anomalies is not easily found. It is obvious that merely putting state tax liens on a parity with federal tax liens and giving state and federal claims equal rank in insolvency, as heretofore proposed,⁵² would not resolve this problem, for such equality exists in bankruptcy and a wrong result is reached nevertheless. The real trouble lies, not in the various rules of priority, but in the concept that credit is to be allowed only to the extent that the state tax is paid. That concept is designed to assure that the amounts for which credit is provided actually reach the state fund. But, when assets are insufficient, it has the opposite effect of depriving the state fund of its share while giving the Government more than it would be entitled to if assets were sufficient, thereby penalizing the state fund for the employer's inability to pay.⁵³ The Government should be satisfied if it gets the net amount to which it would be entitled if the full credit were allowed, and should be content to let the state have whatever excess can be recovered.⁵⁴ Or, if the principle of parity is applicable (as it is in bankruptcy, and as has been herein recommended for lien and insolvency situations as well), it would be appropriate to divide the available fund in the proportion which such net amount bears to the state tax.⁵⁵

The proper solution, therefore, should be to provide that whenever the Federal Government has collected more than its proper share (determined under one of the principles last stated), the excess shall be treated as collected on behalf of, and shall be paid over to, the state fund.⁵⁶

51. The formula, which was approved in *United States v. New York*, 315 U.S. 510, 518 (1942), was set out and explained by the trial court, *sub nom. In re Independent Automobile Forwarding Corp.*, 38 F. Supp. 976, 978 (W.D.N.Y. 1940). See also Note, 81 MINN. L. REV. 479 (1947), *supra* note 43.

52. See Sections 1 and 2 of pt. IV.C. *supra*.

53. As well as, in one situation, *Massachusetts v. United States*, 333 U.S. 611 (1948), penalizing general creditors by allowing what, in substance, is double proof.

54. The solution, however, is not to be found in treating the federal tax claim as if it were only that net amount and regarding the rest as a state tax claim. For there would be no assurance that the assets thus released would not be absorbed by other claims having intermediate priority, leaving the state tax, for which credit had been allowed, unpaid. See *Massachusetts v. United States*, 333 U.S. 611, 632-33 (1948). By collecting the full amount as a federal claim and then sharing the amount collected, that problem is avoided.

55. In either event, the net federal tax should be computed by allowing the *full* credit, without reduction thereof for late payment, INT. REV. CODE of 1954, § 3302(a)(3), since such reduction improperly penalizes the state for the employer's inability to pay. See First Installment, 280-81 n.330.

56. The Special Committee on Federal Liens tentatively proposed such a solution, 83

4. *Taxes on Property Acquired by the United States at Tax Sales*

In 1966, as we have seen, Congress subordinated the federal tax lien to liens for real property taxes and special assessments attaching to the property between the time a federal tax lien arises and the time the federal lien is enforced.⁵⁷ If the United States then buys the property at its own tax sales,⁵⁸ however, the property is immunized from later special assessments⁵⁹ and is removed from the local property tax rolls until it is redeemed by the taxpayer or is resold by the Government.⁶⁰ That interval will in no event be less than 120 days⁶¹—a period which may well embrace the date when one whole year's property taxes would otherwise attach—and in exceptional cases may extend for many years.⁶²

There is ample precedent for Congressional consent to nondiscriminatory taxation of real property acquired through the enforcement of debts arising in connection with federal loan and guarantee programs⁶³

A.B.A. REP. 556, 539-40 (1958), but abandoned the proposal in its final report because it lacked the time (and, frankly, the know-how) to resolve the drafting problems encountered, which, however, should not be insoluble. The tentative proposal was framed as an amendment to the insolvency priority statute, but the problem is a more general one and the amendment really belongs in INT. REV. CODE OF 1954, § 3302. A technical amendment of the bankruptcy law would be required, however, in order to prevent double proof, by providing that state unemployment contributions shall rank as taxes only to the extent that the state tax exceeds the allowable credit against the federal tax; and a like provision would be needed in the insolvency priority statute if it is amended to put federal and state tax claims on a parity.

A similar problem might conceivably arise if a decedent's estate, of sufficient net value (over \$100,000) to qualify for a credit against the federal estate tax for state death taxes paid, becomes insolvent (as a result of shrinkage in value or otherwise) and is unable to pay both the state and federal taxes. Cf. *In re Levy's Estate*, 70 N.Y.S.2d 72 (Surr. Ct. 1947), which antedates *Massachusetts v. United States*, 333 U.S. 611 (1948), and thus applied a more sensible solution. See Plumb, *Federal Tax Collection and Lien Problems*, 13 TAX L. REV. 459, 519 (1958). The situation would probably arise too rarely to warrant legislative attention.

57. INT. REV. CODE OF 1954, § 6323(b)(6).

58. *Id.* § 6335(c)(1).

59. Cf. *Mullen Benevolent Corp. v. United States*, 290 U.S. 89 (1933); *Board of Directors of Red River Levee Dist. No. 1 v. Reconstruction Fin. Corp.*, 170 F.2d 430 (8th Cir. 1948).

60. In *Van Brocklin v. Tennessee*, 117 U.S. 151 (1886), it was held that property taxes accruing during the period allowed for redemption, as well as while the United States held title, were invalid and that liens therefor could not be enforced against the property in the hands of later private owners.

61. Treas. Reg. § 301.7506-1(b)(1) (1957) directs that realty be retained for at least one year after it is purchased by the United States as a tax sale, but that period may be shortened when the regulations are conformed to the 1966 amendment of INT. REV. CODE OF 1954, § 6337(b), reducing the redemption period from one year to 120 days.

62. E.g., *United States v. City of New York*, 233 F.2d 307 (2d Cir. 1956) (federal lien arose in 1933, sale to United States in 1942, title of United States quieted in 1956); *Cobb v. United States*, 172 F.2d 277 (D.C. Cir. 1949) (federal lien arose in 1931, sale to United States in 1935, title of United States quieted in 1949). There were newspaper reports in 1958 of an attempt by the District of Columbia to tax property which the United States had held off the local tax rolls—and leased to the original owner—for more than 21 years.

63. See First Installment, 290 n.386.

—functions which are no less “governmental” than taxation itself.⁶⁴ The criteria for such consent which were recommended in a study by the Commission on Intergovernmental Relations are met—the property is acquired as a result of a debt to the Government, is temporarily held, and ordinarily continues to be devoted to a use comparable to privately owned property.⁶⁵ The property enjoys the benefits of the services of local government, or is enhanced by the improvement for which a special assessment is levied, just as surely during the period of federal ownership as in the period when the property was merely subject to lien. The injury to state or local government from loss of tax revenues may be greater, because there is here no chance to recoup from a mortgagee under the circular priority principle.⁶⁶ Congress should, therefore, consider consenting to the taxation of such property.⁶⁷

64. *Pittman v. Home Owners Loan Corp.*, 308 U.S. 21 (1939).

65. COMMISSION ON INTERGOVERNMENTAL RELATIONS, A STUDY COMMITTEE REPORT ON PAYMENTS IN LIEU OF TAXES AND SHARED REVENUES 4, 30, 57-58 (1955).

66. See First Installment, 231-32.

67. A draft submitted to, but not acted upon by, the Special Committee on Federal Liens would amend INT. REV. CODE of 1954, § 7506, relating to administration of real estate acquired by the United States, by adding a new subsection, as follows:

(e) Property Taxation.—Real estate acquired by the United States as provided in this section, while held pending disposition and until put to permanent use by the United States, may be subjected to State and local property taxes to the same extent and in the same manner according to its value as if it were privately owned, and any such tax shall be based upon an assessed valuation which does not represent a larger percentage of true value than is used by assessing authorities in valuing properties generally for tax purposes within the taxing jurisdiction; provided, that any special tax treatment accorded to other similar property shall be applied to such property held by the United States. Such real estate may also be subjected to special assessments imposed by any taxing authority directly upon such real estate to defray the cost of any public improvement, in the same manner as against real estate privately owned in such jurisdiction; provided, that in the undertaking of any such public improvement project the United States shall have the same rights and privileges in approving, rejecting or contesting such project or assessment as are accorded to owners of private property. Such property taxes and special assessments shall be paid only from the proceeds of resale of such real estate, except that, if the property is not sold but is converted to permanent use by the United States, payment of taxes and special assessments incurred before such conversion shall be made from funds appropriated for the acquisition of property so used. The United States shall not be subject to penalties or penalty interest nor shall its property be subject to any lien, foreclosure or other proceedings because of its nonpayment or failure to make timely payment of such taxes or special assessments, nor shall subsequent owners be liable therefor; provided, that this shall not preclude the payment of interest charged on special assessments paid in installments over a period authorized by State or local law. In the event that State constitutions or statutes prohibit the taxation of federally-owned property, the Secretary or his delegate shall make payment in lieu of taxes or special assessments in the amounts and at the times when such levies would otherwise be payable hereunder if such prohibition did not exist. After any real estate acquired as provided in this section is put to permanent use by the United States, its status with respect to property taxation and special assessments shall be governed by other provisions of law applicable to property so used.

D. *Federal Estate and Gift Taxes*

Federal estate and gift taxes may be, and usually are, assessed and collected in the same manner as other federal taxes, the executor⁶⁸ or the donor being the person against whom the tax is assessed and from whom payment is expected.⁶⁹ If the assessment is not paid on demand, a general federal tax lien arises against property of the estate (as an entity) or of the donor. In the case of these two taxes, however, those collection principles of general application are supplemented by provisions imposing personal liability for the tax on certain third parties and creating special liens on property transferred by the decedent or by the donor.⁷⁰

In this area the Special Committee on Federal Liens largely confined itself to recommending changes (which in substance were adopted by Congress) to conform the priorities of the special liens for estate and gift taxes to those which it was recommending with respect to the general tax lien.⁷¹ The Special Committee took note, however, of the possibility that "the Government's protection is unnecessarily broad and unnecessarily disturbing to titles in light of the fact that the Government has other remedies available for collection of the estate and the gift tax," and commended the matter to the attention of the interested Sections of the American Bar Association for further study.⁷²

1. *Personal Liability*

The estate tax may be collected from property of the probate estate,⁷³ if that is still in existence when the assessment is made. If the estate has been distributed, "transferee" liability may be imposed upon the distributees.⁷⁴ The executor also may be held individually responsible for the tax, unless he took the precaution of obtaining from the federal

68. In this discussion, the term "executor" is used to include an administrator or, if there is neither, "any person in actual or constructive possession of any property of the decedent." INT. REV. CODE of 1954, § 2203.

69. INT. REV. CODE of 1954, §§ 2002, 2502(d).

70. INT. REV. CODE of 1954, § 6324.

71. 84 A.B.A. REP. 693-95, 721-23 (1959).

72. 84 A.B.A. REP. 669-71 (1959).

73. For convenience of reference, the term "probate estate" will sometimes be used herein to embrace realty passing directly to heirs or devisees, without going through probate, and the term "distributee" will include such heirs and devisees.

74. INT. REV. CODE of 1954, § 6901(a)(1)(ii). The usual procedure for determination of a tax deficiency is followed, leading to an assessment which, if not paid on demand, becomes a general lien on all property of the distributee. *Id.* § 6321. Without need for assessment of the transferee liability, the *special* lien for estate tax attaches to the specific property received but, as we shall see, the effects of the two liens on third parties' rights are different. Section 2 of pt. IV.D *infra*.

tax collector a discharge of his personal liability.⁷⁶ Despite the availability of those remedies, however, whenever the estate tax is not paid when due, personal liability therefor may also be enforced against "the spouse, transferee, trustee . . . , surviving tenant, person in possession of the property by reason of the exercise, nonexercise or release of a power of appointment, or beneficiary who receives, or has on the date of the decedent's death, property included in the gross estate under Sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent's death, of such property."⁷⁷ The quoted language is a marvel of concise drafting; but conciseness, like extremism, is a virtue only when it reaches defensible results. Here, in some circumstances, the formulation results in burdens on the wrong persons, which might be avoided if the law gave more individualized attention to the cases covered by the provision.

The sequence of terms used parallels the provisions of Sections 2034 to 2042 of the Internal Revenue Code, and they are interpreted in the light thereof.⁷⁷ Thus, since the term "beneficiary" comes at the end of the sequence, paralleling the position of Section 2042 (which subjects certain life insurance proceeds to estate tax), it is held that the term refers to a life insurance beneficiary and not a beneficiary of an *inter vivos* trust. Therefore, if an *inter vivos* trust is included in the gross estate (under §§ 2035, 2036, 2037, or 2038), the person held liable is not the beneficiary but the trustee, whose position in the sequence of statutory terms corresponds to the position of those sections in the series. It makes sense to hold the trustee rather than the beneficiary if the trust remains undistributed at the time the estate tax liability is determined, for the trustee then has funds in his hands from which to indemnify himself, while the beneficiary who has no right to present possession of the funds and perhaps has a terminable interest therein might be hard put to raise the money to meet a personal liability equal to the actuarial value of his interest.⁷⁸ Yet the same principle has been

75. INT. REV. CODE OF 1954, § 2204. The discharge of the executor by the probate court will not, by itself, protect him, if he does not get clearance from the federal tax collector. The executor's personal liability, in the absence of a discharge, is limited to the amount of property which had passed through his hands. Treas. Reg. § 20.2002-1 (1958). It may be determined and assessed in the same manner as a tax deficiency. INT. REV. CODE OF 1954 § 6901(a)(1)(B). See generally W. PLUMB & L. WRIGHT, FEDERAL TAX LIENS 267-69 (1967) [hereinafter cited as PLUMB & WRIGHT].

76. INT. REV. CODE OF 1954, § 6324(a)(2). The surviving spouse may incur such personal liability, even though, by reason of the marital deduction, none of the tax was actually attributable to property she held or received (e.g., as joint tenant or insurance beneficiary). *Schuster v. Commissioner*, 312 F.2d 311, 316 (9th Cir. 1962).

77. See PLUMB & WRIGHT 269-72.

78. *Higley v. Commissioner*, 69 F.2d 160 (8th Cir. 1934).

applied, with much less justification, to hold the trustee personally liable when he has already innocently distributed the trust corpus to the beneficiary⁷⁹—who himself continues free of personal liability.⁸⁰

As a result, the trustee of an *inter vivos* trust which terminates at or after the grantor's death cannot distribute such property with any assurance that he will not later be subjected to personal liability, up to the full amount that had been in the trust, for an estate tax deficiency arising, perhaps, not out of the transfer in trust, but out of other transactions of the decedent of which the trustee may have had no knowledge or means of knowledge. It is anomalous that the executor of the decedent's estate can free himself of personal liability by obtaining a discharge, thereby permitting closing of the estate within a reasonable time,⁸¹ but there is no comparable provision for a trustee.⁸² It is true that one court has held the Government *estopped* to assert personal liability against a trustee who had made distribution in reliance upon the initial (but not conclusive) finding of the tax collector that no additional tax was payable.⁸³ But estoppel against the Government is grudgingly granted by most courts,⁸⁴ and is a slender reed to rely upon, particularly where, as here, the reasonableness of the trustee's reliance upon a non-final determination may be subject to question.

Some means should be provided, therefore, whereby a trustee may safely distribute the corpus at the time prescribed for such distribution or within a reasonable period thereafter. One solution would be to relieve the trustee automatically if he properly makes distribution without knowledge of an estate tax liability,⁸⁵ thus leaving the Government to pursue the distributee under its continuing lien on the former trust assets or under a newly imposed personal liability. If Congress is unwilling to go so far, it should at least provide for a discharge for the trustee under the same conditions prescribed for the executor. A reasonable middle ground, which would facilitate the timely closing of trusts that reach their termination date at or soon after the death of the grantor, might be to discharge a trustee under the same conditions

79. *First Western 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). For the grounds of reversal, see text accompanying note 83 *infra*.

80. *Patricia B. Englert*, 32 T.C. 1008 (1959).

81. See note 75 *supra*.

82. Rev. Rul. 57-423, 1957-2 CUM. BULL. 623.

83. *Schuster v. Commissioner*, 312 F.2d 311, 317 (9th Cir. 1962).

84. See *Lynn & Gerson, Quasi-Estoppel and Abuse of Discretion as Applied against the United States in Federal Tax Controversies*, 19 TAX L. REV. 487 (1964).

85. Cf. *First Installment*, 258-61.

that particular property may be discharged from the estate tax *lien*—*i.e.*, if it appears to the District Director that the estate tax, although not yet definitely determined, has been “fully provided for” through property in the executor’s hands and through the lien on the property distributed to the trust beneficiaries (or such further security as may be required).⁸⁶

The positions of an insurance beneficiary and the insurance company holding the proceeds pursuant to a settlement option are the exact reverse of those of a trust beneficiary and a trustee. Here, the personal liability falls, not on the insurance company but on the beneficiary, even though he cannot immediately reach the funds from which he might meet the liability and even though his interest therein may be terminable.⁸⁷ The same grounds that dictate against imposing personal liability on a trust beneficiary who has no present right to possession⁸⁸ should lead Congress also to relieve the insurance beneficiary who is similarly situated. It does not follow, however, that personal liability should be imposed on the insurance company, even with the modifications above proposed with respect to trustees. The insurance company has no fiduciary obligation to the beneficiary and should not be required or relied upon to litigate the merits of the estate tax in a proceeding to determine its personal liability.⁸⁹ It should suffice that the Government may enforce its lien on the insurance proceeds while they are held by the company, in a proceeding in which the real party in interest would be joined, letting the company stand neutral. Personal liability might still be imposed on the beneficiary, but only after distribution.

In the case of the gift tax, the positions of the trustee and trust beneficiary are apparently the opposite of those they occupy with respect to the estate tax. Although the gift tax is primarily the obligation of the donor, the “donee” of any gift made by the donor during the calendar year is also made personally liable if the donor does not pay the gift tax when due.⁹⁰ Because the Supreme Court has held, for

86. Such a discharge of property from the lien may, on a proper showing, be granted before audit, Treas. Reg. § 301.6325-1(c)(2) (1955), although the wide margin for differences of opinion on valuations and other factors affecting estate tax liability make it difficult to obtain at that stage, in actual practice.

87. *John Hancock Mut. Life Ins. Co. v. Helvering*, 128 F.2d 745 (D.C. Cir. 1942); *Equitable Life Assur. Soc.*, 19 T.C. 264 (1952). See *Brafman v. United States*, 381 F.2d 863 (5th Cir. 1967).

88. See p. 1118 *supra*.

89. *John Hancock Mut. Life Ins. Co. v. Helvering*, 128 F.2d 745, 751 (D.C. Cir. 1942).

90. INT. REV. CODE of 1954, § 6324(b). The donee is liable, to the extent of the full value of the gift, even if his particular gift was not taxable or was fully tax-paid. *LaFortune v. Commissioner*, 263 F.2d 186 (10th Cir. 1958).

an entirely different purpose, that the beneficiary, not the trustee, is the "donee" of a gift in trust,⁹¹ the lower courts generally make the beneficiary personally liable for the gift tax, although he cannot reach and may never receive the trust fund.⁹² That inequity should be corrected, by imposing personal liability only when and if the beneficiary comes into possession.

It may be noted that holding the beneficiary to be the "donee" for this purpose has not resulted in relieving the trustee. Not only does the special gift tax lien attach to the property in his hands, but he is subjected to another form of personal liability as a "fiduciary" for the donee.⁹³ There is an important difference, however, between personal liability as "donee" and liability as "fiduciary." Since the latter liability is incurred in a representative capacity, it is limited to property in the trustee's hands as a fiduciary when the liability is enforced, and ends when the trustee gives notice that the fiduciary relationship has terminated. Thus, the problems encountered in the case of the trustee's personal liability for the *estate tax*⁹⁴ do not arise here. Nevertheless, because one appellate court has suggested that a trustee may after all be personally liable for the gift tax as donee,⁹⁵ clarification is desirable, either to confine the trustee's liability strictly to his fiduciary capacity or, if he is to be made liable as donee, to provide a procedure to discharge the liability upon distribution of the trust.

2. *Lien Priorities*

In addition to imposing personal liability for estate and gift taxes upon designated third parties, the law provides special liens for such taxes, which arise without any governmental action at the moment of the death or of the gift, before the tax liability is or can be determined,

91. *Helvering v. Hutchings*, 312 U.S. 393 (1941), involving the exclusion from tax of the first \$5,000 (now \$3,000) of gifts by the donor "to any person." INT. REV. CODE OF 1954, § 2505(b).

92. *Alma M. Myer*, 2 T.C. 291 (1943), *aff'd*, 149 F.2d 642 (8th Cir. 1945) (beneficiary was entitled to income only in trustee's discretion, and could not reach corpus until age 30). See *Fletcher Trust Co. v. Commissioner*, 141 F.2d 36 (7th Cir. 1944), *cert. denied*, 323 U.S. 711 (1944). In *Charles A. E. Goodhart*, 2 CCH Tax Ct. Mem. (13279[M]) 267, 270 (1943), it was stated that even a contingent remainderman of a trust could incur personal liability as a "donee," but in the particular case the contingency was held so remote that the value of the interest could not be ascertained. Happily, the court did not move from that premise to the conclusion that the contingent remainderman, having failed the burden of proving the valuation which sets the outer limit of the donee's liability, was liable for the gift tax without limitation! See also *Fidelity Trust Co. v. Commissioner*, 141 F.2d 54 (3d Cir. 1944).

93. INT. REV. CODE OF 1954, § 6903; *Fletcher Trust Co. v. Commissioner*, 141 F.2d 36 (7th Cir. 1944).

94. See pp. 1118-20 *supra*.

95. *Fidelity Trust Co. v. Commissioner*, 141 F.2d 54 (3d Cir. 1944).

and which continue for ten years unless the tax is paid in full or becomes barred by lapse of time.⁹⁶ Although the special liens arise sooner and may terminate sooner than the general liens covering assessments of the same tax liabilities, the liens will co-exist during the major part of their life spans, and the tax collector may rely on whichever lien applies or is in a stronger position in the particular circumstances.⁹⁷

The special estate tax lien attaches to all property includable in the decedent's gross estate for estate tax purposes.⁹⁸ The lien is not confined to property passing through the probate estate and subject to the decedent's debts but embraces interests which he had created *inter vivos* in third parties, if for any reason such interests are includable in his gross estate.⁹⁹ Although paralleling the personal liability for estate tax, as indicated above, the special lien may attach to property in the hands of one (e.g., an insurance company or a trust beneficiary) who is not subject to personal liability. The special gift tax lien attaches to all gifts made by the donor during the year to which the tax relates.¹⁰⁰

Since no provision is made for filing notice of the special liens,¹⁰¹ third parties would have no warning of their possible existence unless they knew that, somewhere in the chain of title, the property had been the subject of a transfer to which either the estate tax or the gift tax might have applied. Congress has acknowledged this difficulty, however, only in selected situations. In the case of property that passed through the probate estate, or directly to the heirs or devisees of a decedent, the law seems, in general, to take it for granted that a subsequent purchaser or encumbrancer can discover a death in the chain of title, and hence it protects them only if the executor had obtained a discharge from his personal liability for the estate tax.¹⁰² That assumption may be valid enough in the case of real estate, but the chain of title to personal property is less readily ascertainable, and a purchaser or encum-

96. INT. REV. CODE OF 1954, § 6324(a)(1), N(b). PLUMB & WRIGHT, pt. II, is devoted to these special liens.

97. Thus, if the special lien is divested under one of the provisions considered below, third parties must still be alert to the general lien, which arises upon assessment. *United States v. Security-First Nat'l Bank*, 30 F. Supp. 113 (S.D. Cal. 1939).

98. Including property which, by reason of passing to charity or to a surviving spouse, is deductible and thus had no net effect on the tax liability. *Cf.* note 76 *supra*.

99. *Detroit Bank v. United States*, 317 U.S. 329 (1943) (tenancy by the entirety).

100. Whether or not the particular gift was subject to tax. *Cf.* note 90 *supra*.

101. *Detroit Bank v. United States*, 317 U.S. 329 (1943). So far as the decision holds a mortgagee to be unprotected, it has been modified by later amendments.

102. INT. REV. CODE OF 1954, § 6324(a)(3). Concerning discharge of the executor, see note 75 *supra*. Provision ought to be made for the maintenance of a public record of such discharges in the District Director's office, in order that more remote purchasers and encumbrancers, not dealing directly with the executor, can ascertain whether the title is clear of the estate tax lien.

brancer may be unable to discover such a latent defect in the title unless dealing with the executor himself. Congress has recognized the difficulty in part by granting protection without regard to the executor's discharge to purchasers of and lenders on securities, purchasers of motor vehicles, retail purchasers, casual purchasers for less than \$250, and certain lenders on savings passbooks and life insurance policies.¹⁰³ But the problem exists in the case of almost any personal property, and Congress should consider broadening that protection further to cover purchasers of and holders of security interests in *all* forms of personal property, unless the property is still under administration in the estate or unless the purchaser or secured lender knew the transaction was intended to defeat collection of the tax.¹⁰⁴

Obviously, whether the property is real or personal, third parties would have difficulty in anticipating the possible existence of an estate tax lien if the property was included in a decedent's gross estate for reasons other than that it was owned by the decedent at his death and passed either through the probate estate or directly to heirs and devisees.¹⁰⁵ Therefore, in the case of any property which was includable in the gross estate under Sections 2034-2042 of the Internal Revenue Code—*e.g.*, property transferred by the decedent *inter vivos*, or over which he held a power of appointment, or in which he was a joint tenant—the law provides, in general, for divestment of the estate tax lien in favor of a “purchaser or holder of a security interest” without reference to whether the executor had obtained a discharge.¹⁰⁶ For the same practical reason, the gift tax lien is also divested in favor of a “purchaser or holder of a security interest.”¹⁰⁷ In either case, the estate or gift tax lien, when thus divested from any specific property, becomes a general lien on *all* property of the transferor, subject again to divestment from any additional property he may sell or encumber.

Formerly, protection in those cases was extended only to a “bona fide” purchaser, mortgagee or pledgee, and there was cause for concern among title examiners that a chain of title that disclosed a transfer in

103. INT. REV. CODE of 1954, §§ 6323(b), 6324(c)(1). Concerning retail and casual purchasers, Second Installment, 674-76.

104. The American Bar Association so recommended. 84 A.B.A. REP. 694, 722 (1959).

105. This comment does not apply with equal force to all such property. A purchaser of real estate from a surviving joint tenant would no doubt be better able to ascertain the possible existence of an estate tax lien than a purchaser from an *inter vivos* donee who might be held to have received the gift in contemplation of death. But the law draws no distinction.

106. INT. REV. CODE of 1954, § 6324(a)(2).

107. INT. REV. CODE of 1954, § 6324(b).

trust, a deed reciting a consideration of "love and affection," a joint tenancy in which one tenant had died, or similar circumstances could be construed to put a purchaser or lender upon inquiry that a gift tax or estate tax might have been incurred with respect to the property and might remain unpaid.¹⁰⁸ We may hope that the omission of the words "bona fide" in the new law, although unexplained in the Committee Reports, was intended and will be construed to remove those uncertainties and to make the protection of purchasers and secured lenders in these circumstances unconditional, assuming they have given full value.¹⁰⁹

Strangely enough, because of ancient drafting oversights that were not rectified in the 1966 legislation, there are gaps in the protection generally accorded purchasers and holders of security interests with respect to the estate tax lien on non-probate property, as well as the gift tax lien. For technical reasons (which might better be explained in footnotes than in the text), a purchaser from or lender to an *inter vivos* trustee is probably not protected against the *gift tax* lien on the property held in trust.¹¹⁰ However, while a purchaser from or lender to such a trustee is protected against the *estate tax* lien, one who deals with the person to whom the property is distributed at termination of the trust is probably not protected against the estate tax lien (unless the grantor's executor has obtained a discharge or unless one of the special exceptions relating to securities, etc., applies).¹¹¹ And if those *original* takers are not protected, then there is no protection from those secret liens for subsequent owners of such property or subsequent

108. 84 A.B.A. REP. 670-71, 722 (1959). See Wright, *Title Examinations as Affected by the Federal Gift and Estate Tax Liens*, 51 MICH. L. REV. 325 (1953). Actually, the one published ruling in the area indicated that a liberal interpretation of "bona fide" would be applied. Rev. Rul. 56-144, 1956-1 CUM BULL. 563.

109. See PLUMB & WRIGHT 260-63, 274-75, discussing this and related ambiguities in the new law.

110. Section 6324(b) protects purchasers and holders of security interests only if the transfer to them was made "by the donee (or by a transferee of the donee)." The trustee, of course, is not a transferee of the donee. And, as we have seen, pp. 1120-21 *supra*, the prevailing view is that the trustee is also not the "donee" of the gift, although the lien does attach to the property in trust. Therefore (unless § 6324(c) is satisfied), the divestment will not take effect and the lien will adhere to the property in the hands of anyone thereafter acquiring an interest in the property. See PLUMB & WRIGHT 264-65.

111. Section 6324(a)(2) protects purchasers and holders of security interests only if the property was transferred by "(or transferred by a transferee of) such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary. . . ." The word "such" refers to the persons, so described, on whom personal liability for the estate tax is imposed. As we have seen, at pp. 1118-19 *supra*, in the case of an *inter vivos* trust, the personal liability is imposed on the trustee and not on the distributee of the remainder, who is held to be neither a "beneficiary" nor a transferee of the trustee. Nevertheless, the estate tax lien attaches to the property and, since the divestment provision is inapplicable (unless § 6324(a)(3) or (c) is satisfied), the secret lien follows the property into the hands of later owners and encumbrancers. See PLUMB & WRIGHT 283-84.

holders of the encumbrance. The drafting of Section 6324 ought to be carefully reviewed in these respects.¹¹²

The status of most statutory and common law liens, as against the secret estate and gift tax liens, parallels their situation with respect to the general federal tax lien. Some are expressly protected,¹¹³ while others remain vulnerable¹¹⁴ although the lienors ordinarily could not possibly anticipate the existence of an estate or gift tax lien—a lien which begins life as a charge on specific property but becomes general as soon as any of such property is sold or encumbered. What has been said above concerning extending protection to liens of landlords, attachments, state and local taxes, and miscellaneous liens¹¹⁵ would be equally applicable here.

It has never been Congressional policy to grant judgment liens protection against secret estate and gift tax liens comparable to that which judgment liens enjoy as against the general federal tax lien.¹¹⁶ One consequence of this is that those special liens will apparently occupy a preferred position in bankruptcy, since the trustee stands in the shoes of a judgment lien creditor.¹¹⁷ Since ordinarily an estate or gift tax lien, although secret and frequently general, is an offset to a fairly recent “windfall” accretion to the wealth of the bankrupt, that priority may not conflict seriously with bankruptcy policy. But the matter might well be reviewed by the interested organizations.

E. *Withheld Taxes*

A quarter century ago, when individual income taxes first reached levels far beyond the capacity of the average person to provide for by foresight and savings, the Government pressed employers into service as collection agents (a role they were already filling with respect to the old-age tax under Social Security). Undoubtedly, vast numbers of individual tax delinquencies were prevented thereby. But the problem of

112. The remedy would seem to lie in the deletion of the language in quotation marks in the two preceding footnotes. The second sentence of § 6324(a)(2) and the third sentence of § 6324(b) would then read simply “transferred to a purchaser or a holder of a security interest,” which form of expression has solid precedent in § 6324(a)(3).

113. Mechanics’ liens, certain possessory liens on personal property, attorneys’ liens and liens for real property taxes, special assessments and public service charges. INT. REV. CODE of 1954, § 6324(c).

114. *Michigan v. United States*, 317 U.S. 338 (1943). That case involved real property taxes, which have since been protected; but its principle applies to other liens still not expressly relieved.

115. See Second Installment, sections 7-10 of pt. IV.B., pt. IV.C. *supra*.

116. *United States v. McGuire*, 42 F. Supp. 337 (D.N.J. 1941).

117. 11 U.S.C. § 110(c) (1964). See *United States v. Speers*, 382 U.S. 266 (1965).

employer delinquencies arose in their stead,¹¹⁸ as shoestring operators took advantage of the reduction of their net payroll obligations to provide themselves with a new source of working capital—in effect borrowing the funds which the law required them to hold inviolate as a trust.¹¹⁹ If the employer's gamble failed, there was usually no trust fund that could be traced by the Government.¹²⁰ In the scramble for such assets as the employer might have, the competing lienors, sureties, and secured lenders—now fortified by their newly expanded priorities—would inevitably come out ahead of the tax collector, whose lien for the withheld taxes can arise only after returns become due and assessments are made. Yet the workers get credit for having paid their taxes even though the amounts withheld from their wages never reach the Government.¹²¹

It was primarily this situation that initially led the Government to advance and the courts to accept the doctrine of the "inchoateness" of many liens competing with the federal tax liens—although, since the doctrine was not tailored to meet the specific situation, it had pernicious applications far beyond the withholding tax area. As a condition to relaxing its opposition to legislative relief from that doctrine, the Treasury was properly insistent that it be provided with more effective weapons against abuses involving trust fund taxes.

The Treasury asked Congress for two provisions, one of which was granted. No longer can a lender or surety keep a failing employer's labor on the job in order to salvage a loan or complete a bonded contract by supplying only enough funds for the "net payroll." One who steps in and pays wages directly, on behalf of an employer, or who loans funds specifically for payrolls with knowledge that the employer does not intend or will not be able to pay withholding taxes, is now made personally responsible for such taxes.¹²²

The second Treasury proposal was directed specifically at the con-

118. \$57,604,521 of "trust fund" taxes (including \$16,290,098 attributable to the construction industry) was written off as uncollectible in the fiscal year 1964, and another \$210,950,140 was delinquent as of January 1965 (of which \$55,608,622 was attributable to the construction industry, including \$29,730,508 which was more than one year old). *Hearings on H.R. 11256 & H.R. 11290 Before the House Comm. on Ways and Means*, 89th Cong., 2d Sess. 42-43 (1966).

119. INT. REV. CODE of 1954, § 7501.

120. See First Installment, 275 n.297.

121. INT. REV. CODE of 1954, § 31(a).

122. INT. REV. CODE of 1954, § 3505. For the previous situation, see *United States v. Hill*, 368 F.2d 617 (5th Cir. 1966) (bank); *Venneri Co. v. United States*, 340 F.2d 937 (Ct. Cl. 1965) (general contractor); *Century Indem. Co. v. Riddell*, 317 F.2d 681 (9th Cir. 1963) (surety). But cf. *Pacific Nat'l Ins. Co. v. United States*, 270 F. Supp. 165 (N.D. Cal. 1967).

struction industry, which withholds less than 6 per cent of the trust fund taxes collected annually from all employers, yet is responsible for 28 per cent of the dollar volume of such taxes written off as uncollectible and 26 per cent of the cases in which there is a history of repeated delinquencies.¹²³ That situation results, apparently, from the common practice of undercapitalized contractors to bid low in order to get large jobs, relying on the withholding tax margin to save them from disaster if the bid proves to have been inadequate (sometimes known as "shell financing"). Unfortunately, the proposal proved so controversial that it had to be withdrawn from the bill lest passage of the entire measure be jeopardized. But the problem to which it was addressed is a real one, and the proposal will no doubt be revived in some form.¹²⁴ Therefore, it merits full discussion here, and careful study by those genuinely interested in finding a workable solution that will not injure legitimate business operations.

As originally introduced in 1964,¹²⁵ the proposal would have required a person who contracted with an employer of labor for work on real property to obtain from the employer, at the time of the final contract

123. *Hearings, supra* note 118, at 40, 42-44.

124. When the provision was withdrawn by action of the House Ways and Means Committee, the Treasury urged "that hearings be held on proposed section 3506 of H.R. 11256, designed to solve a pressing withholding tax collection problem in the construction industry," and that "measures must be found to end the failure of this industry properly to account for the trust funds which it obtains through the withholding system." *Hearings, supra* note 118, at 41.

125. Proposed § 3506 of the Internal Revenue Code of 1954, in H.R. 12545, 88th Cong., 2d Sess. (1964), read as follows:

SEC. 3506. CERTIFICATE OF PAYMENT OR DEPOSIT OF WITHHOLD TAXES.

(a) **LIABILITY.**—If a person contracts with an employer (as defined in subtitle C) for the construction, improvement, alteration, repair, replacement, or demolition of real property (other than a residence occupied or to be occupied by such person) and the contract price exceeds \$1,000, such person shall be liable in his own person and estate to the United States for all taxes (together with interest), if unpaid, required by this subtitle to be deducted and withheld from wages paid by such employer for work performed under such contract, if a return was due under section 6071 or a deposit was required under section 6302 with respect to such taxes on or before the date on which final payment of the contract price is made.

(b) **EXCEPTION.**—The liability imposed by subsection (a) shall not apply with respect to any such taxes with respect to which such person obtains a certificate executed by such employer under penalty of perjury certifying that such taxes have either been paid over to the Secretary or his delegate, as provided under section 6151, or deposited, as provided under section 6302. This subsection shall not apply—

(1) if such certificate is false and the person obtaining such certificate had knowledge of its falsity at the time the certificate was received, or

(2) to the extent of any payments made by such person to such employer after such person learns of the falsity of such certificate.

(c) **EFFECT OF PAYMENT.**—Any amounts paid to the United States pursuant to this section shall be credited against the liability of the employer. The person making such payments shall be relieved of any liability to the employer to the extent of such payments.

(d) **CROSS REFERENCE.**—For penalty imposed for willfully making a false certificate, see section 7206.

payment, a certificate that all required payments and deposits of taxes withheld from his employees for work under the contract had been made, up to the latest due date thereof. The requirement would have applied in the case of contract payments by the owner to a contractor, or by a contractor to a subcontractor; the owner would have incurred no responsibility with respect to a subcontractor's withholdings. A specific exception was made for work on owner-occupied residences, so that the ordinary homeowner would not have been concerned. Also excepted were jobs involving less than \$1,000 (increased in the later version of the bill to \$2,000).

If the employer was in fact delinquent and the certificate was not obtained, the owner or contractor would have been made responsible for the unpaid withholding taxes, and would have been entitled to indemnify himself by retaining a like amount of the contract price. If the delinquent employer, however, falsely certified that he was current in his withholding tax obligations, risking the penalties of perjury, the owner or contractor would have been protected in relying on the certificate unless he had actual knowledge of its falsity. He would have had no obligation to verify its correctness by investigation.¹²⁶

The proposal was subjected to a barrage of criticism, centering on the argument that it would require "an enormous amount of paperwork and the expense of accumulating and storing certificates"—although it is difficult to believe that businessmen, in connection with construction or improvement jobs of substantial size, do not customarily retain in their files receipts for payments made, in which the contractor could incorporate a simple printed form of certificate. Only if the certificate was not forthcoming would the payor have to do any more than that—and then his responsibility would be only to freeze the final payment until the tax collector and the employer worked out what was due. True, the businessmen would have to learn a new rule, but they

126. One possible flaw in the proposal was the absence of a provision protecting the contract payor in relying on interim certificates, given by the employer other than at the time of final payment. Therefore, it would have been necessary for the payor, for perfect safety, to increase the customary holdback until the final payment, to cover not only his possible defenses and offsets but also the maximum delinquency in withholding taxes that might occur during the entire course of the job. Yet the employer, in order to meet his obligations, would need the same money that the contract payor is holding back against the possibility that they will not be paid. If the employer, in order to get interim payments, told the payor that his taxes were current but, under penalties of perjury, admitted at completion that he had been delinquent all along, the payor would not have the protection of the statutory certificate with respect to *any* of the taxes. The proposal might readily be amended, however, to protect the payor in relying on interim certificates, and to limit his liability to taxes accruing thereafter if he is unable to get the final certificate.

should be hardened to that by now, for they face the same problem whenever the withholding rates or the mechanic's lien laws or the commercial laws or the zoning regulations are changed. On any substantial improvement job, the businessman would probably have legal advice in drawing the contract.

The Treasury, however, under heavy pressure, went on the defensive. Having cited the analogy to the mechanic's lien enjoyed by the employee himself, the Treasury produced a substitute designed to place the tax collector squarely in the employee's shoes, with respect to the withheld portion of his wages, without imposing any obligation on the contract payor to do more than the state law already required him to do to protect the employees of his contractor (or subcontractors). The substitute proposal provided that if taxes withheld from wages paid for services performed in the construction or improvement of real property (with the exceptions above noted) were not paid over to the tax collector, the United States should have "the same rights (including liens), remedies, and priorities against any person or property to collect such unpaid taxes as are provided by any law for the collection of such wages by such employee."¹²⁷ However, because the normal time limits for filing or giving notice of mechanics' liens might well expire before the federal tax collector even knew a delinquent tax claim existed, the bill provided that whatever time limits were set by state law should run, not from the date specified therein (*e.g.*, completion of the work), but from the due date of the quarterly return of withheld taxes (usually a month after the quarter ends). Further, since the return might be filed late, it was provided that the time should ordinarily not expire sooner than 30 days after the actual filing of the return; but, to provide a cut-off if no return was filed, the time was in no event to extend beyond six months after the return became due. If the required action was taken within that extended period, it would be regarded as "timely for all purposes," and the Government's rights would "then have the same *priority* as the rights of such employee would have if such employee had taken the same actions *on the first day when such employee may take such actions*."¹²⁸

127. Proposed § 3506(a) of the Internal Revenue Code of 1954, in H.R. 11256, 89th Cong., 2d Sess. (1966). The bill as introduced is set out in *Hearings, supra* note 118, at 3, 12.

128. Proposed § 3506(b), *Hearings, supra* note 118, at 12 (emphasis added). This provision seems to jeopardize the position of mortgagees, in those few states where the priority of a mechanic's lien dates only from its *filing*, which the federal law would, in effect, *deem* to have occurred as soon as the wages were paid with respect to which the withheld portion was not paid over.

In those states which follow the so-called "Pennsylvania rule," a mechanic's lien may be imposed in favor of a contractor's employees (and in some cases subcontractors' employees as well), even though no part of the contract price remains unpaid when notice of the lien is given. The retention of part of the contract price for a limited period to guard against unknown liabilities may be a familiar practice in those states, although the proposal would require withholding a probably larger sum for a substantially longer period.¹²⁹ As a practical matter, apart from the proposed federal law, a holdback for any significant period is ordinarily unnecessary if the contractor produces releases from subcontractors and suppliers; employees' liens are rarely a threat since any default in the payment of wages, other than in the final week, is likely to come promptly to the owner's attention through stoppage of work. Since the contractor can produce no effective release of lien from the federal tax collector (who will not yet even have received a return for the final period), withholding of part of the contract price may become necessary where it might otherwise have been dispensed with.

If the substitute proposal is revived, the certificate procedure originally proposed should be superimposed on the "mechanic's lien" substitute, in order to bring the contract payor's obligations more truly in line with what would be required of him under state law. The certificate, made under penalties of perjury, that taxes are current would be equivalent to the "statement under oath" that is sometimes accepted from a contractor as a condition to his receiving payments without holdback.¹³⁰

The effect of the substitute proposal is unclear in those states following the so-called "New York rule," under which the owner's liability

129. In the case of a job completed in January, for example, the return for the quarter would not be due until April 30, making the earliest required notice date (with respect to January withholdings) May 30, even in a state which requires notice to be given 30 days after completion. If the period under state law is three months from completion, the time under the proposal would expire July 31. But, unless the contractor could then present proof that he had filed his return, the owner would not be completely secure until October 30.

130. Also imported from the original proposal should be the limitation of the contract payor's responsibility to those tax payments and deposits already due, excluding those the employer will be obliged to pay over after the contract relationship has terminated; and also the limitation of the responsibility to taxes withheld from wages by his immediate contractor, not by subcontractors from whom he is in no position to exact a certificate. On the latter point, the Treasury made a puzzling statement, with respect to its substitute proposal, that "[i]n the case of employees of subcontractors the property owner often shifts the risk of nonpayment of wages to the general contractor." *Hearings, supra* note 118, at 41. If that means that the Government's rights, in the shoes of the employee, could be controlled by contracts which are binding on the employee, the principle would seem to extend even to "no lien" contracts (which may bind even the employees of the general contractor) and to waivers given by employees whose net wages have been satisfied—which would make the proposal of little effect.

to anyone other than the contractor himself is limited to the amount remaining unpaid on the contract at the time the owner receives notice of a claim of lien. Conceivably, the proposal to treat the belated notice as "timely for all purposes" could be construed as deeming the notice to have been given *before the owner paid the contractor*. But the question here is not one of timeliness; rather it is a substantive question of whether an act was done before knowledge was acquired, and it would be rather startling if the law were to presume that knowledge existed before it could in fact have been acquired. Therefore, the extended time periods which the Treasury regarded as so essential to the workability of its proposal would have no real effect in those states—which may well constitute a majority¹³¹—and the owner could there pay the contractor before the tax collector could possibly give notice concerning the unpaid taxes. Thus, the provision would have a non-uniform operation and would fail to resolve the financial problem at which it is directed, except in a limited number of states.

The substitute proposal was torpedoed as its predecessor had been. Since it is evident that compromising the objective did not blunt the opposition, the Treasury should revert to its original proposal, which would operate more uniformly and more effectively than the substitute, and fight it out on the merits, especially now that the fate of the long-sought tax lien reform bill is not hanging on the outcome.¹³² The trust fund taxes, being a part of wages, contribute value to the owner's property just as do the labor and materials that go into the building. The owner or contractor who benefits from a low bid made possible by "shell financing" gets a free ride on non-tax-paid labor. Owners and contractors who receive the ultimate value of the tax portion of the wages that go into the work may fairly be called upon to cooperate in a reasonable way to see that such taxes reach their destination.

V. Tax Collection Procedures

"Taxes," said Mr. Justice Holmes, "are what we pay for civilized society."¹³³ Or, as the present Commissioner has phrased it, they are

131. In 4 AMERICAN LAW OF PROPERTY § 16.106F, at 230 (A.J. Casner ed. 1952), this is characterized as "by far the more prevalent" rule.

132. The Treasury stated at the hearings that "the earlier proposal had some advantages over the present solution from the standpoint of those affected by the proposal, but either solution to this problem would be acceptable to the Treasury Department." *Hearings*, *supra* note 118, at 40.

133. *Compania General de Tabacos v. Collector*, 275 U.S. 87, 100 (1927) (dissenting opinion).

"the heart and soul of the production of those things that a government must do for its people."¹³⁴ A system that must raise over 100 billion dollars a year from vast numbers of taxpayers must operate speedily and to a large extent impersonally if it is to be effective.¹³⁵ Arbitrary actions in individual cases are inevitable, and the remarkable thing is not that they occur, but that they occur so seldom. Nevertheless, while unimportant in the mass, such instances may be traumatic for the individuals affected. As the Lord is concerned with the smallest bird that falls, so also must the Government be concerned with preventing and remedying such isolated injustices—if not on grounds of benevolence, then for the pragmatic reason that the sense of justice is essential to the working of a system so heavily dependent upon voluntary compliance and cooperation.¹³⁶

Much progress appears to have been made in this regard in recent years, both through legislation and through administrative action. Congress should, however, continue to re-examine tax collection procedures with a view to avoiding injustices to individual taxpayers or third parties.

A. Remedies of the Taxpayer

1. Jeopardy Assessments

Much attention has been focused on the problem of jeopardy assessments, whereby income, estate and gift taxes may be summarily assessed and collected, without prior opportunity for review, if "the Secretary or his delegate (*i.e.*, the local District Director) believes that the assessment or collection of a deficiency . . . will be jeopardized by delay."¹³⁷

134. Cohen, *Administration and Control of Tax Collection*, A.B.A. TAX SECTION BULL., April 1966, 44, 45.

135. See *Enochs v. Williams Packing & Navigation Co.*, 370 U.S. 1, 8 (1962); *Bull v. United States*, 295 U.S. 247, 259 (1935).

136. Whether or not exaggerated and distorted, as the Internal Revenue Service asserts, 113 CONG. REC. 10,459 (daily ed. August 14, 1967), the instances reported in congressional hearings and in such popular exposes as Barron, *Tyranny in the Internal Revenue Service*, READER'S DIGEST, Aug., 1967, at 42, contribute to a public "sense of injustice" that may one day undermine the system.

137. INT. REV. CODE of 1954, § 6861(a). While the making of a jeopardy assessment does not preclude Tax Court review of the merits of the deficiency, *id.* § 6861(b), collection efforts may proceed concurrently and independently, *Cohen v. United States*, 297 F.2d 760, 773-74 (9th Cir. 1962); *United States v. O'Connor*, 291 F.2d 520, 525 (2d Cir. 1961), unless the taxpayer is able to give bond. INT. REV. CODE of 1954, § 6863. In the typical jeopardy assessment case, where the taxpayer's assets are insufficient to assure collection of the assessed liability, the right to stay collection by giving bond is illusory. *Shelton v. Gill*, 202 F.2d 503, 507 (4th Cir. 1953); *Kimmel v. Tomlinson*, 151 F. Supp. 901, 902 (S.D. Fla. 1957); *Macejko v. United States*, 174 F. Supp. 87 (N.D. Ohio 1959); see Note, *Jeopardy Assessment: The Sovereign's Stranglehold*, 55 GEO. L.J. 701, 705-06 (1967).

Jeopardy assessments are commonly made under emergency conditions without adequate audit, and may thus sometimes be arbitrary and excessive, perhaps far exceeding the taxpayer's assets.¹³³ With all his property seized or tied up by liens and levies, the taxpayer may then be unable to employ counsel and pay the other expenses of establishing that the tax is not owing,¹³⁹ or of defending related criminal charges.¹⁴⁰ Financial pressure may force him to settle an asserted tax liability that he might have successfully defended.¹⁴¹ Even if the taxpayer is able to obtain a refund of the erroneous tax, he can never be made whole if its collection has meanwhile deprived him of his livelihood and reduced his family to destitution,¹⁴² or if his business, built over a lifetime, has been forced to close because it could not meet payrolls and maturing obligations,¹⁴³ and has perhaps lost irreplaceable franchises and good will.¹⁴⁴

Undoubtedly we have come a long way from the days when the ruling principle was that the taxpayer must "pay first and litigate later,"¹⁴⁵ for fear that "no government could exist that permitted the collection of its revenues to be delayed by every litigious man or every embarrassed man, to whom delay was more important than the payment of costs."¹⁴⁶ In 1924, rightly sensing that such fears were exaggerated and concluding that the "right of appeal after payment of the tax is

133. *E.g.*, Anthony J. Petrone, 18 T.C.M. 787 (1959) (deficiency of \$1,718,238 in tax and \$1,552,767 in penalties, based on gross "unexplained bank deposits" of one whose net worth admittedly was only \$38,819).

139. *Illinois Redi-Mix Corp. v. Coyle*, 360 F.2d 848 (7th Cir. 1966); *Lloyd v. Patterson*, 242 F.2d 742, 744 (5th Cir. 1957).

140. *United States v. Rinieri*, 304 F.2d 885 (2d Cir. 1962) (mem.); *Summers v. United States*, 250 F.2d 132 (9th Cir. 1957); *United States v. Brodson*, 241 F.2d 107 (7th Cir.), *cert. denied*, 354 U.S. 911 (1957), *rev'g* 156 F. Supp. 158 (E.D. Wis. 1955). See Plumb, *Federal Tax Collection and Lien Problems*, 13 TAX L. REV. 247, 294 (1958).

141. *Funkhouser v. Commissioner*, 226 F.2d 910 (4th Cir. 1955).

142. Injunctive relief has been granted on that ground. *Macejko v. United States*, 174 F. Supp. 87 (N.D. Ohio 1959); *Arnold v. Cobb*, 57-2 U.S. Tax Cas. ¶ 9711 (N.D. Ga. 1957); *Long v. United States*, 148 F. Supp. 758 (S.D. Ala. 1957). But such a result is no longer possible. *McClure v. Rountree*, 330 F.2d 954 (6th Cir. 1964); *Johnson v. Wall*, 329 F.2d 149 (4th Cir. 1964); *Botta v. Scanlon*, 314 F.2d 392 (2d Cir. 1963). The taxpayer's "financial situation may well appeal to the discretionary authority of the Government as a creditor," see Second Installment, 608-09, but it affords no ground for equitable relief. *Stanton v. Machiz*, 183 F. Supp. 719, 726 (D. Md. 1960).

143. See *Melvin Bldg. Corp. v. Long*, 58-2 U.S. Tax Cas. ¶ 9792 (N.D. Ill. 1958), *rev'd*, 262 F.2d 920 (7th Cir. 1959). In *Mensik v. Long*, 261 F.2d 45 (7th Cir. 1958), the court said that the very fact that the taxpayer's funds were in use in his business and might be lost constituted jeopardy and was justification enough for putting him out of business.

144. The injunctions granted on that ground in *Hirst & Co. v. Gentsch*, 133 F.2d 247 (6th Cir. 1943), and *Midwest Haulers v. Brady*, 128 F.2d 496 (6th Cir. 1942), would not be obtainable today. *Licavoli v. Nixon*, 312 F.2d 200 (6th Cir. 1963).

145. *Cheatham v. United States*, 92 U.S. 85, 89 (1876). See *State Railroad Tax Cases*, 92 U.S. 575, 613 (1876).

146. See *Tennessee v. Sneed*, 96 U.S. 69, 75 (1877).

an incomplete remedy, and does little to remove the hardship occasioned by an incorrect assessment,"¹⁴⁷ Congress reversed that principle and established the Tax Court¹⁴⁸ as a forum in which—in the case of income, estate and gift taxes, which now constitute by far the larger part of federal revenues—the taxpayer might litigate a proposed deficiency assessment before payment, unless the delay would jeopardize its collection.¹⁴⁹

It is only in the exceptional cases today, therefore, that a taxpayer's property may be taken to pay a disputed income, estate or gift tax before he has had a chance to prove his case in court. In recent years controls have been established which require that jeopardy assessments shall be made "sparingly," and subject to high level administrative review both before and after the assessment¹⁵⁰ to assure abatement if jeopardy does not exist or the assessment is excessive.¹⁵¹ It has been reported that jeopardy assessments were made in only 270 cases in the fiscal year 1966,¹⁵² in contrast to 2,500 as recently as 1958.¹⁵³ Congress has mitigated the hardships occasioned by jeopardy assessments by providing that, with certain exceptions, the sale of the taxpayer's property (but not its seizure, which may be as destructive of its value) may be stayed until he has had an opportunity to litigate the liability in the Tax Court.¹⁵⁴ His bank accounts, wages and other claims may

147. H.R. REP. NO. 179, 68th Cong., 1st Sess. 7 (1924), in 1939-1 CUM. BULL., pt. 2, at 246.

148. Then known as the Board of Tax Appeals.

149. Revenue Act of 1924, ch. 234, § 900, 43 Stat. 336. The taxpayer is ordinarily entitled to receive a notice of deficiency, from which he may appeal to the Tax Court within 90 days, and no assessment or collection of the tax is permitted during that period or thereafter, if an appeal is filed, during the pendency of the case in the Tax Court. INT. REV. CODE OF 1954, §§ 6212, 6213. The taxpayer's right to litigate in the Tax Court before payment is so jealously guarded by Congress that, *in the absence of an administrative finding of jeopardy*, the taxpayer is entitled to have any violation of those restrictions judicially enjoined, without need for showing irreparable injury or other extraordinary circumstances. *Id.* § 6213(a); *Maxwell v. Campbell*, 205 F.2d 461 (5th Cir. 1953); *Ventura Consol. Oil Fields v. Rogan*, 86 F.2d 149, 154-55 (9th Cir. 1936), *cert. denied*, 300 U.S. 672 (1937). See *Quigley v. IRS*, 289 F.2d 878, 880 n.4 (D.C. Cir. 1960).

150. Rev. Proc. 60-4, 1960-1 CUM. BULL. 877. See Note, *supra* note 137, at 718-19.

151. INT. REV. CODE OF 1954, § 6861(g). Before such power was expressly granted, the Service doubted that it had the "authority to revoke the assessment even though it finds that a mistake has been made and that there is no danger of losing the tax." S. REP. NO. 730, 83d Cong., 1st Sess. I (1953).

152. See Note, *supra* note 137, at 717.

153. Gould, *Jeopardy Assessments—When They May Be Levied and What to Do About Them*, N.Y.U. 18TH INST. ON FED. TAX 937, 944 (1960). Strict comparability between the statistics cannot be established, as it is not stated whether the assessments in 1958 were made in 2,500 "cases" or involved 2,500 tax years (in which event the comparable 1966 figure is 636).

154. INT. REV. CODE OF 1954, § 6863(b)(3); *Smith v. Flinn*, 261 F.2d 781 (8th Cir. 1958), *modified*, 264 F.2d 523 (8th Cir. 1959). This provision does not prevent sale during the pendency of an appeal by the taxpayer from a Tax Court decision, unless he can provide a *supersedeas* bond. INT. REV. CODE OF 1954, § 7485; Treas. Reg. § 301.6863-2(a)(2) (1958). See Note, *supra* note 137, at 706-07, 714.

nevertheless still be appropriated by levy, pending contest of the merits,¹⁵⁵ although the risk that irreplaceable life insurance values will be destroyed by surrender of his policies has been minimized by the 1966 legislation.¹⁵⁶

Almost without exception the courts have held that the requisite "belief" that jeopardy exists is a subjective judgment to be made in the uncontrolled discretion of the collection officials, free of any power of the courts to review it.¹⁵⁷ Although the power to make jeopardy assessments is currently exercised with restraint and the harshness of their enforcement has in some circumstances been mitigated, it seems contrary to the ordinary citizen's concept of fairness and justice that the only protection against abuse of this exceptional procedure lies in the Service's internal policy limitations, and that the only remedy for the victim is a plea addressed to the same officials who made the determination in the first place.¹⁵⁸ Since there are no more than a few hundred cases a year in which even the Service believes that use of the jeopardy procedure is necessary, it can hardly be claimed that the "lifeblood" of the nation would be seriously threatened by permitting impartial judicial review of that necessity before possibly destroying

155. If seizure of his cash assets leaves the taxpayer without funds to live on, a sacrifice sale of his property may be unavoidable. See *Darnell v. Tomlinson*, 220 F.2d 894, 896 (5th Cir. 1955).

156. INT. REV. CODE of 1954, § 6932(b). See Second Installment, 612-17.

157. *Lloyd v. Patterson*, 242 F.2d 742, 744 (5th Cir. 1957); *Publishers New Press, Inc. v. Moysey*, 141 F. Supp. 340, 343 (S.D.N.Y. 1956). Yet the fact which the tax collector must "believe" exists is an objective fact, which the courts are capable of ascertaining. Comparable language, requiring that "the Secretary or his delegate" must be "satisfied" that a fact exists, has recurred frequently in the tax laws, e.g., INT. REV. CODE of 1954, §§ 166 (a)(2), 355(a)(1)(D), 911(a)(1), and has generally been deemed "largely admonitive and [to mean] that the additional element is not lightly to be inferred but to be established by proof which convinces in the sense of inducing belief." *United States v. Jefferson Elec. Co.*, 291 U.S. 386, 397-98 (1934); see *Stranahan v. Commissioner*, 42 F.2d 729, 731 (6th Cir. 1930), cert. denied, 283 U.S. 822 (1931). But cf. *Brush Terminal Bldgs. Corp. v. Commissioner*, 204 F.2d 575, 578 (3d Cir. 1953); see Mintz, *Corporate Separations*, 36 TAXES 882, 886-87 n.39 (1958). It has been persuasively argued that INT. REV. CODE of 1954, § 6213(a), as well as Section 10 of the Administrative Procedure Act, 5 U.S.C. § 1009 (1964), entitle the taxpayer to an injunction upon a court's finding that the fact which the tax collector must "believe" exists does not in fact exist. Kaminsky, *Administrative Law and Judicial Review of Jeopardy Assessments under the Internal Revenue Code*, 14 TAX L. REV. 545 (1959). But only one court seems to have been persuaded. *Philanthropic Inst. of America v. Wise*, 65-2 U.S. Tax Cas. ¶ 9492 (D. Ariz. 1965), relying on the Administrative Procedure Act.

158. "It is repugnant to the values of a free society to leave citizens at the mercy of the bureaucracy solely on the faith that the bureaucracy will not act arbitrarily." Note, *supra* note 137, at 721-22. I am indebted to Nelson, *Sovereign Immunity and Federal Liens*, 26 BROOKLYN L. REV. 18 (1959), for a pertinent quotation from Shakespeare's *Measure for Measure*, act II, scene 2: "[I]t is excellent to have a giant's strength, but . . . tyrannous to use it like a giant." To which Nelson adds, "The power of modern government is undoubtedly greater than any giant can conjure; one of society's vital problems therefore is to protect itself from the abuse of such power, however manifested." Nelson, *supra*, at 18.

the taxpayer, even if some loss of revenue might occasionally result from that small delay.

The American Bar Association has therefore proposed that the federal district courts, under the Declaratory Judgments Act,¹⁵⁹ be permitted to review, not the merits of the tax deficiency, but the finding that assessment or collection of the tax would be jeopardized by delay.¹⁶⁰ The proposal provides that such actions be given calendar preference to minimize delay in the collection of the tax where jeopardy in fact exists.¹⁶¹

One defect that has been noted in the proposal is that no standards are provided by which the courts may measure the existence of jeopardy, with the single exception that the imminent expiration of the statute of limitations shall not be considered to constitute jeopardy.¹⁶² Judicial review may thus be ineffective, since without standards the courts may tend to defer to the judgment of the collection officers.¹⁶³ The fact that the assessment exceeds the taxpayer's net worth is a factor now given weight by the Service in finding that the tax is in jeopardy,¹⁶⁴ and it would no doubt also influence the courts if they are not instructed to the contrary. Yet the only really relevant factor should be whether a delay to permit the merits to be determined is likely to

159. 28 U.S.C. §§ 2201-02 (1964).

160. 83 A.B.A. REP. 221-23 (1958). For more discussion, see A.B.A. SECTION OF TAXATION, 1958 PROGRAM AND COMMITTEE REP. 157-60. The proposal was embodied in Section 88 of H.R. 11450, 89th Cong., 1st Sess. (1965), an omnibus bill consisting of A.B.A. recommendations.

161. A proceeding as summary as a writ of habeas corpus or a magistrate's hearing on whether there is probable cause to detain a criminal has been suggested as appropriate. Note, *supra* note 137, at 728, 730.

162. On occasion, the threat of a jeopardy assessment has been used as a club to extract from a solvent taxpayer an agreement to extend the period of limitations, although that is claimed to be contrary to present policy. Note, *supra* note 137, at 719-21. *Veeder v. Commissioner*, 36 F.2d 342 (7th Cir. 1929), and *Foundation Co. v. United States*, 15 F. Supp. 229 (Ct. Cl. 1936), have been cited for the point that the imminence of expiration of the statute of limitation is justification for a jeopardy assessment. Actually, a normal deficiency notice will protect the Government as fully against the running of the statute as will the making of a jeopardy assessment. INT. REV. CODE OF 1954, § 6503(a)(1). At the time involved in the cited cases, a deficiency notice suspended the time for assessment only for the period during which an appeal to the Board of Tax Appeals (now the Tax Court) could be filed, and until final decision if an appeal was filed. The court in *Veeder* noted that, if only a few days remained for assessment when the notice was sent, the same few days would be all the time available for getting the assessment machinery moving after the restraint on assessment was removed, and that this might constitute jeopardy. Section 277(b) of the Revenue Act of 1926 rectified that situation by adding 60 days to the suspension period, thus removing that justification for a jeopardy assessment. It has been suggested that the Government gains a *burden of proof* advantage by making a jeopardy assessment, giving it 60 more days to perfect an otherwise inadequate or arbitrary deficiency notice. Note, *supra* note 137, at 720. But that seems an inadequate excuse for subjecting a taxpayer to a jeopardy assessment.

163. Note, *supra* note 137, at 735.

164. *Id.* 718.

reduce the fund available to satisfy the Government's claim through concealment or disposition of assets, intervention of judgment liens, or the like.¹⁶⁵ The mere fact that the assessment exceeds the taxpayer's net worth does not alone justify impoverishing the taxpayer to satisfy the still disputed liability.

Even where such dangers are found to exist, the court might be empowered to grant relief from the jeopardy assessment if the taxpayer could make less burdensome alternative arrangements to preserve the status quo and prevent the encumbrance or dissipation of assets. Giving a security interest in such assets as exist might serve that purpose for one who could not possibly provide the surety bond for the full amount claimed which would be required if the jeopardy assessment were allowed to stand.¹⁶⁶ If such an encumbrance would unduly hamper the operations of a business, some supervision by a court appointee might protect the Government without putting the taxpayer out of business or depriving him of possession and general control while the merits of the tax remain in doubt.¹⁶⁷ The court should in any event retain jurisdiction so that it may make such orders as changes in the situation may require, including reinstatement of the jeopardy assessment or extension of the security interest to new properties.

A coordinate proposal by the American Bar Association would empower a district court, even where jeopardy exists, to order the release from the lien of sufficient funds to pay the expenses of contesting the civil and criminal aspects of the liability.¹⁶⁸ Tax litigation is often

165. Compare the standards set out in INT. REV. CODE of 1954, § 6851, concerning the power to terminate a taxpayer's taxable year in case of jeopardy. It has been suggested that the proposed review procedure be made available also in cases under § 6851. See Note, *supra* note 137, at 736.

166. Concerning bonds, see note 137 *supra*.

167. In *Melvin Bldg. Corp. v. Long*, 58-2 U.S. Tax Cas. ¶ 9792 (N.D. Ill. 1958), and *Homan Mfg. Co. v. Sauber*, 55-2 U.S. Tax Cas. ¶ 9666 (N.D. Ill. 1955), *final decree rev'd sub nom.* *Homan Mfg. Co. v. Long*, 242 F.2d 645 (7th Cir. 1957), the district courts granted injunctions conditioned upon supervision of the taxpayer's property by the court or by a receiver, but the appellate courts held that an injunction was improper under existing law, even upon conditions.

168. 83 A.B.A. REP. 223 (1958); H.R. 11450, 89th Cong., 1st Sess. § 87 (1965). See authorities cited notes 139-40 *supra*. Since the release would be discretionary with the court, consideration could still be given to the availability of funds, free of the lien, from stockholders of a corporate taxpayer or from others with a common interest in the controversy (*cf. Lebanon Woolen Mills v. United States*, 311 F.2d 364 (1st Cir. 1963); *United States v. Allied Stevedoring Corp.*, 138 F. Supp. 555 (S.D.N.Y. 1956)), although the hope for the largess of friends should not be a factor, as it was in the decision of the Court of Appeals in *United States v. Brodson*, 241 F.2d 107, 109 (7th Cir. 1957). The proposal seems deficient in confining the relief to jeopardy assessments under INT. REV. CODE of 1954, § 6861, which is limited to income, estate and gift taxes, whereas the same problem may arise in the case of other taxes which, without need for finding jeopardy, may be assessed before the merits are adjudicated. See pp. 1141, 1144 *infra*. In addition, no provision is made for cases where the lien has already been enforced, as by seizure of the bank

complex and expensive, and the taxpayer reduced to indigency by the Government's lien on all his property may be inadequately served by appointed counsel and by the \$300 worth of accounting and other expert services which the present law allows him—and then only for a criminal case.¹⁶⁹ Whatever the limits of the constitutional requirements,¹⁷⁰ common fairness should require that the government not prosecute the taxpayer, and perhaps strip him of all he owns, while depriving him of access to the means of defending himself—in effect, what one court characterized as “holding and hitting.”¹⁷¹

The proposal would also permit release of funds necessary to repair, maintain and preserve the liened property (expenditures which ordinarily will be as beneficial to the Government as to the taxpayer),¹⁷² and also to pay other taxes “whether due before or after the making of [the] jeopardy assessment.”¹⁷³ Consideration might be given to permitting the court also to release moderate amounts for the taxpayer's essen-

account on which the taxpayer must rely for payment of the expenses. See Note, *supra* note 137, at 736. It would be desirable also to amend INT. REV. CODE of 1954, § 6325, to authorize administrative release of funds for such purposes, in order to avoid burdening the courts when the parties are in agreement on the amount needed. Judge Finnegan, dissenting in *United States v. Brodson*, *supra*, at 116, erred in suggesting that § 6861(g) might permit such relief to be granted by administrative action; the standard prescribed for abatement of the assessment would not be met.

169. Criminal Justice Act of 1964, 18 U.S.C. § 3006A (1964).

170. Counsel: see *Gideon v. Wainwright*, 372 U.S. 335 (1963). Lay expert: see cases cited note 140 *supra*; cf. *United States ex rel. Smith v. Baldi*, 344 U.S. 561, 568 (1953). Civil litigation: see Note, *The Right to Counsel in Civil Litigation*, 66 COLUM. L. REV. 1322 (1966).

171. *United States v. Brodson*, 136 F. Supp. 158 (E.D. Wis. 1955). The majority of the appellate court, in reversing, raised the question whether the person who had property and was not able to get at it was entitled to more consideration than the one who was too poor in the first place to afford an adequate defense. 241 F.2d 107, at 111. Chief Judge Duffy, in dissent, saw a vast difference:

Here the Government, by its deliberate act, by a jeopardy assessment, captured the defendant's assets and thus denied him the use of his own funds to defend himself; the tools of defense were taken from him; the Government pauperized him by placing him in a financial straight-jacket [*sic*].

Id. at 111. The problem might arise more often than it does were it not for the strong policy of the Government to refrain, if at all possible, from prejudicing its criminal case by making an assessment while the prosecution is pending, thereby precipitating premature exposure of its case in civil litigation. See Ferguson, *Jurisdictional Problems in Federal Tax Controversies*, 48 IOWA L. REV. 312, 320 (1963). On remand of *Brodson*, the district court granted a continuance to permit the civil case to be tried first, in order that the amount of the lien could be fixed and any excess assets made available for the expenses of criminal defense. *United States v. Brodson*, 155 F. Supp. 407 (E.D. Wis. 1957). But how the civil litigation would be financed was not explained.

172. Cf. the 1966 amendment adding INT. REV. CODE of 1954, § 6325(d)(2), which permits administrative action to subordinate the tax lien to security interests and lien, incurred for purposes beneficial to the Government's lien.

173. The latter involves some inversion of priorities, but apparently contemplates that the taxpayer be permitted to use current income to pay the taxes incurred in the process of earning it. See A.B.A. SECTION OF TAXATION, 1958 PROGRAM AND COMMITTEE REP. 161. So confined, the provision is supportable, but it may be misunderstood and misused if the wording is not narrowed. Cf. pp. 1108-09 *supra*.

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tial living expenses where his entire assets have been encumbered by a lien the merits of which remain in doubt.¹⁷⁴

2. *Litigation of the Merits Before Payment*

There are two customary methods for litigating the merits of federal tax assessments. The method used by a substantial majority of taxpayers (although available only with respect to income, estate and gift taxes) is to file a petition with the Tax Court, within 90 days (in special circumstances 150 days) after the Internal Revenue Service mails a notice of deficiency. When that method is followed, the tax need not be paid until the Tax Court has reached a decision, unless there is a jeopardy assessment.¹⁷⁵ The second method is to pay the tax, file a claim for refund, and bring suit for refund after rejection of the claim or a six-month wait, against the United States in a federal district court or the Court of Claims.¹⁷⁶ Many taxpayers, for a variety of reasons, prefer the remedy by refund suit, particularly in the district courts.¹⁷⁷

Efforts by taxpayers to obtain the advantages of district court jurisdiction without having to prepay the tax demanded have been generally unsuccessful. At one time there was a tendency for the courts to permit the taxpayer to test the merits in an injunction suit if he could show that collection of the disputed tax would be a business or personal disaster for him.¹⁷⁸ But it is now firmly established that, no matter how

174. Such relief was granted by the district court in the case from which the Government's appeal was dismissed in *United States v. Fauci*, 242 F.2d 237 (1st Cir. 1957). The hardships involved are evidenced in the cases cited note 142 *supra*. Cf. Second Installment, 605-10.

175. See note 149 *supra*. Once the Tax Court has reached a decision, collection of the amount redetermined by it is not stayed pending an appeal, unless the taxpayer files a *supersedeas* bond. INT. REV. CODE OF 1954, § 7485.

176. 28 U.S.C. §§ 1346(a)(1), 1491(2) (1964); INT. REV. CODE OF 1954, §§ 6532(a)(1), 7422(a). The further alternative remedy, by suit against the District Director to whom the tax was paid, see *Plumb, Tax Refund Suits against Collectors of Internal Revenue*, 60 HARV. L. REV. 685 (1947), is no longer available. INT. REV. CODE OF 1954, § 7422(f), *as amended*, by Pub. L. 89-713, 80 Stat. 1107 (1966).

177. The precedents may be more favorable in another forum. Or the taxpayer may prefer trial before a judge familiar to him or his counsel (perhaps known for his "pro-taxpayer" leanings) rather than before a stranger visiting from Washington. The Tax Court may rarely or never sit in the taxpayer's vicinity, so that trial in another court means a saving of time and expense. The issue may be one that might better be heard by a judge of broad general experience, or by a jury, rather than by a specialist in the intricacies of the tax laws. The taxpayer may wish to make use of the more effective discovery and pre-trial procedures which the district court affords, or to avail himself of equitable defenses which the Tax Court has no jurisdiction to entertain. Or he may fear the possibility that the proposed deficiency will be enlarged if he braves the Tax Court, where the statute of limitations is automatically held open for the assertion of additional tax. INT. REV. CODE OF 1954, § 6503(a)(1). See Beaman, *When Not to Go to the Tax Court: Advantages and Procedures in Going to the District Court*, 7 J. TAX. 356 (1957); Carey, *Choosing Tax Procedures for Tactical Advantage*, 40 NOTRE DAME LAW. 363 (1965); Ferguson, *supra* note 171, at 339.

178. See notes 142-44 *supra*.

extreme the hardship or how irreparable the injury, the taxpayer may not enjoin the enforcement of the assessment by levy or sale except in the rare (and perhaps hypothetical) case where he can show that the tax was not merely illegally imposed but is so arbitrary that by no possibility, under the most liberal view of the law and the facts, could the assessment be sustained.¹⁷⁹ Nor can the taxpayer obtain relief before payment by suing to have the tax lien removed as a cloud on the title to his property,¹⁸⁰ or by seeking a declaratory judgment on the merits of the tax.¹⁸¹

Some taxpayers have sought to obtain the practical effect of a declaratory judgment by paying a small part of a disputed tax, filing a claim, and bringing suit for refund, intending thereby to obtain an adjudication that would govern the entire assessment. The Supreme Court, however, held in *Flora v. United States*¹⁸² that full payment of the amount demanded was a jurisdictional prerequisite to a refund suit, because Congress has established "a system in which there is one tribunal [the Tax Court] for prepayment litigation and another for post-payment litigation."¹⁸³

Actually, the jurisdictional dichotomy between "prepayment" and "post-payment" litigation is not nearly so clear-cut as that quotation would suggest. Except for income, estate and gift taxes, for which Congress has failed to provide an alternative tribunal for prepayment litigation,¹⁸⁴ the courts have circumvented the jurisdictional prerequisite of

179. INT. REV. CODE of 1954, § 7421; *Enochs v. Williams Packing & Navigation Co.*, 370 U.S. 1 (1962). Injunction is, of course, permitted where, in the absence of jeopardy, an assessment of income, estate or gift tax has been made without giving the taxpayer an opportunity to go to the Tax Court. But that would not bring the *merits* before the district court. See note 149 *supra*.

180. *Falik v. United States*, 343 F.2d 38 (2d Cir. 1965); *Quinn v. Hook*, 231 F. Supp. 718 (E.D. Pa. 1964), *aff'd*, 341 F.2d 920 (3d Cir. 1965); *Broadwell v. United States*, 234 F. Supp. 17 (E.D.N.C. 1964), *aff'd*, 343 F.2d 470 (4th Cir. 1965), *cert. denied*, 382 U.S. 825 (1965). The taxpayers relied unsuccessfully on 28 U.S.C. § 2410, which consents to making the United States a defendant in an action to quiet title.

181. 28 U.S.C. § 2201 (1964); *Martin v. Andrews*, 238 F.2d 552, 554 (9th Cir. 1956); see *Flora v. United States*, 362 U.S. 145, 164 (1960).

182. 362 U.S. 145 (1960).

183. *Id.* at 163. Although the majority placed great stress on what it deemed to be restrictive language in 28 U.S.C. § 1346(a)(1) (1964), giving the *district courts* jurisdiction over refund suits against the United States, the Court's expressions concerning the *general intention* of Congress (as evidenced in the Declaratory Judgments Act, 28 U.S.C. § 2201 (1964), and other legislation) leave little hope that the much broader jurisdictional language of 28 U.S.C. § 1491(2) (1964) would be construed to give the taxpayer any more right to sue for refund in the Court of Claims than he would have in the district court, before full payment of the disputed assessment. Cf. *Eastman Kodak Co. v. United States*, 292 F.2d 901, 903-04 (Ct. Cl. 1961), in which (in an entirely different connection, but citing *Flora*) that court reasoned backward from the words, "concurrent with the Court of Claims" in 28 U.S.C. § 1346 (1964), and declared that its refund jurisdiction was the same as that of the district courts.

184. The Tax Court has no jurisdiction over liabilities for employment and other

prepayment by devising a theory that such other liabilities are "divisible," so that the amount attributable to a single transaction may be paid and its refund sued for, in order to test the validity of the entire assessment covering all transactions in the year or quarter.¹⁸⁵ Thus the specter of suits for refund of token payments designed to test the validity of much larger assessments that remain unpaid—the specter that so alarmed the Government and the Supreme Court where income taxes were involved¹⁸⁶—is not only tolerated but encouraged in the case of these other liabilities. Furthermore, even in the case of an income, estate or gift tax liability, if the taxpayer has already commenced a suit for refund of an amount previously paid before the tax collector determines that, on the contrary, he owes additional tax, the refund suit may be allowed to proceed if the taxpayer so elects; the Government will ordinarily file a counterclaim, thereby permitting the district court or the Court of Claims to pass on the merits of the unpaid tax.¹⁸⁷ In either of the situations last mentioned, the Government will usually refrain from collecting the balance until the dispute is resolved by the court.¹⁸⁸ But the taxpayer is entirely dependent upon the grace of the tax collector, since there is no *legal* barrier—not even the requirement of an administrative finding of jeopardy—to the enforcement of the additional liability by levy and sale, despite the pendency of the suit in which the taxpayer claims he has already paid too much.¹⁸⁹

excise taxes, or over the penalty imposed on a corporate officer or other person, under INT. REV. CODE of 1954, § 6672, for not collecting, withholding, or paying over certain taxes. INT. REV. CODE of 1954, §§ 6211-13; *Shaw v. United States*, 331 F.2d 493 (9th Cir. 1964).

185. *Steele v. United States*, 280 F.2d 89 (8th Cir. 1960), *rev'g* 172 F. Supp. 793 (W.D. Ark. 1959) (divisibility conceded by Government in appellate court); *Jones v. Fox*, 162 F. Supp. 449 (D. Md. 1957-58). See *Flora v. United States*, 362 U.S. 145, 171 n.37 and 175 n.38 (1960).

186. *Flora v. United States*, 362 U.S. 145, 164-65 (1960).

187. INT. REV. CODE of 1954, § 7422(e); see *Rosamond Gifford Charitable Corp. v. United States*, 170 F. Supp. 239, 244 (N.D.N.Y. 1958). Upon receiving a deficiency notice, the taxpayer has the option of going to the Tax Court, in which event the Tax Court has jurisdiction to find either a deficiency or an overpayment (INT. REV. CODE of 1954, § 6512(b)), and under § 7422(e) the district court or Court of Claims will lose jurisdiction to the extent that the Tax Court acquires it.

188. See *Kelly v. Lethert*, 362 F.2d 629, 635 (8th Cir. 1966); A.B.A. TAX SECTION BULL., April 1966, at 88. The courts, while refusing to require such restraint, see note 189 *infra*, have been free with pointed suggestions that the tax collector "should refrain" from enforcement pending the suit. *Sherwood v. Scanlon*, 207 F. Supp. 686, 688 (E.D.N.Y. 1962).

189. *Florida v. United States*, 285 F.2d 596, 602-04 (8th Cir. 1960); see *Bushmiaer v. United States*, 230 F.2d 146, 152 (8th Cir. 1956); *Sirian Lamp Co. v. Manning*, 123 F.2d 776, 778 (3d Cir. 1941). Although the *Bushmiaer* and *Sirian Lamp* cases were overruled by the Supreme Court in *Flora v. United States*, 362 U.S. 145 (1960), both the majority, *id.* at 166, 176, and the dissent, *id.* at 193, were in accord with their view that collection was not prevented by the pendency of the refund suit. Injunctions against collection of the unpaid balance were denied in *Kelly v. Lethert*, 362 F.2d 629 (8th Cir. 1966), *Vuin v.*

It has been urged that Congress grant the federal district courts concurrent jurisdiction with the Tax Court over appeals from determinations of deficiencies in income, estate and gift taxes.¹⁰⁰ The competence of the district courts to determine the merits of federal tax liabilities has been acknowledged by Congress in refund suits and in the exceptional cases last mentioned, the argument runs, and the free choice among those forums should not be limited to those who are sufficiently affluent to afford to tie up funds equal to the entire amount demanded during the pendency of litigation. Under this proposal, collection would in the absence of jeopardy be restrained pending the outcome of the proceeding. The impediment to tax collection would be no greater than it is at present if the right to "litigate first and pay later," well established for over 40 years in the Tax Court, were made available in the district courts as well.¹⁰¹ The proposal has been opposed, however, on the ground that it would change the basic theory underlying establishment of the Tax Court as "a specialized tribunal for disposition of tax controversies" and would "tend to produce an unsatisfactory body of tax law."¹⁰²

Burton, 327 F.2d 967 (6th Cir. 1964), *Wood v. United States*, 64-2 U.S. Tax Cas. ¶ 9686 (N.D. Ind. 1964), and *Sherwood v. Scanlon*, 207 F. Supp. 686 (E.D.N.Y. 1962). It has been held, however (in a pre-*Flora* decision), that once the Government has elected to file a counterclaim, administrative collection may be enjoined as an interference with the jurisdiction of the court. *Bushmiera v. United States*, 146 F. Supp. 329, 337 (W.D. Ark. 1956). *But see* *Harding v. Woodcock*, 137 U.S. 43, 47-48 (1890).

190. Bills to this effect, although confined to income taxes, died in the 81st, 82d, and 83d Congresses. *See* *Flora v. United States*, 362 U.S. 145, 162-63 (1960). Such bills were endorsed by the Committee on Tax Court Procedure of the Section of Taxation, with the recommendation that they be extended to estate and gift taxes, but the resolution was not submitted by the Section to the House of Delegates. A.B.A. SECTION OF TAXATION, 1953 PROGRAM AND COMMITTEE REP. 115-17. The proposal was revived in 1962, A.B.A. SECTION OF TAXATION, 1962 PROGRAM AND COMMITTEE REP. 55-69, but the Section voted to recommend it for study in connection with the American Bar Foundation Federal Tax Procedure Study rather than to submit it to the House of Delegates for approval. A.B.A. TAX SECTION BULL., Oct. 1962, at 9.

191. The proposal would give incomplete relief from *Flora* unless it were supplemented by a provision that a refund suit may be maintained without full payment of the assessment, in order to take care of the cases where the taxpayer has no real opportunity to appeal from a deficiency notice. *See* note 193 *infra*. Restraint on collection of the balance might or might not be provided in such cases. The Committee on Court Procedure of the Section of Taxation in 1961 proposed that collection be restrained pending suit for refund of a partial payment (a restraint that had been omitted from the Bar's recommendation of overturning *Flora*, a year earlier, *see* note 198 *infra*), but the proposal was withdrawn for further study, from which nothing has materialized. A.B.A. SECTION OF TAXATION, 1961 PROGRAM AND COMMITTEE REP. 44.

192. The Council of the Section of Taxation opposed the 1953 proposal, *supra* note 190, on these grounds, which presumably also influenced the withdrawal of the 1961 proposal, *supra* note 191. They reflect the view of the Tax Court as the body of experts best qualified to interpret and apply the tax laws (*see* *Dobson v. Commissioner*, 320 U.S. 489, 499 (1943)), a view which, if carried to its logical conclusion, would suggest that the Tax Court be given *exclusive* jurisdiction of refund litigation as well as deficiencies. *See* Traynor, *Administrative and Judicial Procedure for Federal Income, Estate and Gift Taxes—A Criticism and a Proposal*, 38 COLUM. L. REV. 1393 (1938); Surrey, *The Traynor*

An analysis of the division of jurisdiction between the Tax Court and the federal district courts would carry us far beyond the scope of this study. The *Flora* case is relevant to a study of collection problems, however, in those situations where the assessment exceeds the taxpayer's ability to pay and he has failed without choice or fault to petition the Tax Court.¹⁹³ The tax collector can then seize all the taxpayer has for application on the disputed assessment, and the taxpayer may be without a remedy either to prevent such collection or to recover the amount which is in excess of the correct liability.¹⁹⁴ Or, if he is able to pay the tax only in installments over a period of years, the statute of limitations on recovery of the earlier payments, which runs from the date of each payment, may expire before he ever becomes entitled under the *Flora* rule to sue for them.¹⁹⁵

Rare as such cases may be,¹⁹⁶ a just government should be concerned about the existence of a wrong without a remedy.¹⁹⁷ Even if it goes

Plan—What It Is, 17 TAXES 393 (1939); Traynor & Surrey, *New Roads toward the Settlement of Federal Income, Estate and Gift Tax Controversies*, 7 LAW & CONTEMP. PROB. 336 (1940). A bibliography of commentaries on the proposal is found in Ferguson, *supra* note 171, at 371.

193. His time for petitioning the Tax Court, which runs from the mailing of the deficiency notice to his "last known address," may have expired before the notice even reached him. INT. REV. CODE of 1954, §§ 6212(b), 6213(a); *Brown v. Lethert*, 360 F.2d 560 (8th Cir. 1966); *Luhning v. Glotzbach*, 304 F.2d 556, 558 (4th Cir. 1962); *Cohen v. United States*, 297 F.2d 760, 772 (9th Cir. 1962). He may have shown on his return (or consented to the assessment of) a tax he believed at the time to be correct, but which a later decision or better information leads him to question. *Coates v. United States*, 111 F.2d 609 (2d Cir. 1940). Or he may have been in such financial straits when the deficiency notice was received that he was unable to employ counsel to advise him of his rights and to take the necessary action. Because of a judicial exception to the *Flora* rule, see pp. 1140-41 *supra*, the problem does not arise in the case of taxes outside Tax Court jurisdiction.

194. This "grossly unfair" and "shockingly inequitable" effect was noted by the four dissenting Justices in *Flora v. United States*, 362 U.S. 145, 195-96 n.22 (1960). See Ferguson, *supra* note 171, at 335.

195. INT. REV. CODE of 1954, § 6511(b)(2) limits the refund to the amount paid within a prescribed period prior to the filing of a refund claim, and § 6532(a)(1) requires bringing suit within two years after its rejection. In *Hanchett v. Shaughnessy*, 126 F. Supp. 769 (N.D.N.Y. 1954), the taxpayer had paid \$4,100 on a disputed income tax assessment of \$10,536.96, and arranged to pay the balance monthly over a six-year period. To avoid the bar of the statute of limitations, he filed a claim for the \$4,100 and, when it was rejected, filed suit, although the full assessment had not been paid. Prior to *Flora*, the suit was permitted, but it would be precluded today. See *Flora v. United States*, 362 U.S. 145, 195-96 (1960) (dissenting opinion). The Government asserted that § 6511(b) was designed for "discouraging installment payments when litigation is contemplated." Brief on Reargument at 13. But long-term installment payments are permitted only when the taxpayer is unable to pay otherwise, and the statute of limitations on refunds was never intended to penalize taxpayers for their inability to pay a disputed tax. See Kaminsky, *Mandatory Injunction: A Promising Escape from Flora v. United States*, 39 TAXES 699, 701-02, 706-07 (1961).

196. See Ferguson, *supra* note 171, at 335-36.

197. It has been suggested that a mandatory injunction (not to restrain collection, which is prohibited, see note 179 *supra*, but to require a refund) may be available under present law, despite the *Flora* decision. INT. REV. CODE of 1954, § 6402(a), imposes a mandatory duty on "the Secretary or his delegate" to credit or refund "any overpayment," without reference to whether the full assessment has been paid. Where inability to meet

no further, Congress should permit one who has overpaid his tax to recover the overpayment by suit,¹⁹⁸ without interfering with the Government's right to collect the balance of the outstanding assessment.¹⁹⁹ Moreover, in those exceptional situations where a taxpayer is demonstrably unable to pay a disputed assessment without extreme business or personal hardship, and is unable for any good reason to petition the Tax Court before payment, Congress should relax the ban on injunctions against tax collection, subject to conditions, such as those discussed earlier in connection with jeopardy assessments, designed to preserve the status quo until the merits are determined.²⁰⁰

Much of the opposition by the Supreme Court and certain commentators to permitting litigation of the merits before full payment revolves around a number of procedural problems with which present law fails to deal. If those problems were resolved by legislation, at least some of the grounds for such opposition would disappear. The principal problems were succinctly stated by the Supreme Court in the *Flora* opinion:

[W]ould the Government be required to file a compulsory counterclaim for the unpaid balance in District Court under Rule 13 of the Federal Rules of Civil Procedure? If so, which party would have the burden of proof?²⁰¹

If the taxpayer is permitted to sue for refund of a partial payment, as proposed, the Government not only is but should be required to

the *Flora* condition makes the normal legal remedy for enforcement of that official duty inadequate, Section 10 of the Administrative Procedure Act, 5 U.S.C. § 1009 (1961) may authorize a mandatory injunction. See Kaminsky, *supra* note 195. Although mandamus (the antecedent of the mandatory injunction) was held not a permissible substitute for a suit for a disputed tax refund in *Empire Ordinance Co. v. Harrington*, 249 F.2d 680 (D.C. Cir. 1956), that view was premised on the adequacy of the remedy by suit for refund. The suggested remedy is untested, however, and in any event is a less satisfactory remedy than a suit for refund. See generally *Developments in the Law—Remedies against the United States and Its Officials*, 70 HARV. L. REV. 827, 846-50, 861-64 (1957).

198. Promptly following the *Flora* decision, the American Bar Association recommended such legislation. The A.B.A. report sets out the resolution, 86 A.B.A. REP. 333 (1961), but inadvertently fails to show its adoption, *id.* 123-26, n.312, as a result of which error it was omitted from the omnibus bill containing A.B.A.-approved recommendations, H.R. 11450, 89th Cong., 1st Sess. (1965). See A.B.A. SECTION OF TAXATION, REVISED EXPLANATION OF H.R. 11450, at 85 (1967).

199. By expressly providing that collection efforts may proceed, the law would assure—if that is the purpose of Congress—that a suit for refund of a token payment may not be used as a substitute for a Tax Court proceeding, by one who has assets from which voluntary or involuntary collection may be effected, while also assuring a remedy to those who have already paid all they can. See note 189 *supra*. Regarding the procedure for refunding excessive collections made during the pendency of the suit, see pp. 1145-46 *infra*.

200. P. 1137 *supra*. Regarding the release of certain essential funds from the lien during the pendency of the proceeding, see pp. 1137-39 *supra*.

201. 362 U.S. 145, 165-66 (1960).

counterclaim for the unpaid balance, in order to avoid multiplicity of litigation.²⁰² A “horrible example” propounded by a supporter of the *Flora* rule²⁰³ affords sufficient reason for insisting on this: Suppose a \$50,000 tax is assessed, based on five disputed \$10,000 issues. The taxpayer pays \$10,000 and brings suit for its refund. He must win all five issues if he is to recover, since if he loses any he will owe at least the \$10,000 he has paid. If he wins the suit, therefore, there is no problem, because an adjudication that he did not owe even \$10,000 clearly precludes his owing the balance of the assessment. But if he loses and no counterclaim has been filed or required to be filed by the Government, the decision affords no guidance at all on whether the \$40,000 balance is owing. The court may decide any one of the issues against the taxpayer and find it unnecessary to consider the others, or the jury may render a general verdict without specifying on which issue he lost. Indeed, when he pays the next \$10,000 and sues for refund, all the issues must be litigated over again, since none is *res judicata*. But if the Government must raise its counterclaim or be barred by the judgment, whichever way it goes, the entire liability can be determined in a single suit.

In order to prevent the compulsory counterclaim rule from unduly interfering with tax collection, however, it should be expressly provided—unless Congress decides to go all the way and restrain collection while a tax is being litigated in the district court²⁰⁴—that the pendency of the counterclaim shall not prevent *administrative* collection of the balance owing.²⁰⁵ This suggestion too has stirred procedural nightmares in the minds of *Flora*’s supporters, but they could be easily dealt with by providing that any amounts collected pending the suit shall be taken into account in the computation of the final judgment, without need

202. Rule 13(a) of the Federal Rules of Civil Procedure reads in part:

A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party’s claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction

An income, estate or gift tax liability is a single cause of action, no matter how many issues it may involve, and a judgment thereon precludes subsequent litigation of additional issues involved in the same tax. *Chicago Junction Rys. v. United States*, 10 F. Supp. 156 (Ct. Cl. 1935); *Guettel v. United States*, 95 F.2d 229 (8th Cir.), *cert. denied*, 305 U.S. 603 (1938). The same is not true of the “divisible” taxes (see pp. 1140-41 *supra*), but the issues in those cases are ordinarily single, and *stare decisis*, if not collateral estoppel, will suffice to discourage repeated litigation.

203. *Riordan, Must You Pay Full Tax Assessment before Suing in the District Court?* 8 J. TAX. 179, 181 (1958).

204. See p. 1142 *supra*.

205. See pp. 1141, 1144 *supra*.

for the formality of an additional claim for refund or amendment of the complaint.²⁰⁶

Provision should also be made that the burden of proof on the counterclaim shall be on the taxpayer, in order that he may gain no advantage from being permitted to put the Government in the position of moving party.²⁰⁷ Congress has already expressly placed the "burden of proof" on the taxpayer when the Government files a counterclaim in a case where a deficiency is determined after a refund suit has been commenced.²⁰⁸ There, however, the Committee Reports interpret the taxpayer's burden as "the same burden of proof as he would bear if he had appealed the case to the Tax Court,"²⁰⁹ a burden (essentially an obligation to make a prima facie case) apparently no greater than he would bear in resisting the Government's counterclaim if the statute were silent.²¹⁰ In dealing more broadly with counterclaims in situations where the alternative from which the taxpayer is relieved is to sue for refund, Congress might consider the refund suit standard of proof. It would not be amiss, however, to consider establishing a uniform general

206. This should resolve the procedural complications visualized in *Riordan*, *supra* note 203, at 181. Even if multiple issues are involved in the assessment, as in the example in the text, the original claim and complaint must have raised all of them, since if the taxpayer controverts less than all, the \$10,000 he has paid will not be an overpayment. Therefore, additional payments, pending suit, would inject no new issues and no new claim should be required.

207. If the taxpayer were required to pay the full tax before suing for refund, the burden of proof would be on him, not only to show that the tax assessment is erroneous, but to produce evidence from which the correct tax can be determined, which includes an obligation to negative any offsetting issues raised by the Government. *David v. Phinney*, 350 F.2d 371 (5th Cir. 1965); *Missouri Pac. R.R. v. United States*, 338 F.2d 668 (Ct. Cl. 1964). *But cf. Fulton Container Co. v. United States*, 355 F.2d 319, 324 (9th Cir. 1966). If the Government is required to counterclaim, the assessment makes a prima facie case, but once the taxpayer introduces evidence, the traditional view would place the burden of proof on the Government. The result might be that, if the evidence is well balanced, the court would deny both the refund and the counterclaim (which might be much the larger amount). See *United States v. Molitor*, 337 F.2d 917 (9th Cir. 1964). The Second Circuit, however, has placed the burden of proof (not merely the burden of going forward) on the taxpayer, so that he will be no better off for having avoided the need to pay and sue for refund: *Lesser v. United States*, 368 F.2d 306, 310 (2d Cir. 1966); see *United States v. Lease*, 346 F.2d 696, 700 (2d Cir. 1965) (same view expressed in a collection suit).

208. INT. REV. CODE of 1954, § 7422(e). See note 187 *supra*.

209. H.R. REP. NO. 1337, 83d Cong., 2d Sess. A491 (1954); S. REP. NO. 1622, 83d Cong., 2d Sess. 611 (1954).

210. In the Tax Court, the Commissioner's determination, unless arbitrary, is presumptively correct, but the presumption disappears when the taxpayer introduces evidence sufficient to sustain a contrary finding, and the burden of proof is then held to be on the Commissioner. *Herbert v. Commissioner*, 377 F.2d 65, 69 (9th Cir. 1966); *Robert Louis Stevenson Apts. v. Commissioner*, 377 F.2d 681, 688 (8th Cir. 1964). *Contra*, *United Aniline Co. v. Commissioner*, 316 F.2d 701, 704 (1st Cir. 1963). See 9 J. MERTENS, LAW OF FEDERAL INCOME TAXATION § 50.61 (1965). In a collection suit, or a counterclaim by the Government outside the scope of § 7422(e), the taxpayer's burden is certainly no less, *United States v. Rindskopf*, 105 U.S. 418, 422 (1882), *United States v. Molitor*, 337 F.2d 917, 922-23 (9th Cir. 1964), *United States v. Streblor*, 313 F.2d 402 (8th Cir. 1963), and may well be greater. See note 207 *supra*.

rule for the burden of proof applicable in all tax litigation, in whatever forum it may arise and whoever may be the moving party.²¹¹

A problem closely related to the foregoing involves the right of the taxpayer to raise the merits of his tax liability as a defense when the Government has to resort to the district court in aid of collection (independently of any refund suit by the taxpayer). Although the great bulk of involuntary collection is effected by levy, without need for judicial proceedings, the Government occasionally finds it necessary or expedient to bring suit, either to foreclose its lien on property of the taxpayer (especially where the existence of rival claims might make it difficult to realize an adequate price on a sale under levy),²¹² or to reduce the tax claim to judgment (and thus permanently toll the running of the statute of limitations).²¹³ The Government may also, when joined as a defendant in a private foreclosure action in a federal or state court, cross-claim against the taxpayer for foreclosure of its own lien,²¹⁴ or it may intervene for that purpose in a suit in which it has not been joined.²¹⁵

At one time the Government argued, and some courts held, that the assessment was *conclusive* in such a proceeding, and that the taxpayer's only recourse was to sue for refund in a separate proceeding.²¹⁶ It now seems well established, however, and is acknowledged by the Government,²¹⁷ that the taxpayer may raise the merits of the tax liability as a defense to such a suit.²¹⁸ This position has been criticized on the ground that the taxpayer should be in no better position merely because the Government is forced to sue than if the tax had been col-

211. This would not, of course, exclude special rules for the burden of proof or of going forward on particular issues. E.g., INT. REV. CODE of 1954, §§ 269(c), 341(c), 534, 6902(a), 7454(a).

212. INT. REV. CODE of 1954, § 7403. See PLUMB & WRIGHT 209-10.

213. PLUMB & WRIGHT 47-48.

214. 28 U.S.C. § 2410(c) (1964).

215. INT. REV. CODE of 1954, § 7424. In addition, the Government may file claims in bankruptcy and receivership proceedings. *Id.* § 6871; *Abel v. Campbell*, 334 F.2d 339 (5th Cir. 1964).

216. *United States v. 360 Acres of Land*, 60-2 U.S. Tax Cas. ¶ 9630 (S.D. Cal. 1960); *Commercial Credit Corp. v. Schwartz*, 126 F. Supp. 728 (E.D. Ark. 1954); *United States v. Hauser*, 25 F. Supp. 689 (S.D. Cal. 1938); see *Pipola v. Chicco*, 274 F.2d 909, 911-12 (2d Cir. 1960). The Government sought, in the House version of the bill that became the Internal Revenue Code of 1954 (H.R. 8300, 83d Cong., 2d Sess. § 7403(c) (1954)), expressly to make the assessment conclusive in lien foreclosure actions, but the provision was not enacted. H.R. REP. NO. 1337, 83d Cong., 2d Sess. A431 (1954); S. REP. NO. 1622, 83d Cong., 2d Sess. 610 (1954).

217. See 1961 ATT'Y GEN. ANN. REP. 310-11; Ferguson, *supra* note 171, at 318.

218. *United States v. O'Connor*, 291 F.2d 520, 526 (2d Cir. 1961), repudiating (at the instance of the Government) the contrary dictum in *Pipola v. Chicco*, 274 F.2d 909 (2d Cir. 1960).

lected administratively,²¹⁹ and that the injection of the merits may delay collection more than if the litigation involved only the issues normally incident to a foreclosure suit.²²⁰ But, once the matter is in court, it seems a futile duplication of litigation to exclude consideration of the merits in the first suit.²²¹ The Government's power to collect by administrative action from any property it can find which is not directly involved in the pending suit need not be delayed or interfered with, at least if the law is amended to provide expressly that it shall not be.²²² While it would ordinarily be inappropriate to levy on the property which is the subject of the foreclosure suit,²²³ the Government's interests therein can be protected by the appointment of a receiver if necessary.²²⁴ The enforcement of non-federal liens that have priority over the tax lien need not be delayed to await adjudication of the merits of the tax; and subordinate non-federal liens can only be benefited by a delay for that purpose.²²⁵

The objection that permitting the taxpayer to raise the merits in a collection suit forces the Government to assume the burden of proof can be met by expressly placing that burden on the taxpayer, as suggested above in connection with counterclaims.²²⁶ A further objection

219. The administrative levy (INT. REV. CODE of 1954, §§ 6331, 6332) has the practical effect of an execution on a final judgment, even though the merits of the tax remain to be determined. See *Bull v. United States*, 295 U.S. 247, 259-60 (1935); *United States v. Morris & Essex R.R.*, 135 F.2d 711, 713 (2d Cir. 1943), *cert. denied*, 320 U.S. 754 (1943). See PLUMB & WRIGHT 200-07.

220. In Note, *Conclusiveness of the Merits of a Tax Assessment and the Congressional Policy of Summary Tax Collection*, 71 YALE L.J. 1329, 1334-36 (1962), the conclusiveness rule is supported on this ground in the case of foreclosure suits, which are likened to levies. On the other hand, it is there acknowledged that the merits should be open in a suit to reduce the tax to a personal judgment (frequently brought when the statute of limitations is about to expire), in order to get the issues settled without further delay. Since the Government in a foreclosure suit normally asks a personal judgment as well, unless it lacks personal jurisdiction over the taxpayer, and since the taxpayer could raise the merits only if he appears, the distinction seems an academic one. See 84 A.B.A. REP. 677 (1959) (discussion without recommendation).

221. If the merits *can* be raised as a defense to the collection suit, it follows that the taxpayer *must* raise them there or not at all, and the judgment will bar contesting the issue by later suit for refund, *United States v. Hoper*, 242 F.2d 468 (7th Cir. 1957), *United States v. Graham*, 243 F.2d 919 (9th Cir. 1957), or even in an already pending Tax Court proceeding with respect to a jeopardy assessment. See *United States v. Mauro*, 243 F. Supp. 413 (S.D.N.Y. 1965). In its discretion, the district court may defer to the Tax Court and withhold final judgment until that body has reached a decision. *United States v. O'Connor*, 291 F.2d 520, 528 (2d Cir. 1961); *Florida v. United States*, 285 F.2d 596, 604 (8th Cir. 1960). Cf. *Herman Roberson*, 41 T.C. 577, 581 (1964).

222. *Harding v. Woodcock*, 137 U.S. 43 (1890). See p. 1145 *supra*.

223. Cf. *Smith v. United States*, 254 F.2d 865 (6th Cir. 1958).

224. INT. REV. CODE of 1954, § 7403(d). In a state court proceeding, the Government would be dependent on state procedures. See note 228 *infra*, concerning litigation of the merits of the tax in a state court.

225. Concerning the junior lienor's or purchaser's right to litigate the merits of the tax if the taxpayer does not, see pp. 1183-84 *infra*.

226. See notes 207-10 *supra*.

has been raised that the same issues might have to be litigated repeatedly if the merits may be raised in foreclosure suits involving property worth less than the amount of the tax.²²⁷ The problem is not likely to arise, however, because the Government's practice is to ask for a personal judgment for the full tax in conjunction with a foreclosure suit, if personal jurisdiction over the taxpayer is obtained. And he must, of course, make an appearance if he is to defend on the merits. Thus, if the merits are placed in issue, they will be conclusively decided by the first suit, even if later suits to reach other property prove necessary.

There may be some question, however, whether the Government should have to litigate the merits of the tax if the taxpayer raises such a defense when the Government intervenes or cross-claims to enforce a tax lien in a *state court* action. State courts are not equipped by experience to determine complicated issues of federal tax liability.²²⁸ Rather than deny the taxpayer that defense, however, and force him to bring a later suit for refund, the Government should follow the practice of removing such cases to the federal court when a defense on the merits is raised.²²⁹ In order to facilitate that practice, the American Bar Association recommended that the time for seeking removal (which now expires 30 days after the Government receives the initial pleading or summons, before the taxpayer frames the issues he will rely on)²³⁰ should run from the receipt of any plead-

227. Note, *supra* note 220, at 1336 n.48. Reverting to the case of a \$50,000 assessment involving five disputed \$10,000 issues (p. 1145 *supra*), a suit to foreclose a lien on property worth \$10,000 might be disposed of by deciding any one of the issues for the Government, making the others unnecessary to the decision and theoretically requiring their relitigation in the next suit to foreclose on other property.

228. A recent decision holds that, since a state court is not qualified to consider substantive federal tax issues, it must allow the Government's claim without question, leaving the taxpayer to his remedy by suit for refund. *P.C. Monday Tea Co. v. Milwaukee County Expressway Comm.*, 29 Wis. 2d 372, 139 N.W.2d 26 (1966). *But see* *United States v. Hoper*, 242 F.2d 468 (holding that failure to raise defense on the merits when Government filed claim in state probate court precluded later refund suit); *Paddock v. Siemoneit*, 147 Tex. 571, 218 S.W.2d 428 (1949) (passing on the merits).

229. The Government has the right to remove to the federal court any foreclosure or similar suit in which it is joined, 28 U.S.C. § 1444 (1964) and even one in which it intervenes. INT. REV. CODE of 1954, § 7424. Since mortgage foreclosures ought not to be made a burden on the federal courts, the right is exercised sparingly, unless it is anticipated that the merits of the tax will be controverted. Certain proceedings (receivership, probate, etc.) may not be removed by the United States, but a federal court determination of the merits may be obtained by suing the representative for the tax and then filing the judgment as a claim in the state proceeding. *See* Plumb, *Federal Tax Collection and Lien Problems*, 13 TAX L. REV. 247, 281 (1958).

230. Act of May 24, 1949, ch. 138, § 83, 62 Stat. 101, *as amended*, 28 U.S.C. § 1446(b) (Supp. I, 1965). The taxpayer, when he is a co-defendant in a mortgage foreclosure suit, would not have raised his defenses to the Government's plea for affirmative relief until after that time. When the United States intervenes under INT. REV. CODE of 1954, § 7424, it is unclear when the time for removal would run.

ing, motion, order, or other paper which for the first time injects into the case any new issue concerning a right of the United States.²³¹

3. *Recovery by Taxpayer for Damages Suffered*

The taxpayer against whom an erroneous assessment is enforced may suffer damages far exceeding the face amount of the tax liability, damages which cannot be redressed merely by refunding the amount of the tax with interest. At the very least, his property will probably have been sacrificed at forced sale prices, and in some cases he may have had his credit impaired and his business interrupted or wholly destroyed. Similar injuries may, of course, be suffered by one who actually owes the asserted tax liability, but must in that event be accepted as the normal lot of the delinquent debtor. Even that taxpayer, however, may have a just complaint if his property is sold without following the procedures which the law has provided to ameliorate or prevent such harms,²³² or if his property is sold when it should legally have been retained by the tax collector to await the outcome of litigation over a jeopardy assessment,²³³ or if loss or damage to his property while in custody prevents his receiving credit for what might have been realized from its sale.²³⁴

231. The Bar proposed that the time run 20 days from such date, but it should be 30 days in view of the general enlargement of time now provided by 28 U.S.C. § 1446(b) (Supp. I, 1965). It was also proposed that the federal court be permitted, in its discretion, to remand the case to the state court after disposing of the federal issues. 84 A.B.A. REP. 677, 736, 739 (1959). The idea of removing the case to the federal court for the sole purpose of determining the federal rights, and then remanding for final action by the state court, was embodied in the House-passed version of H.R. 980, in 1931, dealing with making the United States a defendant in mortgage foreclosure suits (see note 349 *infra*). It was argued that "[t]he balanced scheme of the bill thus preserves the rights of each sovereign power within its proper sphere of action. The jurisdiction of the State courts over its real estate is preserved while at the same time the granting of the right of removal to the Federal courts for the determination of the status of the Government's lien spares the Federal Government from having its interests passed on by a State court." H.R. REP. NO. 95, 71st Cong., 2d Sess. 2 (1930). The Senate rejected that view, contending that the state courts could be relied on to deal fairly with federal rights, and that removal and remand of every case would entail needless delay and expense. S. REP. NO. 351, 71st Cong., 2d Sess. 2 (1930). The final compromise, the antecedent of 28 U.S.C. §§ 1444 and 2410, permitted state courts to adjudicate federal rights in mortgage foreclosures unless the United States asked removal, in which case all issues would be dealt with by the federal court. The present proposal would, like the 1931 House bill, preserve the state court's proper sphere, but would eliminate the objectionable feature of that bill, by removing only those cases where the Government considers it essential, and leaving remand to the discretion of the federal court in the light of the circumstances of each case. In order to minimize the trespass on Judiciary Committee jurisdiction, the provisions in this and the preceding note were omitted from the Federal Tax Lien Act of 1966.

232. INT. REV. CODE OF 1954, §§ 6335-36. The requirements are detailed in Plumb, *supra* note 229, at 272-75.

233. INT. REV. CODE OF 1954, § 6863(b)(3). Cf. *Smith v. Flinn*, 261 F.2d 781 (8th Cir. 1958), *modified*, 264 F.2d 523 (8th Cir. 1959) (injunction).

234. A recurring situation involves levies on receivables, which after levy the taxpayer-creditor is helpless to collect, and which the tax collector then fails to pursue, with the

Under the modern adaptation of the ancient feudal principle that "the king can do no wrong,"²³⁵ it seems clear that in none of those circumstances can the wronged taxpayer obtain compensation from the United States for his injuries,²³⁶ except by the unsatisfactory process of getting a private bill through Congress, which simply does not have the time or facilities for making an impartial "judicial" determination of the facts.²³⁷ For more than 150 years, that was the only means by which a citizen could obtain redress from the Government for tortious injuries. In 1946, however, culminating over 20 years of effort to achieve reform, Congress delegated to the courts the power to adjudicate tort claims against the Government—subject to a number of exceptions.²³⁸ One type of claim for which relief under the Federal Tort Claims Act is expressly denied is "[a]ny claim arising in respect of the assessment or collection of any tax or customs duty, or the detention of goods by any officer of customs or excise"²³⁹ The precise reason for that exclusion is obscure.²⁴⁰ It is not separately discussed in the reports, but is referred to only as one of a group of exceptions for "claims which relate to certain governmental activities which should be free from the threat of damage suits or for which adequate remedies are already

result that they become uncollectible. The taxpayer receives no credit on his taxes for the amounts not collected from his debtors, and is denied recovery of damages. *Catalina Properties, Inc. v. United States*, 166 F. Supp. 763 (Ct. Cl. 1958); *United States v. Banner*, 226 F. Supp. 904 (N.D.N.Y. 1963); *Estate of Samuel Stein*, 40 T.C. 275, 278 (1963). Recovery in tort for goods seized under the tax laws, then lost or misdelivered, was denied in *Chambers v. United States*, 107 F. Supp. 601 (D. Kan. 1952). On the other hand, recovery was allowed, both in tort and on an implied contract to use due care, where goods detained under the customs laws mysteriously disappeared. *Alliance Assur. Co. v. United States*, 252 F.2d 529 (2d Cir. 1968). See also *Agnew v. Haymes*, 141 F. 631 (4th Cir. 1905) (limited tort remedy against tax collector).

235. For an excellent capsule review of the history of the doctrine of sovereign immunity, see *Developments in the Law—Remedies against the United States and Its Officials*, 70 HARV. L. REV. 827, 829-30 (1957). See also Nelson, *Sovereign Immunity and Federal Liens*, 26 BROOKLYN L. REV. 18 (1959).

236. *Hill v. United States*, 149 U.S. 593, 598 (1893); *Heasley v. United States*, 348 F.2d 40, 42 (8th Cir. 1965); cases cited note 234 *supra* & notes 243, 260 *infra*.

237. Congress tends to rely heavily on the facts reported by the accused agency, although it may refer the matter to the courts for determination of the facts. See 64 A.B.A. REP. 211 (1939); Gellhorn & Lauer, *Congressional Settlement of Tort Claims against the United States*, 55 COLUM. L. REV. 1, 5 (1955). Such a reference, pursuant to 28 U.S.C. §§ 1492, 2509 (1964), was made by Congress to the Court of Claims following the decision in *Catalina Properties, Inc. v. United States*, 166 F. Supp. 763 (Ct. Cl. 1958). *Id.*, 305 F.2d 380 (Ct. Cl. 1962).

238. Federal Tort Claims Act, Title IV of the Legislative Reorganization Act of 1946, ch. 753, 60 Stat. 812, 842, 28 U.S.C. §§ 1346(b), 2671-80. The history of the reform effort is recorded in Gottlieb, *The Federal Tort Claims Act—A Statutory Interpretation*, 35 GEO. L.J. 1 (1946). See also *United States v. Spelar*, 338 U.S. 217, 219 (1949) referring to twenty-eight years of congressional "drafting and redrafting," dating from 1919.

239. 28 U.S.C. § 2680(c) (1964). The exception precludes administrative relief under 28 U.S.C. § 2672 (1964), as well as judicial relief.

240. The list of exceptions went through many accretions and attritions during the many years such bills were pending, but the tax exception, which was in the bill introduced in 1925 (S. 1912, 69th Cong., 1st Sess.), if not earlier, survived to the end. See *United States v. Muniz*, 374 U.S. 150, 155 (1963) (which ignores the pre-1925 bills, note 238 *supra*).

available."²⁴¹ The commentators have assumed that Congress considered the tax collection exception to fall in the second category²⁴² but, if so, Congress acted under a misapprehension, for the existing remedies by refund suit and in the Tax Court afford no relief for tortious wrongs.²⁴³ More likely the Internal Revenue Service, placing itself on a plane with the military's "combatant activities . . . during time of war,"²⁴⁴ quietly persuaded Congress that its functions were "activities which should be free from the threat of damage suits." If the sovereign is no longer without sin, at least it may still be said that "the Internal Revenue Service can do no wrong."

The traditional safety valve for the inequities of sovereign immunity, in the days when immunity was complete, was the judicial development of theories by which redress might be obtained by personal suit against a public officer.²⁴⁵ The officer could be sued for damages caused by his nonperformance or malperformance of ministerial duties²⁴⁶—and even for unlawful acts done, without personal fault, under superior orders.²⁴⁷ Congress collaborated in the fiction, in the case of revenue officers, by indemnifying them out of public funds if they acted under orders or had "probable cause" for their actions.²⁴⁸ But the remedy had its limitations and may now even be extinct. A tax assessment was deemed sufficient warrant for its enforcement, and hence an officer who followed legal requirements was protected from liability for the harm (over and above the amount collected) caused

241. S. REP. NO. 1400, 79th Cong., 2d Sess. 33 (1946) (emphasis added).

242. Gottlieb, *supra* note 238, at 45; Comment, *The Federal Tort Claims Act*, 56 YALE L.J. 534, 547 (1947).

243. The contention that the exception related only to errors in the determination of tax liability (for which another remedy does exist), and not to "collection of a tax by wrongful means," was rejected in *Broadway Open Air Theatre v. United States*, 208 F.2d 257 (4th Cir. 1953). See also *United States v. Worley*, 213 F.2d 509 (6th Cir. 1954), *cert. denied*, 348 U.S. 917, 918 (1955); *Pargament v. Fitzgerald*, 272 F. Supp. 553 (S.D.N.Y. 1967), *aff'd per curiam*, 68-1 U.S. Tax Cas. ¶ 9301 (2d Cir. 1968); *United States v. Banner*, 226 F. Supp. 904 (N.D.N.Y. 1963).

244. Excepted by 28 U.S.C. § 2680(j) (1964).

245. *United States v. Lee*, 106 U.S. 196, 220 (1882). See *Developments in the Law*, *supra* note 235, at 830. The process paralleled the development of the "personal" liability of tax collectors for the refund of customs and internal revenue taxes erroneously assessed, a fiction which served as "a remedial expedient for bringing the Government into court." *George Moore Ice Cream Co. v. Rose*, 289 U.S. 373, 383 (1933). See Plumb, *Tax Refund Suits against Collectors of Internal Revenue*, 60 HARV. L. REV. 685, 687-91 (1947).

246. *Little v. Barreme*, 6 U.S. (2 Cranch) 170 (1804); *Agnew v. Haymes*, 141 F. 631 (4th Cir. 1905).

247. *Little v. Barreme*, 6 U.S. (2 Cranch) 170, 178-79 (1804); *Mitchell v. Harmony*, 54 U.S. (13 How.) 115, 137 (1851); *Bates v. Clark*, 95 U.S. 204, 209 (1877).

248. 28 U.S.C. § 2006 (1964); INT. REV. CODE OF 1954, § 7423(2). See *George Moore Ice Cream Co. v. Rose*, 289 U.S. 373, 382 (1933). The very fact that the officer was thus indemnified caused the court in *Film Truck Service, Inc. v. Nixon*, 216 F. Supp. 77 (E.D. Mich. 1963), to view a suit against the officer for his own tort as an attempted evasion of the sovereign immunity from tort suits.

by such enforcement, even though the assessment turned out to be erroneous.²⁴⁹ Furthermore, the superior official who formally or actually made the erroneous tax determinations was sheltered from personal liability under the doctrine that the exercise of judgment and discretion must be free from that threat.²⁵⁰ And even in the case of wrongs negligently, knowingly or maliciously committed by subordinate officers, for which there once was a remedy, the trend of modern decisions is to grant absolute immunity, in order that they may not be hesitant to act with the boldness and expedition that the circumstances may require.²⁵¹

It may be acknowledged that the tax collection function is too important to be hampered by imposing on the revenue officers a threat of ruinous personal liability for error.²⁵² But it is the public as a whole that benefits through more efficient and effective operations from the officer's personal immunity. It is more consistent with the "steadily expanding conception of public morality"²⁵³ that the losses caused by the inevitable excesses and mistakes should not be borne by the individual taxpayer but should be "charged against the public treasury [so that] they are in effect spread among those who contribute financially to the support of the Government and the resulting burden on each taxpayer is relatively slight."²⁵⁴ Tax collection would suffer no more from the Government's acceptance of that responsibility than have the other vital governmental functions which have been subject to it for many years.²⁵⁵

249. *Harding v. Woodcock*, 137 U.S. 43 (1890); *Erskine v. Hohnbach*, 81 U.S. (14 Wall.) 613 (1871); *Herwig v. Crenshaw*, 188 F.2d 572 (4th Cir. 1951), *cert. denied*, 342 U.S. 905 (1952); *Powell v. Rothensies*, 183 F.2d 774 (3d Cir. 1950).

250. *Standard Nut Margarine Co. v. Mellon*, 72 F.2d 557 (D.C. Cir. 1934), *cert. denied*, 293 U.S. 605 (1934). *See also Spalding v. Vilas*, 161 U.S. 483 (1896); *Cooper v. O'Connor*, 99 F.2d 135 (D.C. Cir.), *cert. denied*, 305 U.S. 643 (1938). *See Developments in the Law*, *supra* note 235, at 834-37.

251. *Bershad v. Wood*, 290 F.2d 714 (9th Cir. 1961); *National Dairy Products Corp. v. O'Connell*, 66-2 U.S. Tax Cas. ¶ 9598 (D.R.I. 1966). *See also Norton v. McShane*, 332 F.2d 855 (5th Cir. 1964), *cert. denied*, 380 U.S. 981 (1965); *Gregoire v. Biddle*, 177 F.2d 579 (2d Cir. 1949), *cert. denied*, 339 U.S. 949 (1950). *But cf. Kelley v. Dunne*, 344 F.2d 129 (1st Cir. 1965). In the area of non-tax torts, this policy is carried to the point that even the Government itself, when held liable under the Tort Claims Act, is denied a remedy over against the offending employee. *United States v. Gilman*, 347 U.S. 507 (1954).

252. The indemnity provided by 28 U.S.C. § 2006 (1964) and by INT. REV. CODE of 1954, § 7423(2), might be deemed, under the modern philosophy, to afford the employee insufficient assurance for this purpose, since he would have to establish "probable cause."

253. *Larson v. Domestic & Foreign Corp.*, 337 U.S. 682, 709 (1949) (dissenting opinion of Frankfurter, J.). *See also National City Bank v. Republic of China*, 348 U.S. 356, 359 (1955).

254. *Rayonier, Inc. v. United States*, 352 U.S. 315, 320 (1957), discussing the general policy of the Federal Tort Claims Act. On like grounds, it has been urged that the controversial "discretionary function" exception, 28 U.S.C. § 2680(a) (1964), should be modified. *Developments in the Law*, *supra* note 235, at 838, 900.

255. The abortive notion that "it was not contemplated that the Government should

Rather than merely repealing the exception to the Tort Claims Act quoted above (a reform which might be partially nullified by a labored reading of certain other exceptions from the coverage of the Act,²⁵⁶ and by the reluctance of judges to acknowledge that a new law changes familiar concepts²⁵⁷), Congress should recognize that tax collection has no clear counterpart in the private sector²⁵⁸ and should tailor its acceptance of liability to the special circumstances.²⁵⁹ The law should expressly provide that the taxpayer from whom an erroneous tax is exacted shall be entitled, without need for showing negligence in the determination, to recover not merely the tax paid but any consequential damages suffered,²⁶⁰ if he has taken all reasonable steps to

be subject to liability arising from acts of a governmental nature or function," *Dalehite v. United States*, 346 U.S. 15, 28 (1953), was quickly abandoned by the Supreme Court. *Indian Towing Co. v. United States*, 350 U.S. 61 (1955). See Caruso, *An Analysis of the Evolution of the Supreme Court's Concept of the Federal Tort Claims Act*, 26 *FED. B.J.* 35 (1966). Repeal of the tax collection exception (and all but two of the others) was urged by Judge Holtzoff in his review of L. JAYSON, *HANDLING FEDERAL TORT CLAIMS* (1964), in 53 *GEO. L.J.* 1151, 1153 (1965).

256. The exception for claims "based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty," 28 U.S.C. § 2680(a) (1964), although confined by some courts to acts on the policy and planning levels rather than on the operational level (*United Air Lines v. Weiner*, 334 F.2d 379, 392-93 (9th Cir. 1964), *petition for cert. dismissed*, 379 U.S. 951 (1964); *United States v. Hunsucker*, 314 F.2d 98 (9th Cir. 1962)), is applied by others whenever an exercise of judgment by an operating employee goes amiss. *E.g.*, *Blitz v. Boog*, 328 F.2d 596, 599 (2d Cir. 1964), *cert. denied*, 379 U.S. 855 (1964). See *Developments in the Law*, *supra* note 235, at 894; Jayson, *Application of the Discretionary Function Exception*, 24 *FED. B.J.* 153 (1964). Decisions broadly immunizing revenue officers from personal liability for acts involving judgment or discretion, *e.g.*, *O'Campo v. Hardisty*, 262 F.2d 621 (9th Cir. 1958), might be applied to restrict relief against the United States if the Tort Claims Act were merely made applicable to tax collection cases, without further amendment. In addition, one court has declared that the Tort Claims Act applies only to negligent acts and not to wrongs which amount to a *conversion* of property, *United States v. Banner*, 226 F. Supp. 904 (N.D.N.Y. 1963), a conclusion that is difficult to reconcile with the jurisdictional words of 28 U.S.C. § 1346(b) (1964), "negligent or wrongful act or omission." See Hatahley v. United States, 351 U.S. 173, 181 (1956); *Aleutco Corp. v. United States*, 244 F.2d 674, 678 (3d Cir. 1957). See also note 263 *infra*, regarding the possible effect of the exception in 28 U.S.C. § 2680(h) for "interference with contract rights."

257. See Caruso, *supra* note 255, attributing the Supreme Court's initial reluctance to apply the Tort Claims Act to the fact that "[a]ll human beings [in which category he includes Supreme Court Justices] are in favor of progress—provided it doesn't change anything they believe in."

258. 28 U.S.C. § 2674 (1964) makes the United States liable "in the same manner and to the same extent as a private individual under like circumstances." The absence of any private parallel to the Government's relationship to the armed forces caused the Court to deny servicemen a remedy under the Act, *Feres v. United States*, 340 U.S. 135 (1950), although the Court—after going through some evolution in its thinking, Caruso, *supra* note 255—held otherwise as to claims by the inmates of federal prisons. *United States v. Muniz*, 374 U.S. 150 (1963).

259. Cf. INT. REV. CODE OF 1954, § 7426 (Supp. II, 1965-66), which constructs a system of remedies for *third parties* injured by tax collection, but unfortunately (in harmony with the present policy of the Tort Claims Act) omits a remedy for consequential damages suffered through the seizure and sale of one person's property for another's tax. See note 326 *infra*.

260. In *Harding v. Woodcock*, 137 U.S. 43 (1890), the Court denied recovery against the tax collector for such a loss, suggesting that the liability, if any, was that of the Government. *Id.* at 43. But in *Kjar v. United States*, 108 Ct. Cl. 119, 140-41, *cert. denied*,

delay collection until the dispute has been settled.²⁶¹ The taxpayer who suffers harm through unlawful acts or omissions in the enforcement of a tax, whether valid or invalid, should also be entitled to recover.²⁶² The recovery, however, should in either event be limited to actual pecuniary loss.²⁶³ Even though jury trials are excluded,²⁶⁴ the Internal Revenue Service is too attractive a target to risk subjecting it to judicial measurement of the mental pain and anguish resulting from improper tax collection!²⁶⁵

B. Remedies of Person Levied On

The federal tax collector may levy upon all property or rights to property belonging to a delinquent taxpayer or on which a lien

332 U.S. 768 (1947), the court on rehearing (not included in the report in 69 F. Supp. 406) declared: "It is true that the assessment was erroneous and consequently that the levy and sale of the property pursuant to the assessment was erroneous; however, when the Government returns to the taxpayer whose property has been erroneously seized and sold the amount it has received for the property, it has discharged the full responsibility placed upon it by the law. There is no duty to realize from a sale of property its full market value, and which makes the United States liable if it fails to do so." Despite the court's denial of a "duty," the court suggested the possibility of tort liability but had no power to impose it. The violation of duty, of course, lies not in the sale but in the wrongful assessment, of which the sale and the sacrifice of value are consequences. If the assessment is only partially incorrect, the sale might have occurred irrespective of the error; it would be necessary to determine whether the injury would have been as great if only the correct amount had been collected.

261. A taxpayer who voluntarily (compare note 177 with note 193 *supra*) passes up the opportunity to defer collection by petitioning the Tax Court with respect to a disputed tax, there being no finding of jeopardy, would be in no position to complain of the injury caused by enforced collection. Whether a taxpayer should be required to attempt to defer collection by injunction would depend on whether that remedy is made more readily available, see pp. 1139-40, 1144 *supra*, and on whether the taxpayer's financial situation made such an effort feasible. But at least the existence of the dispute should have been made known to the tax collector so that he could avoid the injury by deferring collection if he saw fit to do so.

262. See p. 1150 *supra*.

263. This might, however, include recovery for loss of use of property, *Laney Tank Lines, Inc. v. United States*, 237 F. Supp. 205 (E.D.S.C. 1965), and lost profits from a destroyed or damaged business. See *United States v. Griffith, Gornall & Carman, Inc.*, 210 F.2d 11 (10th Cir. 1954). 28 U.S.C. § 2680(h) (1964) excludes liability under the Tort Claims Act for "[a]ny claim arising out of . . . interference with contract rights," which has been read by some courts to exclude recovery of damages for any tort so far as it results in interference with business. *Small v. United States*, 333 F.2d 702 (3d Cir. 1964); *Dupree v. United States*, 264 F.2d 140 (3d Cir.), rehearing denied, 266 F.2d 373 (3d Cir.), cert. denied, 361 U.S. 823 (1959); *United States v. Mullins*, 228 F. Supp. 748 (W.D. Va. 1964); *Pargament v. Fitzgerald*, 272 F. Supp. 553 (S.D.N.Y. 1967). Therefore, it may be desirable to clarify the law in order that only the specific tort described as "interference with contract rights" will be excluded, as was held, under present law, in *Nicholson v. United States*, 177 F.2d 768, 769 (5th Cir. 1949); *United States v. Ein Chemical Corp.*, 161 F. Supp. 238, 247 (S.D.N.Y. 1958).

264. 28 U.S.C. § 2402 (1964).

265. The Tort Claims Act does not permit recovery of "punitive" damages, but the only express limitation to "actual or compensatory damages, measured by . . . pecuniary injuries" relates to certain wrongful death cases. 28 U.S.C. § 2674 (1964). In other cases, recovery for pain, suffering and mental anguish may be allowed. *Dempsey v. United States*, 176 F. Supp. 75, 83 (W.D. Ark. 1959).

exists.²⁶⁶ A person in possession of such property or indebted to the taxpayer must tread with care, as he is literally "the man in the middle." If he improvidently satisfies his original obligation to the taxpayer in disregard of the levy, he must pay again to the tax collector, probably with a 50 per cent penalty added,²⁶⁷ and it will be no defense for him that the taxpayer did not in fact owe the tax.²⁶⁸ On the other hand, if he honors the levy, he will have a complete defense to any liability to the taxpayer for failure to pay the debt or to surrender the property to him.²⁶⁹ But he will not be protected against the claim of a third party who may have an interest in or lien on the property or debt, unless the circumstances are such that delivery or payment to the taxpayer himself would be a defense.²⁷⁰

When the person levied on has notice of such an adverse claim, he may protect himself by interpleading the rival claimants, including the United States. That procedure was facilitated by the Federal Tax Lien Act of 1966, in which the Government expressly consented to be sued in interpleader.²⁷¹ But the expense to the innocent stakeholder of initiating such a proceeding may be substantial,²⁷² and must be borne by him without the customary reimbursement from the fund in court, if the Government's claim to the property is sustained.²⁷³ It should be possible to devise a simple standard procedure by which a person levied on, knowing there are adverse claimants, may pay into court and be discharged, without need for a formal pleading, merely by giving notice or asking the court to give notice to the claimants.

Alternatively, Congress might provide that delivery or payment to the United States, in response to a levy, of property or a debt in which the taxpayer has or is claimed or believed to have an interest shall dis-

266. INT. REV. CODE of 1954, § 6331(a).

267. INT. REV. CODE of 1954, § 6332(a)—(c).

268. The merits of the tax are of no concern to the third party and may not be raised by him as a defense to the levy. *United States v. American Exch. Irving Trust Co.*, 48 F.2d 829 (S.D.N.Y. 1930).

269. INT. REV. CODE of 1954, § 6332(d).

270. See Plumb, *supra* note 229, at 300-01.

271. 28 U.S.C. § 2410(a)(5). Formerly, it was necessary to go through a ritual dance in which the United States moved to be dismissed as a defendant for lack of consent—and then immediately intervened in the suit!

272. Legal fees of \$500 were incurred by the stakeholders in *Ball Constr. Co. v. Jacobs*, 140 F. Supp. 60 (W.D. Tex.), *aff'd sub nom. United States v. R.F. Ball Constr. Co.*, 239 F.2d 384 (5th Cir. 1956), *rev'd*, 355 U.S. 587 (1958), and *United States v. Hubbell*, 323 F.2d 197, 201 (5th Cir. 1963). And a fee as high as \$1,500 has been reported. *American Alliance Ins. Co. v. Mitchell*, 299 S.W.2d 536 (Mo. Ct. App. 1957).

273. *United States v. R.F. Ball Constr. Co.*, 355 U.S. 587 (1958); *United States v. Hubbell*, 323 F.2d 197 (5th Cir. 1963). See PLUMB & WRIGHT 250. Although the liability of the United States for the costs has been enlarged by 28 U.S.C. § 2412 (Supp. II, 1965-66), "the fees and expenses of attorneys" are still excluded.

charge the obligation of the person levied upon, not only to the taxpayer (as at present) but also to any other claimants. It would then be up to the adverse claimants, the real parties in interest, to initiate proceedings against the United States to establish their interests. Uncle Sam, despite some lingering fears for his solvency, is probably as safe a custodian of the property or funds as the court clerk. And the suggested procedure would not merely relieve the stakeholder of expense and risk, but would reduce litigation, since many interpleader claims are now commenced by uneasy stakeholders with respect to possible claims that would not be pressed at all if the initiative to litigate had to be taken by the adverse claimant. But the acceptability of the proposal depends upon the existence of a completely adequate system of remedies against the United States by which the adverse claimant can vindicate and protect his rights.²⁷⁴

Sometimes the person levied on may face the possibility of liability to third parties unknown to him; in this situation he cannot protect himself by bringing an interpleader action. He may be required to surrender the taxpayer's property or pay an obligation, without the tax collector having to produce the supporting document (note, warehouse receipt, bill of lading, stock certificate, savings passbook, or insurance policy) which the taxpayer himself would have had to produce. The asserted threat of double liability may be illusory if the document remaining at large is nonnegotiable, and if a previous transfer of the document without notice to the obligor would not bind him.²⁷⁵ But the threat can be a real one if the document is negotiable, even if negotiation is enjoined by a court.²⁷⁶ The risk of double liability may also be present if the tax collector levies on a domestic bank with respect to a foreigner's deposit in a foreign branch of the bank, when

274. A system of remedies against the United States for third parties whose property has been taken under levy is provided in INT. REV. CODE of 1954, § 7426, added by the Federal Tax Lien Act of 1966. The procedure set out in the text was suggested by a government attorney to the Special Committee on Federal Liens, but it did not find favor because of doubts (perhaps remediable) concerning the adequacy of § 7426 to protect the adverse claimant's position in the way it would be protected if the property or fund were in judicial custody. See p. 1165 *infra*.

275. Accordingly, savings accounts may be levied upon without surrender of the passbook. *United States v. Manufacturers Trust Co.*, 198 F.2d 366 (2d Cir. 1952); *United States v. Bowery Savings Bank*, 297 F.2d 380 (2d Cir. 1961). And life insurance may be levied upon without surrender of the policy. INT. REV. CODE of 1954, § 6332(b)(1); *Equitable Life Assur. Soc'y v. United States*, 331 F.2d 29, 33 (1st Cir. 1964).

276. An injunction against transfer by the taxpayer, as in *United States v. Lusk*, 65-1 U.S. Tax. Cas. ¶ 9156 (N.D. Ill. 1964), and *United States v. Schuermann*, 105 F. Supp. 86 (E.D. Mo. 1952), would not protect the person levied on if in fact a transfer has already been made, or if a transfer is later made in contempt of court. See UNIFORM COMMERCIAL CODE § 8-317, Comment 1; Austin & Nelson, *Attaching and Levying on Corporate Shares*, 16 BUS. LAW. 336 (1961).

a court in this country has no power to protect the foreign branch from being required by a foreign court to pay the depositor.²⁷⁷

The American Bar Association proposed that when the tax collector fails to surrender a document in connection with a levy, the Government should indemnify and defend the person levied upon in the event of any claim being made by a holder of the document,²⁷⁸ but the provision was omitted from the Federal Tax Lien Act of 1966. The proposal could readily be broadened to cover levies on foreign bank deposits.²⁷⁹ The alternative discussed above, by which the person levied on would be discharged of liability to third parties, whose exclusive remedy would then be against the United States,²⁸⁰ might equally serve to remove the risk of double liability in cases of failure to surrender documents; but it would not resolve the problem where levies are made to reach deposits in foreign branch banks, since the statutory discharge could not be made effective in a foreign court.

In general, the person levied on may resist the levy on any substantive ground establishing that he is not obligated to the taxpayer.²⁸¹ But what of defenses that do not exist at the time the tax lien attaches to all the taxpayer's property, although they arise before the levy is made? Some courts adhere to the view that, as soon as the lien attaches, "the property has, in effect, two owners, the United States and the taxpayer,"²⁸² and that "once a federal tax lien has attached to such a portion [of a debt] it is no longer a part of the balance 'due' the [taxpayer] but is 'due' to the Government."²⁸³ Courts influenced by that concept are apt to hold that the Government cannot be concluded by a compromise or concession made by the taxpayer after the Govern-

277. See *United States v. First Nat'l City Bank*, 379 U.S. 378, 401-02 (1965) (dissenting opinion), and the opinions below, 321 F.2d 14 (2d Cir. 1963), *reaffirmed en banc*, 325 F.2d 1020 (2d Cir. 1964), which the Supreme Court reversed. See Plumb, *What the Banker Should Know about Federal Tax Liens and Levies—Revisited*, 84 BANKING L.J. 1, 6-9 (1967).

278. 84 A.B.A. REP. 697-98, 727 (1959). Compare the provisions for indemnification where a note or document of title cannot be surrendered because it has been lost, stolen or destroyed. UNIFORM COMMERCIAL CODE §§ 3-804, 7-601. There would be no occasion to require a bond where the indemnitor is the United States.

279. With the bank thus protected, the tax collector might feel less constrained to use such levies sparingly, see *Treas. Reg. § 301.6332-1(a)(2)* (1964), and the Government might benefit in those cases where its jurisdiction to reach the deposit by levy on the domestic bank is recognized by the foreign court or is not challenged.

280. P. 1157 *supra*.

281. Cf. *United States v. Durham Lumber Co.*, 363 U.S. 522 (1960).

282. See *Beeghly v. Wilson*, 152 F. Supp. 726, 730 (N.D. Iowa 1957). This unfortunate verbal flourish originated in *United States v. City of Greenville*, 118 F.2d 963, 965 (4th Cir. 1941), where the issue presented involved merely the priority of liens.

283. *Randall v. Colby*, 190 F. Supp. 319, 335 (N.D. Iowa 1961). See PLUMB & WRIGHT 238-39, from which this discussion is in part drawn.

ment becomes his "silent partner," so the later levy may force the obligor to reopen the merits of his liability.²⁸⁴ Furthermore, since a local statute of limitations cannot run against a claim once it becomes owned by the United States, such a court may also hold an obligor liable to respond to a levy made years after he has lost or properly destroyed the evidence on which he might have based a defense, if the tax lien against his creditor arose unknown to the obligor, before the statute expired.²⁸⁵ The Service has not attempted to pursue that theory to the point of requiring a debtor on whom no levy has been made to ascertain the Government's interest by searching the records before *paying* a debt,²⁸⁶ although one court adhering to the "co-ownership" theory has credited the Service's position to self-restraint rather than to the requirements of the law.²⁸⁷

The better reasoned decisions, however, although they have not dealt with those specific issues, recognize that "the lien, unaccompanied by timely service of notice of levy, did not amount to an assignment or attachment of the claim and the creation of a debt due the United States,"²⁸⁸ and that "the Commissioner acts pursuant to the collection process in the capacity of lienor as distinguished from owner."²⁸⁹ In

284. *Bensinger v. Davidson*, 147 F. Supp. 240 (S.D. Cal. 1956) (settlement reopened); *United States v. Rentz*, 213 F. Supp. 521 (N.D. Iowa 1962) (taxpayer's default on cross-claim by debtor held not to relieve debtor of liability to Government, which is entitled to litigate merits). See Plumb, *Federal Tax Collection and Lien Problems*, 13 TAX L. REV. 247, 310 (1958).

285. *United States v. Jacobs*, 155 F. Supp. 182 (D.N.J. 1957); *United States v. Polan Indus.*, 196 F. Supp. 333 (S.D.W. Va. 1961). In *Polan*, the levy (as well as the lien) came within the local period of limitations, and only the suit was late; but the court by dictum approved *Jacobs*, where the levy was not made within such time. See PLUMB & WRIGHT 245. The Government may be bound by a time limitation which is expressed as a condition to the contract obligation of the taxpayer's debtor. *General Cas. Co. v. United States*, 205 F.2d 753, 755 (5th Cir. 1953).

286. Rev. Rul. 57-367, 1957-2 CUM. BULL. 846. The ruling held out the threat of common law tort liability for impairment of the lien if the debtor paid the taxpayer with *actual*, rather than constructive, knowledge of the lien, and such liability (of an escrow agent) was sustained in *United States v. Allen*, 207 F. Supp. 545 (E.D. Wash. 1962). See PLUMB & WRIGHT 240-43. In a recent "clarifying" ruling, the Service has *withdrawn* the implied threat (which some tax collectors made expressly) that a bank might be chargeable with knowledge of the lien after one levy (not fully satisfied) had been made, and that the bank might incur tort liability if it failed to watch for new deposits and give the tax collector an opportunity to levy again before honoring checks or withdrawals. Rev. Rul. 67-162, 1967-1 CUM. BULL. 356.

287. See *Beeghly v. Wilson*, 152 F. Supp. 726, 730 (N.D. Iowa 1957); Note, *Effect of a Federal Tax Lien on a Bank Deposit*, 42 IOWA L. REV. 412 (1957). But see Plumb, *supra* note 284, at 309-10.

288. *United States v. Exchange Nat'l Bank*, 217 F. Supp. 287, 288 (W.D.N.Y. 1963). The court relied on *In re Cherry Valley Homes, Inc.*, 255 F.2d 706, 707 (3d Cir. 1958), *cert. denied sub nom. DuBois v. United States*, 358 U.S. 864 (1958) (discussed in First Installment, 248 n.135) and *United States v. Eiland*, 223 F.2d 118 (4th Cir. 1955), both of which treated the levy as appropriating the debt to the tax claim.

289. *United States v. Sullivan*, 333 F.2d 100, 116 (3d Cir. 1964). See also *United States v. Mitchell*, 349 F.2d 94, 102, 105 (5th Cir. 1965); *In re Brewster-Raymond Co.*, 344 F.2d

harmony with that view, the American Bar Association urged amendment of the law to provide expressly, not only that payment of a debt prior to levy should be a defense, but also that any other valid setoff or defense which might have been maintained in an action commenced by the taxpayer *at the time of the levy* (or at maturity of the obligation, if later) should be valid against a levy or a lien foreclosure suit by the Government.²⁹⁰ The proposal was not enacted, but should be considered further.

The question of setoff is particularly troublesome.²⁹¹ There is much equitable appeal in the view that one should not have to pay over to the tax collector, in response to a levy for taxes of one's creditor, a debt which could not be enforced by the creditor himself because he in turn is indebted to the person levied on; and the courts generally have taken that view in cases not involving bank accounts. Some courts have focused, as did the Bar's legislative proposal, upon the extent of the taxpayer's *property right* in the debt levied upon, based upon whether the debtor's right of setoff had matured and could have served as a defense under state law at *the date of levy*;²⁹² but others consider the rights of the parties with regard to setoff as fixed when the *lien* arises and attaches to the debt.²⁹³ In bank cases the setoff has lately been viewed, not as limiting the depositor's property right in his account, but as constituting an "inchoate lien" securing the bank's claim against the depositor.²⁹⁴ Even viewed as a lien, the bank's setoff right may be in a stronger position under the 1966 Act than it used to be, if the setoff

903, 910 (6th Cir. 1965) (holding that even a levy amounts to no more than a perfection of the lien by seizure and does not make the Government the owner).

290. 84 A.B.A. REP. 697-98, 726-27 (1959). An exception would be made for instances in which payment was made or a defense or setoff was acquired in bad faith, in order to aid the taxpayer in hindering, evading or defeating collection of the tax.

291. See PLUMB & WRIGHT 121-25; Dunker, *The Contractual Right of Set Off: Its Effectiveness with Respect to Advances to Agents*, 20 PROC. ASS'N. LIFE INS. COUNSEL 79, 109-24 (1967).

292. *United States v. Raley Contracting Co.*, 210 F. Supp. 54 (N.D. Miss. 1962). Early cases took the same position with respect to bank setoff. *United States v. Bank of Shelby*, 68 F.2d 538 (5th Cir. 1934); *United States v. Bank of United States*, 5 F. Supp. 942 (S.D.N.Y. 1934).

293. *United States v. Graham*, 96 F. Supp. 318 (S.D. Cal. 1951), *aff'd sub nom. California v. United States*, 195 F.2d 530 (9th Cir. 1952), *cert. denied*, 344 U.S. 831 (1952); *In re City of New York (DeKalb Ave. Reconstruction)*, 11 App. Div. 2d 240, 205 N.Y.S.2d 125 (1960), *aff'd per curiam*, 12 N.Y.2d 1051, 190 N.E.2d 250 (1963); see the conceptual conflict discussed at pp. 1158, 1159 *supra*.

294. On that ground, the unexercised right of setoff was held ineffective against the tax levy, whether the right came into existence only as a result of the levy itself, *Bank of Nevada v. United States*, 251 F.2d 820 (9th Cir. 1957), *cert. denied*, 356 U.S. 938 (1958), or had already matured but had not been exercised before the levy, *Bank of America v. United States*, 345 F.2d 624 (9th Cir. 1965), *aff'g* 229 F. Supp. 906 (S.D. Cal. 1964), *cert. denied*, 382 U.S. 927 (1965). Cf. the comment of Prof. Gilmore in 1 SECURITY INTERESTS IN PERSONAL PROPERTY § 10.7, at 315-16 (1965).

right can satisfy the revised requirements for "choateness" of a security interest²⁹⁵—*i.e.*, if (1) the right is provided by contract and not merely by law;²⁹⁶ (2) the loan was made before the filing of the tax lien, or possibly within 45 days thereafter without actual knowledge thereof;²⁹⁷ and (3) the deposits in the account, against which setoff is sought, were made before the tax lien was filed.²⁹⁸ The banks quite naturally regard such restrictions, requiring frequent searches for tax liens, as an unwarranted impediment to their business and a threat to the security of their unsecured loans. But it is unlikely that the Treasury would ever acquiesce in setoff legislation if it made no exception for the situation where, until the bank takes affirmative action, the depositor is privileged to withdraw his funds at will for any purpose (including voluntary payment of his federal taxes).²⁹⁹

C. Remedies of Purchaser at Tax Sale

Tax sales are notoriously subject to the rule of *caveat emptor*,³⁰⁰ and federal tax sales pursuant to administrative levies are no exception. The purchaser, it is true, has some protection. The law makes the certificate of sale of *personal* property *prima facie* evidence of the right of the officer to make the sale, and conclusive evidence of the regularity of his proceedings in making the sale.³⁰¹ Although that conclusiveness

295. Under prior law, an unexercised right of setoff was given the protection accorded to a "pledgee" (now translated, "holder of a security interest"), as against subsequently filed tax liens. *United States v. Harris*, 249 F. Supp. 221 (W.D. La. 1966).

296. By federal definition, a "security interest" arises by contract, in contrast to a mere lien, which is provided by law. INT. REV. CODE OF 1954, § 6323(h)(1).

297. The 45-day leeway would apply only if there was a loan agreement, antedating tax lien filing, which is effective under local law to make the bank's right to offset later advances superior to intervening judgment liens. INT. REV. CODE OF 1954, § 6323(d).

298. INT. REV. CODE OF 1954, § 6323(d)(1)(A)—(h)(1)(A). This may involve a problem of tracing—*i.e.*, whether the amounts in the account are the earliest or the latest deposits. But at least the minimum balance which the loan agreement requires to be maintained should be protected.

299. In one of the cases that provoked the Government to take a strict position on bank setoff, it is understood that a succession of levies had been made on the account, and each time the bank asserted that, in view of its right to set off an outstanding note, there was no debt due to the depositor; but the setoff was not in fact made, and the bank allowed the depositor to continue to enjoy the benefit of the account. From the bank's viewpoint, it may be said that the bank was merely extending a fluctuating line of credit to the taxpayer, equal to the net excess of the note over the deposit, and that the Government should not complain if, after levy, the bank permitted him to increase the net debt by drawing on the account. See *United States v. Bank of United States*, 5 F. Supp. 942, 945 (S.D.N.Y. 1934), characterizing the privilege of withdrawal as a mere "revocable license." But it is difficult to justify giving such security a more favored position than commercial and other security interests, with respect to loans and deposits made after filing of a tax lien.

300. See 85 C.J.S. *Taxation* § 905b (1954); *cf. Waples v. United States*, 110 U.S. 630 (1884); *The Monte Allegre*, 22 U.S. (9 Wheat.) 616, 644 (1824).

301. INT. REV. CODE OF 1954, § 6339(a)(1). A deed of realty sold under levy, on the other hand, is merely "*prima facie* evidence of the facts therein stated." *Id.* § 6339(b)(1).

does not extend to the regularity of the prior notice of the sale, the sale will ordinarily be set aside for such a defect only upon the condition that the taxpayer repay the purchase price, which was applied on his tax liability.³⁰² The validity and finality of the sale are not affected if the taxpayer is later found not to have owned the tax.³⁰³ But, since the sale is made without warranty and purports to pass no more than the taxpayer's right, title and interest in the property, subject to all liens and interests which are superior to the tax lien,³⁰⁴ the purchaser cannot demand a clear title;³⁰⁵ nor apparently can he be reimbursed for his loss if the title is defective or unexpectedly encumbered, unless perhaps on the ground of mutual mistake if the property sold proves not to have been property subject to the lien at all.³⁰⁶

If the Government has advance knowledge of an adverse claim which it disputes, it may elect to set the matter at rest by judicial foreclosure of the tax lien,³⁰⁷ which is an *in rem* proceeding that normally sets at rest all possible claims to the property.³⁰⁸ But that procedure may be time-consuming and costly, and the Government is unlikely to resort to it if the adverse claim appears frivolous or if the property is not of substantial value. The property may be sold administratively, free of an adverse claim, if the claimant agrees to the transfer of the liens to the sale proceeds, subject to later litigation.³⁰⁹ The adverse claimant may seek to block the sale and recover the property by himself initiating litigation before sale.³¹⁰ The claimant, however, may not know of the proposed administrative sale in time to assert his interest, or he may content himself with announcing his claim at the sale.

302. *Margiotta v. District Director*, 214 F.2d 518 (2d Cir. 1954). If the taxpayer does not complain of the tax collector's noncompliance with a requirement imposed for the taxpayer's protection, the tax collector cannot avail of that irregularity as an excuse to take back and resell the property. *Bartell v. Riddell*, 202 F. Supp. 70 (S.D. Cal. 1962).

303. *Gottlieb v. Cohen*, 93 Ga. App. 268, 91 S.E.2d 362 (1956).

304. INT. REV. CODE of 1954, § 6339; *Mansfield v. Excelsior Ref. Co.*, 135 U.S. 326 (1890).

305. *United States v. Pee Dee Coach Lines*, 55-2 U.S. Tax Cas. ¶ 9650 (E.D.S.C. 1955). Ordinarily, if the Government agrees with the purchaser's position concerning the extent of the title conveyed, it will, without indemnifying him, render him informal assistance in his contest with adverse claimants. *E.g.*, *Atlas Fin. Co. v. Wilkerson*, 382 S.W.2d 529 (Tenn. 1964) (amicus curiae brief filed). If the purchaser loses out, his remedy, if any, would appear to be against the taxpayer, whose debt he satisfied. *Cf.* *United States v. Duncan*, 25 F. Cas. 927, 930 (No. 15,003) (C.C. Ill. 1850); *Lewark v. Carter*, 117 Ind. 206, 20 N.E. 119, 120 (1889).

306. *Sandri v. United States*, 266 F. Supp. 139 (D. Mass. 1967).

307. INT. REV. CODE of 1954, § 7403.

308. *See United States v. Stock Yards Bank*, 231 F.2d 628, 631 (6th Cir. 1956); *cf. United States v. Metropolitan Life Ins. Co.*, 256 F.2d 17, 24 (4th Cir. 1958). Absent claimants not personally served are bound, subject to their right to reopen the decree within one year. 28 U.S.C. § 1655 (1964).

309. INT. REV. CODE of 1954, §§ 6325(b)(3), 7426(a)(3)—(b)(4).

310. INT. REV. CODE of 1954, § 7426(b)(1)—(2); see pp. 1163-66 *infra*.

The risk of such claims, known and unknown, as a result of which the purchaser may lose the property or have to pay an additional amount to clear the title,³¹¹ naturally depresses the prices which can be obtained at sales under levy. The resulting sacrifice of values may reduce the Government's recovery, and thus add to the burdens of an already distressed delinquent taxpayer. The more frivolous or unwarranted the claim may be, the greater the injustice of selling the property with the threat unresolved. Only the speculator (or in some cases the taxpayer, through a relative or friend) can benefit from a system in which uncertain titles are thus sold.

Better prices might be obtained if the law afforded the purchaser more assurance of what he was getting at a sale under levy. Instead of offering merely whatever title the taxpayer may own, the tax collector might be required to make a representation (not a warranty) concerning the extent of the title being sold and the prior liens to which it is recognized to be subject. Then, if the title fell short of the representation, the purchaser could be given a remedy against the Government for his loss (including a right to implead the Government in any suit by an adverse claimant); his recovery should be limited, however, to the proceeds which the Government had retained.³¹² The tax collector could then recoup from other property of the taxpayer, the inadequacy of whose title to the first property caused the loss.³¹³ While there may be practical impediments of which I am unaware, the proposal at least merits serious study.³¹⁴

D. Remedies of True Owner

One of the important but less noticed aspects of the Federal Tax

311. *Sheridan v. Allen*, 153 F. 568 (8th Cir. 1907).

312. I cannot imagine the Government being willing to go further and make a warranty sale, in which it might incur liability greater than the amount it had collected.

313. Suspension of the statute of limitations could be provided, as was done in connection with the related problem of wrongful seizure of a third party's property, in INT. REV. CODE of 1954, § 6503(g), added by the Federal Tax Lien Act of 1966.

314. The proposal was submitted to the Special Committee on Federal Liens of the American Bar Association, which made no recommendation, believing itself unqualified to assess the administrative considerations involved. 84 A.B.A. REP. 680 (1959). With respect to the rule of *caveat emptor* at mortgage foreclosure sales, it has been said that "a would-be purchaser . . . must either make an intensive title search before bidding on property he has no assurance of acquiring or else forego bidding except at a figure that would take into account the hazard he runs. Usually the first course is impracticable, and the second is sure to dampen bidding and result in sacrificing the property at a price below that normally attendant upon a forced sale. The better practice, therefore, is to purport to sell a clear title except as to paramount interests in the property which are definitely stated in the . . . notices of sale." 4 AMERICAN LAW OF PROPERTY § 16.195, at 469 (A. J. Casner ed. 1952). A perhaps unique instance in which Congress determined to indemnify purchasers (of "land sold for direct taxes in the insurrectionary states") is found in the Act of May 9, 1872, ch. 145, § 2, 17 Stat. 69.

Lien Act of 1966 was the codification of the procedural rights of third parties whose property is seized or threatened with seizure for the tax liabilities of another. For generations the law had clearly delineated the procedures by which a taxpayer might litigate his rights, but the law was silent concerning the remedies of innocent third parties, whose claims were therefore often defeated or delayed by procedural technicalities³¹⁵—e.g., that the United States had not consented to be sued,³¹⁶ that the district director could not be sued because he was acting within the scope of his duties³¹⁷ or had paid the proceeds into the Treasury,³¹⁸ or that federal jurisdiction was lacking.³¹⁹ The new law, in which Congress has given its consent to suit *against the United States* in the federal district courts whenever the property of one person has been levied upon or sold for the taxes of another,³²⁰ marks a major step forward, but in a number of respects the relief obtainable in such a suit falls short of the reform which the American Bar Association has sought.³²¹

In such an action, the court may enjoin the enforcement of the levy on, for example, a bank account or may prohibit the sale of the property levied upon, provided the third party shows that he has rights superior to the tax lien and that these rights would be irreparably injured.³²² Injunctive relief cannot be obtained *in advance* of levy, however, even though the mere assertion of a tax lien or the threat of a levy may be injurious to the third party.³²³ If seizure has occurred,

315. H.R. REP. NO. 1884, 89th Cong., 2d Sess. 27 (1966).

316. *Phillips v. United States*, 346 F.2d 999 (2d Cir. 1965); *Trustees of Puritan Church v. United States*, 294 F.2d 734 (D.C. Cir. 1961); *First Nat'l Bank v. United States*, 265 F.2d 297 (3d Cir. 1959); *Nehf v. United States*, 67-2 U.S. Tax Cas. ¶ 9755 (N.D. Ill. 1967).

317. *Bershad v. Wood*, 290 F.2d 714 (9th Cir. 1961).

318. *Maule Indus., Inc. v. Tomlinson*, 244 F.2d 897 (5th Cir. 1957).

319. *Morris v. United States*, 303 F.2d 533 (1st Cir. 1962); *Johnston v. Earle*, 245 F.2d 793 (9th Cir. 1957).

320. INT. REV. CODE OF 1954, § 7426. No dollar limit is imposed on the district court's jurisdiction. 28 U.S.C. § 1346(e) (Supp. II, 1965-66). Venue lies in the district where the property was situated at the time of the levy, or (if no levy was made) in the district where the event occurred giving rise to the cause of action. 28 U.S.C. § 1402(c) (Supp. II, 1965-66).

321. 84 A.B.A. REP. 699, 728 (1959).

322. INT. REV. CODE OF 1954, § 7426(b)(1).

323. Suit under § 7426 may be brought only after levy, although surrender of the property need not have occurred. INT. REV. CODE OF 1954, § 7426(a)(1). Injunctions are prohibited except pursuant to § 7426. *Id.* § 7421(a). The rule was the same under prior law, *Moore v. Hansen*, 325 F.2d 784 (5th Cir. 1954), but the American Bar Association had recommended that an injunction or declaratory judgment be obtainable by a third party whether levy had been made or was merely threatened. 84 A.B.A. REP. 699 (1959). In some circumstances, independently of § 7426, relief may be obtainable in advance of levy by suit to quiet title or for a declaratory judgment, but subject to such procedural uncertainties that it might be better to wait for the levy. See PLUMB & WRIGHT 221-22. A recent case holds declaratory relief impliedly prohibited in circumstances where the law now bars injunctions. *Jules Hairstylists v. United States*, 268 F. Supp. 511 (D. Md. 1967),

the court may order the return of the money or of the specific property levied upon.³²⁴ If the property has already been sold, however, the third party may recover no more than the amount realized by the United States from the sale.³²⁵ Thus, the innocent third party is not only denied recovery for the damages from being unlawfully deprived of the use of the property,³²⁶ but he cannot even be made whole for the actual value of the property taken.³²⁷ The new law makes no provision for relief if the third party's property is lost, injured, or destroyed while in the custody of the tax collector.³²⁸ Nor does the Act provide for recovery in cases where a third party's money or property has been delivered to the tax collector without formal levy by a person having no right to do so.³²⁹

aff'd per curiam, 68-1 U.S. Tax Cas. ¶ 9207 (4th Cir. 1968). *But cf.* *King v. United States*, 68-1 U.S. Tax Cas. ¶ 9237 (Ct. Cl. 1968), which distinguishes declaratory relief (not directly involving the merits of a tax) from the "coercive" form of equitable relief against the United States which the statute restricts.

324. INT. REV. CODE of 1954, § 7426(b)(2)(A)—(B).

325. INT. REV. CODE of 1954, § 7426(b)(2)(C). The effect of this provision is uncertain, in view of the fact that the purchaser at the tax sale acquires only the taxpayer's right, title and interest in the property, *see* p. 1162 *supra*, and the owner has a remedy to recover the property from the purchaser, if he can find him. Under prior law the Government successfully contended that the owner thus lost nothing by the sale and could not recover the proceeds. *Horvitz v. Granger*, 134 F. Supp. 957 (W.D. Pa. 1955). Recovery against the United States under the new law, however, apparently is not meant to be conditioned on inability to recover the property from the purchaser (as it would have been under the American Bar Association proposal, *infra* note 327).

326. Such damages may not be recovered by the third party under the Tort Claims Act. *United States v. One 1951 Cadillac Coupe de Ville*, 125 F. Supp. 661, 663 (E.D. Mo. 1954). *See* pp. 1151-52 *supra*. The Special Committee on Federal Liens, not wishing to bite off too much at one time, refrained from recommending to the American Bar Association that "general liability of the United States for damages suffered" by the third party be provided, in view of "the past unwillingness of Congress to extend the Tort Claims Act to torts committed in enforcing the tax laws (questionable policy though that may be)." Instead, the committee would leave that matter to "the 'common law' liability of the officer committing the wrong" and to his right of indemnity from the United States. 84 A.B.A. REP. 728 (1959). In view of later decisions extending absolute immunity to the officer (*see* authorities cited note 251 *supra*; *PLUMB & WRIGHT* 219-21), further consideration should be given to permitting recovery of such damages from the United States. *See* note 263 *supra*.

327. *Cf.* note 260 *supra*, concerning similar losses of taxpayers against whom tax is erroneously assessed. The American Bar Association proposal would have permitted recovery of the value of the third party's property, but only if the owner was unable to recover the property from the purchaser or another person. 84 A.B.A. REP. 699, 728-29 (1959).

328. The American Bar Association recommended that the value of the property be recoverable in such a case. 84 A.B.A. REP. 699, 728 (1959). Concerning the possibility of relief under existing law, *see* note 234 *supra*.

329. Relief may be obtainable, however, without reference to the 1966 Act. Although the United States in such cases has been held not subject to suit (for conversion) under the Tort Claims Act, even if the tax collector is alleged to have known that the taxpayer was wrongfully using another's money or property to pay his taxes (*Broadway Open Air Theatre v. United States*, 208 F.2d 257 (4th Cir. 1953); *United States v. Worley*, 213 F.2d 509, 512 (6th Cir. 1954), *cert. denied*, 348 U.S. 917, 918 (1955)), there may be a remedy in implied contract, *cf.* *United States v. State Bank*, 96 U.S. 30 (1878), subject to the jurisdictional limitation of 28 U.S.C. § 1346(a)(2) (1964) if the suit is in the district court.

Consideration should be given to remedying those deficiencies in the Act. At the same time, Congress might consider whether the Act went too far in permitting the third party to sue without first seeking relief at the administrative level.³³⁰ Although the Act thus conforms with the American Bar Association's recommendation that suit by a third party be permitted without delay for prior administrative consideration, in order that it might be known as quickly as possible whether the disputed seizure had in fact satisfied the taxpayer's account,³³¹ the provision may be at cross purposes with the 1966 action of Congress in making prior administrative consideration a condition precedent to Tort Claims Act suits in an effort to minimize unnecessary litigation.³³²

E. Remedies of Senior Lienor³³³

The remedies which the Federal Tax Lien Act of 1966 provided for third parties are available to senior lienors as well as to owners of the property levied upon.³³⁴ Therefore, if the tax collector levies upon accounts receivable or other debts on which a creditor of the taxpayer holds a prior lien or security interest, the creditor can recover from the Government any amounts wrongly collected. And, if the circumstances are such that collection by the Government would cause irreparable injury, the senior lienor may be entitled to an injunction.³³⁵

Tri-State Ins. Co. v. United States, 129 F. Supp. 115 (W.D. Okla. 1955). There may also be a remedy against the tax collector. *Pasadena Invest. Co. v. Pasadena Air Prods., Inc.*, 234 F. Supp. 128, 132 (S.D. Calif. 1964). If the tax collector was not aware of the taxpayer's wrongful use of a third party's property, however, no recovery can be had (the third party's only remedy being against the wrongdoer). *J.C. Pitman & Sons v. United States*, 317 F.2d 366 (Ct. Cl. 1963); *Schieck v. United States*, 66-1 U.S. Tax Cas. ¶ 9388 at 85,897 (D. Wyo. 1966). The proposal of the American Bar Association would have permitted suit against the United States, without jurisdictional limitation, whenever "property [including money] has been delivered to the Secretary or his delegate with or without levy, by a person having no right to do so." But the relief permitted in such cases was no broader, and may have unintentionally been narrower than under present law, being confined to the return of money or property "wrongfully seized or wrongfully demanded and paid for the discharge of a lien," or the value of property "unlawfully sold." 84 A.B.A. REP. 699 (1959) (emphasis added).

330. INT. REV. CODE of 1954, § 7426(f). Administrative relief from the Secretary, however, may be sought if desired. *Id.* § 6343(b). See H.R. REP. No. 1884, 89th Cong., 2d Sess. 77 (1966).

331. 84 A.B.A. REP. 729 (1959) states that requirement of an administrative claim would "serve only to delay a matter that would already have been administratively considered and which ought to be resolved by litigation as quickly as possible."

332. 28 U.S.C. §§ 2672, 2675 (Supp. II, 1965-66). See S. REP. No. 1327, 89th Cong., 2d Sess. (1966).

333. The term "senior lienor" is here used to embrace holders of mortgages, deeds of trust, commercial security interests, and statutory and common law liens, which have priority over the federal tax lien.

334. INT. REV. CODE of 1954, § 7426(a).

335. Injunction was granted under prior law in *Tomlinson v. Smith*, 128 F.2d 808 (7th Cir. 1942), but INT. REV. CODE of 1954, § 7421(a), would now permit it only if the conditions of Section 7426 were satisfied. It is not enough that the plaintiff's lien is superior

1. *Seizure and Sale by the Tax Collector*

In the case of those levies that must be enforced by sale, however, a senior lienor would only rarely be entitled either to an injunction³³⁶ or to any part of the sale proceeds,³³⁷ since the existence of a senior lien does not make a federal tax levy "wrongful," and since the sale of all the taxpayer's right, title and interest is considered to leave the senior lien unimpaired.³³⁸ Nevertheless, a sale of property under levy will sometimes cause serious prejudice to a senior lienor's rights for which present law appears to afford him no remedy. Thus, when the tax collector sells chattels under levy, the senior lienor may have no knowledge of the sale and may be unable to trace the purchaser. The law should require the tax collector to keep a record of purchasers of personal property, and to make such information available to anyone claiming an interest in or lien on the property sold.³³⁹ When the United States itself is the purchaser, the senior lienor, if he is required under state law to proceed by judicial foreclosure, may be without a remedy to divest the inferior equity until such time as the property has been resold by the Government to a private party.³⁴⁰ Although, as we shall see in a moment, the United States has consented to be joined as a defendant in a suit to foreclose a lien or mortgage on property whenever it holds or claims another *lien or mortgage* on such property, and has consented to the extinguishment of an *unfiled*

and that he would suffer irreparable injury, *id.* § 7426(b)(1), unless the levy is also *wrongful*. *Id.* § 7426(a)(1). In view of Section 6331(a), the mere existence of a senior lien would not seem to make the levy wrongful, provided the senior lienor's share is paid over to him.

336. The injunction granted, under prior law, in *Rosenthal & Rosenthal, Inc. v. United States*, 63-2 U.S. Tax Cas. ¶ 9819 (E.D.N.Y. 1963), apparently rested upon the fact that under New York law the chattel mortgagee had become the *owner* of the property upon default.

337. *Pargament v. Fitzgerald*, 272 F. Supp. 553, 555 (S.D.N.Y. 1967), *aff'd per curiam*, 68-1 U.S. Tax Cas. ¶ 9301 (2d Cir. 1968). Cf. *National Dairy Prods. Corp. v. O'Connell*, 66-2 U.S. Tax Cas. ¶ 9598 (D.R.I. 1966), in which such defense was not passed on because the court found (prior to the 1966 Act) that there was no consent to suit.

338. INT. REV. CODE of 1954, §§ 6331(a), 6339.

339. In *Pargament v. Fitzgerald*, 272 F. Supp. 553 (S.D.N.Y. 1967), *aff'd per curiam*, 68-1 U.S. Tax Cas. ¶ 9301 (2d Cir. 1968), the prior chattel mortgagee was unable to locate the purchaser, and the tax collector refused to disclose information concerning his identity. The court held that notice of sale is required to be given only to the owner or possessor, INT. REV. CODE of 1954, § 6335, that a record of the purchaser's name is required to be made only in the case of a sale of real property, *id.* § 6340, and that the Internal Revenue Service had no duty to preserve or make available information concerning the purchaser of chattels.

340. See *United States v. Alabama*, 313 U.S. 274 (1941). The senior lienor would have no right to recover the property from the Government under new Section 7426(b)(2) of the 1954 Code, because the levy would not have been "wrongful." See note 337 *supra*. But he might assert a right under the Fifth Amendment to just compensation for the "taking" of his lien (even though not wrongfully) by destruction of the normal remedy for its enforcement. *Armstrong v. United States*, 364 U.S. 40 (1960).

tax lien even without such joinder,³⁴¹ no similar consents have been given where the United States holds *title* to the property, whether recorded or unrecorded.³⁴² Anomalously, the senior lienor who is privileged to proceed by *nonjudicial* sale is permitted thereby to divest not only a federal tax lien but a title derived by the United States from the enforcement of a tax lien, if the lien or title was not timely filed or recorded, or if the senior lienor gives the Government timely notice of the sale.³⁴³ The same principle should, as the American Bar Association recommended, be applied to judicial foreclosures of property to which the United States has acquired title by enforcement of a lien.³⁴⁴

2. Foreclosure of the Senior Lien

The judicial or nonjudicial procedures provided under local law by which the holder of a senior mortgage or other lien may foreclose the interests of the debtor and of junior lienors may not suffice to extinguish a junior *federal* lien, unless the senior lienor complies with the further requirements prescribed by Congress for the protection of the Government.³⁴⁵ Those requirements, so far as they relate to the extinguishment of federal *tax* liens, were much altered by the 1966 legislation and have heretofore been outlined in the First Installment, in connection with a recommendation that the changes be made applicable also to the discharge of junior federal mortgages and nontax liens.³⁴⁶ I shall deal here only with certain improvements that might be made in the procedures as they apply to the removal of federal tax liens.³⁴⁷

341. INT. REV. CODE of 1954, § 7425(a)(2); 28 U.S.C. § 2410 (Supp. II, 1965-66); *see* p. 1169 *infra*.

342. *Trustees of Puritan Church v. United States*, 294 F.2d 734 (D.C. Cir. 1961); *Slissman v. Chicago Title & Trust Co.*, 375 Ill. 514, 32 N.E.2d 132 (1941); *Wells v. Long*, 68 F. Supp. 671 (D. Idaho 1946), *aff'd on other grounds*, 162 F.2d 842 (9th Cir. 1947); *cf.* *Waldoch v. Taylor*, 58-1 U.S. Tax Cas. ¶ 9291 (N.D. Ill. 1958).

343. INT. REV. CODE of 1954, § 7425(b)(2).

344. 84 A.B.A. REP. 737, 740 (1959).

345. Even if the foreclosure failed to conform to the federal requirements, the priority of the lienor or purchaser would be honored in a later proceeding, to the extent of the amount of the prior mortgage or lien. But the Government would get the benefit of any interim appreciation in value. *Miners Sav. Bank v. United States*, 110 F. Supp. 563 (M.D. Pa. 1953); *Bank of America v. United States*, 84 F. Supp. 387 (S.D. Cal. 1949).

346. *See* First Installment, pt. III.B.2. *See also* PLUMB & WRIGHT, ch. 8.

347. It should be pointed out that most of the procedural problems here discussed could ordinarily be avoided by a knowledgeable senior lienor by first obtaining an administrative discharge of the tax lien. INT. REV. CODE of 1954, § 6325(b)(2); Tech. Info. Rel. No. 10, CCH 1956 STAND. FED. TAX REP. ¶ 6578; *see* PLUMB & WRIGHT 226-27. Even if priorities are in dispute, delay of the sale can be avoided by agreement that the sale be made free of liens, subject to later litigation over the proceeds. INT. REV. CODE of 1954, §§ 6325(b)(3), 7426(a)(2)-(b)(4). *See* Temp. Treas. Reg. § 400.2-1(b), T.D. 6944, 1968 INT. REV. BULL. No. 8, at 29; Rev. Proc. 68-9, 1968 INT. REV. BULL. No. 8, at 46.

a. *Judicial Foreclosure*

When a mortgage or lien senior to a federal tax lien is foreclosed by plenary judicial proceedings,³⁴⁸ the federal tax lien may be extinguished by making the United States a party defendant.³⁴⁹ If the United States is *not* made a party, the judgment or sale (regardless of state law to the contrary) will not disturb any federal tax lien which was duly filed *before the commencement* of the proceeding, but it will discharge any other such liens—not only after-arising liens, but existing estate or gift tax liens for which the law makes no provision for filing.³⁵⁰ The Government may, however, assert such liens without time limitation by intervening in the proceeding; and if the court declines to permit intervention—*e.g.*, because it comes so late that it would unduly delay the proceeding or otherwise prejudice the parties—the effect which the adjudication would otherwise have had in discharging such liens will be nullified.³⁵¹ The law ought to provide that, after a certain point of time, intervention should entitle the Government only to claim a share of the proceeds, without delaying the course of the proceedings.³⁵²

If the senior lienor *does* make the United States a party for the purpose of removing some previously filed or recorded tax or nontax lien, the law is not so clear that federal tax liens which may arise or be filed after the commencement of the proceeding will be discharged. The

348. The term "plenary judicial proceeding" as used here does not denote the enforcement of a judgment lien, including a sale under confession of judgment on a mortgage or note. Such a sale may technically be a judicial sale under local law, *e.g.*, *United States v. Brosnan*, 363 U.S. 237, 250 (1960), but in this context it is treated as a nonjudicial sale. Temp. Treas. Reg. § 400.4-1(a)(1)-(b), T.D. 6944, 1968 INT. REV. BULL. No. 8, at 33.

349. 28 U.S.C. § 2410 (Supp. II, 1966). Although one court narrowly construed the Government's consent to be joined in a suit to "foreclose" a mortgage or lien as not embracing a suit to "enforce" a lien, *Lavenburg v. Universal Sportswear, Inc.*, 92 F. Supp. 473 (S.D.N.Y. 1950), Congress ignored the American Bar Association's recommendation that such interpretation be forestalled by using the words "enforcement or foreclosure." 84 A.B.A. REP. 739 (1959). Despite some expressions to the contrary, it seems clear that a foreclosure suit joining the United States under Section 2410 must be brought in the state court in the absence of grounds of federal jurisdiction independent of the fact that the United States has or claims a lien. *Shaw v. United States*, 331 F.2d 493, 496 (9th Cir. 1964); *Remis v. United States*, 172 F. Supp. 732 (D. Mass. 1959), *aff'd*, 273 F.2d 293 (1st Cir. 1960). See PLUMB & WRIGHT 222. Although the Government is entitled to remove the suit to the federal court, 28 U.S.C. § 1444 (1964), it rarely does so unless some issue of federal law, such as the merits of the tax, is expected to arise. See pp. 1149-50 *supra*. The suggestion that the federal courts be given original jurisdiction in such cases, *Nelson, Sovereign Immunity and Federal Liens*, 26 BROOKLYN L. REV. 18, 37-38 (1959), seems unwise. The federal courts ought not to be burdened unnecessarily with mortgage and lien foreclosure cases, in which the essential questions ordinarily involve state law and the relative priorities of private interests.

350. INT. REV. CODE OF 1954, § 7425(a).

351. INT. REV. CODE OF 1954, § 7424. The Government may then remove the action to the federal court as if it had originally been named a party.

352. See Meislin, *Federal Tax Liens: Government Joinder in State Mortgage Foreclosure*, 46 VA. L. REV. 926, 931-43 (1960).

subjection of federal liens to the *lis pendens* doctrine is uncertain, in the absence of express statute.³⁵³ The statute consenting to the joinder of the United States provides for the discharge, in accordance with local law, of "the mortgage or other lien held by the United States."³⁵⁴ But it goes on to prescribe that the complaint or pleading "set forth with particularity the nature of the interest or lien of the United States," and it might conceivably be held that only those so pleaded are discharged,³⁵⁵ thus putting the senior lienor in a worse position than if the United States had not been joined as a party at all.³⁵⁶ This apparent hiatus in the law should be remedied by prescribing only that liens duly filed before the proceeding be set forth in the pleading, and providing for the discharge of any others even though not pleaded.

b. *Nonjudicial Foreclosure*

In many states a mortgage or deed of trust may be enforced by a nonjudicial sale, or by a sale under confession of judgment, without need for a plenary foreclosure suit in which junior lienors are joined. That is also the common method of enforcing pledges and certain statutory and common law liens. Formerly, in the silence of Congress, a divided Supreme Court held that a junior federal lien could be cut off by such a sale, even without notice to the Government.³⁵⁷ The Treasury sought and obtained relief from Congress, in the form of a right to 25 days' written notice of such a sale whenever it has a *tax* lien or a title derived from the enforcement of such a lien,³⁵⁸ provided its lien or title was filed or recorded more than 30 days before the sale.³⁵⁹

353. In *United States v. White Bear Brewing Co.*, 350 U.S. 1010 (1956), *rev'g per curiam* 227 F.2d 359 (7th Cir. 1955), the *lis pendens* doctrine (see J. POMEROY, *EQUITY JURISPRUDENCE* §§ 632, 635 (5th ed. 1941)) did not suffice to protect a mechanic's lienor who had commenced suit to foreclose before the federal tax lien arose. But that case turned on the fact that the federal lien, although later in time, was prior in right to the mechanic's lien. Where the federal lien is junior, *United States v. Brosnan*, 363 U.S. 237, 250 (1960), applied *lis pendens* against the Government, in the silence of Congress. See PLUMB & WRIGHT 229.

354. 28 U.S.C. § 2410(c) (1964).

355. 28 U.S.C. § 2410(b) (1964). Since the general language above quoted is followed by the requirement of *additional* information "if a notice of tax lien was filed," it is inferable that the "nature" even of those liens which are not on file must somehow be pleaded "with particularity." A generalized allegation might be accepted by the courts with respect to unfilled liens. *City of Yonkers v. Goldstein*, 55-1 U.S. Tax Cas. ¶ 11,517 (S.D.N.Y. 1955); *Blinn v. Bowdren*, 198 Misc. 254, 97 N.Y.S.2d 146 (N.Y. Sup. Ct. 1950).

356. See PLUMB & WRIGHT 228-30. INT. REV. CODE OF 1954, § 7425(a)(2), which discharges liens not filed before the proceeding, applies only if the United States is *not* joined as a party.

357. *United States v. Brosnan*, 363 U.S. 237 (1960).

358. INT. REV. CODE OF 1954, § 7425(b)—(c). No like change was made with respect to federal nontax liens.

359. The regulations have filled what might have been a troublesome gap in the stat-

If the tax lien or title was not so filed or recorded (whether or not the law provides for such filing or recording), the Government's interest will be extinguished without notice if that is the effect of local law.³⁶⁰

The brief interval between the 30th day before the sale (the earliest date when the final search for federal tax liens and titles can be made) and the 25th day before the sale (the latest date when notice of the sale can be given) allows the busy lawyer or title company very little time to make the requisite searches—perhaps in several offices—and to prepare and mail the notices of sale.³⁶¹ There is precedent elsewhere in the statute for allowing 45 days of grace,³⁶² and extension of the 30-day period to 45 days would provide welcome relief from the time pressure.

The real problem with the notice provision, however, is more fundamental. The requirement of 25 days' notice reflects an attempt to cover too many dissimilar situations under a uniform rule that fits none of them well. Notice of a sale enables the tax collector to drum up interest among potential bidders, to observe the fairness of the sale, and to reach the surplus proceeds, if any.³⁶³ Notice well in advance of the sale seems necessary only for the first of those purposes; but the tax collector is likely to utilize the opportunity to drum up bids only in the case of real property and certain business personal property, and in these cases 25 days may be too short to be meaningful.³⁶⁴ In the typical sale of pledged or repossessed consumer goods, there is unlikely to be a surplus, and the tax collector would rarely find it worth his while either to drum up bids or to observe the sale. A 25-day delay of the sale after default or repossession can sometimes be prejudicial to the holder of a security interest in personal property and should be required only if it serves a purpose. While the law provides that the tax collector may

ute, with regard to postponed sales. If, for example, a federal tax lien was filed 24 days before the date set for a sale (so that notice of the sale was not required to be given), and the sale was then postponed for a week (to a date 31 days after filing of the lien), a literal reading of the statute would require further postponement in order to give 25 days' notice of the sale. The regulations, however, waive notice in such circumstances, unless the postponement is for a period of more than 30 days. Temp. Treas. Reg. § 400.4-1(c)(2)(ii), T.D. 6944, 1968 INT. REV. BULL. No. 8, at 37.

360. INT. REV. CODE of 1954, § 7425(b)(2)(A)—(B).

361. Fortunately, the notice is considered filed on the day it is mailed, by registered or certified mail, INT. REV. CODE of 1954, § 7502, and Saturday, Sunday, or a legal holiday does not count if it falls on the last day. *Id.* § 7503; Temp. Treas. Reg. § 400.4-1(c), T.D. 6944, 1968 INT. REV. BULL. No. 8, at 36. But the six days can pass very quickly if a holiday weekend intervenes *before* the last day.

362. INT. REV. CODE of 1954, § 6323(c)(2)—(d).

363. The tax collector himself is without authority to bid at the sale.

364. The American Bar Association proposal, which originated with real estate lawyers, provided for 60 days' notice. 81 A.B.A. REP. 189 (1956); 84 A.B.A. REP. 738, 742 (1959). But Congress shortened the period in an effort to accommodate the needs of the personal property situation.

consent to an earlier sale,³⁶⁵ it may (at least in some offices) take as long to obtain the consent as to wait out the notice period. The law also dispenses with the 25-day delay in the case of property which is "liable to perish or become greatly reduced in price or value by keeping, or which cannot be kept without great expense."³⁶⁶ But the effectiveness of the sale to pass title free of the federal tax lien is then dependent on the correctness of the selling creditor's subjective view that the prescribed conditions are satisfied.³⁶⁷

Consideration should therefore be given to minimizing the advance notice period in all those situations where the time interval is unlikely to be useful to the tax collector, and lengthening the period in other cases where it would be helpful. If the required period of notice is to depend on subjective distinctions between classes of property (as under the present "perishable goods" rule), it seems desirable also to provide that the Government's remedy for inadequacy of the notice shall be only against the selling creditor, and that the innocent purchaser's title shall not be impaired if he behaved reasonably.³⁶⁸

c. *Foreclosure Without Sale*

In some jurisdictions, and in some circumstances, real estate mortgages, security interests in personalty, and statutory liens may be enforced by strict foreclosure, cutting off the interests of the debtor and of junior lienors without a sale, but subject to a limited right of redemption. Sometimes strict foreclosure requires judicial proceedings, but it may also be accomplished by taking possession or by publishing notice.³⁶⁹

When resort to the courts is necessary, the existence of a federal tax lien duly filed before commencement of the action would seem to preclude strict foreclosure. Neither a sale *nor a judgment* in an action to

365. INT. REV. CODE of 1954, § 7425(c)(2).

366. INT. REV. CODE of 1954, § 7425(c)(3). The provision finds a precedent in Section 9-504(3) of the Uniform Commercial Code, which adds a further exception for property "of a type customarily sold on an established market"—an exception which was also in the Bar proposal, 84 A.B.A. REP. 738 (1959), but which Congress did not adopt.

367. In the case of securities or motor vehicles, Section 6323(b)(1) and (2) would ordinarily protect the purchaser's title regardless of the sufficiency of the seller's notice to the Government. But purchasers of other personal property, even on a commodities market, would ordinarily enjoy no such protection. See Second Installment, 675. The regulations alleviate the problem by defining the qualified property in terms of the seller's "reasonable view" that the conditions are met. Temp. Treas. Reg. § 400.4-1(c)(2), T.D. 6944, 1968 INT. REV. BULL. No. 8, at 38.

368. Cf. UNIFORM COMMERCIAL CODE § 9-507(1).

369. See 4 AMERICAN LAW OF PROPERTY §§ 16.179-16.182 (A. J. Casner ed. 1952); 3 L. JONES, MORTGAGES, ch. 34 (8th ed. 1928); 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 44.3 (1965).

foreclose a mortgage or other lien can affect a federal tax lien filed before the action commenced if the United States is not made a party;³⁷⁰ and the United States has consented to be joined in a foreclosure proceeding only when a judicial sale is sought.³⁷¹ Conceivably, the senior lienor might first obtain strict foreclosure without joining the United States, and then bring an action to *quiet title*, in which the United States has consented to be joined even though sale is not sought.³⁷² But where the relief sought in a quiet title suit includes the extinguishment of a recognized junior lien, rather than merely an adjudication that there is no lien or that a previous proceeding had effectively extinguished it, the second action might well be regarded as in substance a foreclosure suit, in which a sale would be required, if the United States is to be made a party and bound by the decree.³⁷³

The law, on its face, seems to ignore the possibility that strict foreclosure might be effected nonjudicially as well as judicially. It provides that in the absence of requisite notice to the tax collector a nonjudicial *sale* shall not disturb a federal tax lien or title filed or recorded more than 30 days before the *sale*, but it says nothing one way or the other about the effect of a nonjudicial foreclosure without sale.³⁷⁴ In the absence of congressional action, it might be argued, therefore, that state law still governs the effect on the federal tax lien of such a foreclosure of a senior lien or security interest, as it did under prior law.³⁷⁵ In an effort to close that gap in the statute, the Treasury in its regulations has broadly construed the term "nonjudicial sale" to include "the divestment of the taxpayer's title to property which occurs by operation of law" upon the expiration of the taxpayer-debtor's right of redemption

370. INT. REV. CODE of 1954, § 7425(a)(1).

371. 28 U.S.C. § 2410(c) (1964).

372. *Id.*, see H.R. REP. No. 1884, 89th Cong., 2d Sess. 32 (1966); S. REP. NO. 1703, 89th Cong., 2d Sess. 34 (1966).

373. A quiet title suit, so employed, "embod[ies] all the essentials of an old-fashioned strict foreclosure." *Steffel v. Grissler*, 129 N.J. Eq. 425, 427, 19 A.2d 798, 799 (1941); *cf.* *Warner Bros. Co. v. Freud*, 138 Cal. 651, 72 P. 345 (1903). In *United States v. Morrison*, 247 F.2d 285, 289-91 (5th Cir. 1957), the court declared that an action to quiet title, within 28 U.S.C. § 2410 (1964), is not "one to *extinguish* the lien of the United States," but seeks "a determination that a tax lien does not exist, has been extinguished, or is inferior in rank." The court did acknowledge, however, that a tax lien might be extinguished in a quiet title suit if the court ascertained, without sale, that the value was such as to leave no equity for the Government (as in *Miners Sav. Bank v. United States*, 110 F. Supp. 563 (M.D. Pa. 1953)). Query, whether that would still be permitted in the face of the express requirement that "an action to foreclose a mortgage or other lien, naming the United States as a party under this section, must seek judicial sale." *Cf.* 84 A.B.A. REP. 738, 743 (1959), relating to proposed language differing materially from that which was finally adopted.

374. INT. REV. CODE of 1954, § 7425(b)(1).

375. *United States v. Brosnan*, 363 U.S. 237 (1960).

under state law in a nonjudicial strict foreclosure.³⁷⁶ The Treasury apparently hopes thus to assure itself at least of notice of the foreclosure and of an opportunity to redeem realty therefrom, even though it cannot under the statute insist that there be the kind of "sale" that might produce surplus proceeds for application on the tax lien.

Congress should clarify and make consistent the rules applicable to strict foreclosures. If a sale is thought essential to protect the Government's junior interest from being "harshly, and oppressively"³⁷⁷ extinguished by strict foreclosure, the law should specify that federal tax liens, duly and timely filed, shall not be disturbed by foreclosure without sale, whether the proceeding is judicial³⁷⁸ or nonjudicial. On the other hand, if the right of a senior mortgagee or other lienor under state law and the terms of his agreement to cut off his debtor's equity without sale is to be recognized as against a junior federal tax lien, subject only to the Government's right to notice and an opportunity to redeem, that principle should apply to judicial as well as nonjudicial strict foreclosures.

d. *Redemption by United States*

Formerly, in any judicial foreclosure in which the United States was joined, it was allowed one year in which to redeem *real property* from the sale, whether or not such right was granted generally to junior lienors under applicable local law.³⁷⁹ The right of redemption was originally (in 1931) considered necessary to protect the Government from a sacrifice sale of property which, if there were competitive bidding, might produce something for the junior federal lien. While like protection might have been achieved by permitting the federal collection officer to bid against the senior lienor at the foreclosure sale, that was not thought practicable where the Government did not have a first lien,³⁸⁰ because of the need for obtaining a Congressional appropriation of the amount of the cash price.³⁸¹ Subsequent experience with

376. Temp. Treas. Reg. § 400.4-1(b)(1)–(2), Example (3), T.D. 6944, 1968 INT. REV. BULL. No. 8, at 34.

377. 4 AMERICAN LAW OF PROPERTY § 16.179, at 433 (A. J. Casner ed. 1952).

378. Including a quiet title suit that goes beyond a declaration of existing rights. See note 373 *supra*.

379. United States v. John Hancock Mut. Life Ins. Co., 364 U.S. 301 (1960).

380. The right to bid is so limited by the last sentence of 28 U.S.C. § 2410(c) (1964).

381. The provision for redemption was added in conference as a substitute for a Senate amendment under which, in foreclosure suits in which the Government was joined, the sale itself might be stayed until the expiration of the next session of Congress, in order to allow Congress to appropriate money for a bid. H.R. REP. No. 2722, 71st Cong., 3d Sess. 4 (1931).

revolving fund appropriations, which can be used for purchases at foreclosure sales in the discretion of the proper officer and then replenished from the proceeds of disposition, is persuasive that redemption is not the only feasible way of meeting the problem. Federal officers are now permitted to bid when necessary at the foreclosure of certain junior *mortgages* in which the Government has an interest,³⁸² and in 1950 Congress accordingly felt free to eliminate in the most important of such cases the federal right of redemption, which it found depressed the price obtainable at the sale.³⁸³

About half the states (in numbers but not in population) likewise provide for a period following a foreclosure sale during which the debtor and usually the junior lienors may redeem the property.³⁸⁴ In those states the presence of a federal redemption right rarely adds to the problems that exist in any event. In the remaining states where redemption is not generally provided for, however, the existence of the rarely exercised federal redemption right creates a deterrent to outside bidding, and thus may have the opposite of its intended effect.³⁸⁵ The American Bar Association, therefore, has long urged that the special federal redemption right be abolished, and that the Government's interests be protected in less self-defeating fashion by broadening its right to bid at the sale.³⁸⁶

In enacting the Federal Tax Lien Act of 1966, Congress declined to eliminate the redemption right but, in cases where the federal interest is a *tax* lien,³⁸⁷ it shortened the redemption period from one year to 120 days (or the period provided by state law, if longer), which may

382. 7 U.S.C. § 1985(a) (1964); 38 U.S.C. § 1820(a)(5) (1964).

383. 12 U.S.C. § 1701k (1964); 38 U.S.C. § 1820(d) (1964); see S. REP. NO. 1286, 81st Cong., 2d Sess. 97 (1950).

384. 4 AMERICAN LAW OF PROPERTY §§ 16.175-16.177 (A. J. Casner ed. 1952); Bridewell, *The Effects of Defective Mortgage Laws on Home Financing*, 5 LAW & CONTEMP. PROB. 545, 548 (1938); Durfee & Doddridge, *Redemption from Foreclosure Sale—The Uniform Mortgage Act*, 23 MICH. L. REV. 825 (1925); Note, 5 U. CHL. L. REV. 625 (1938).

385. Cf. 4 AMERICAN LAW OF PROPERTY § 16.8 (A. J. Casner ed. 1952); Durfee & Doddridge, *supra* note 384, at 841 n.51 (declaring that the redemption right "caps the wall we have built to keep the public away from the public sale"). In a few of the states that do provide for statutory redemption, the redemption period *precedes* the sale; but the federal period *follows* the sale and thus has a cumulative effect. This is also true in the case of nonjudicial strict foreclosure, which the Treasury construes as resulting in a sale when the redemption period under state law expires, after which the federal period is added. See pp. 1173-74 *supra*.

386. 84 A.B.A. REP. 740, 742 (1959); cf. 81 A.B.A. REP. 189 (1956). In H.R. REP. NO. 2722, *supra* note 381, it was said that "the provision [for redemption] adds nothing to the present difficulties in States which allow no redemption period, as under present [pre-1931] conditions where present lien holders cannot sue the United States, the rights of the United States never are barred by foreclosure decree." The fact that an unconscionable situation was made no worse, however, is hardly sufficient justification.

387. The redemption period remains unchanged where the Government's interest is other than a tax lien. 28 U.S.C. § 2410(c) (1964).

lessen its price-depressing effect.³⁸⁸ On the other hand, Congress for the first time extended the redemption right to nonjudicial sales,³⁸⁹ and authorized a revolving fund appropriation to be used for redemptions,³⁹⁰ which may cause redemptions to occur more frequently than in the past. The new provision deserves a fair trial, but the practicability of doing away with the redemption right should be studied further.³⁹¹

The new law also for the first time prescribes the price which the Government must pay for redemption.³⁹² It is the sum of:

- (a) the actual amount paid by the purchaser at the sale (which, in the case of a purchaser who is the holder of the lien being foreclosed, includes "the amount of the obligation secured by such lien to the extent satisfied by reason of such sale");
- (b) six per cent interest on such amount; and
- (c) the excess, if any, of "the expenses necessarily incurred in connection with [the] property" over the income derived from the property, including its rental value if it is used by the purchaser himself.³⁹³

In permitting the Government to redeem from the senior lienor without paying off the full indebtedness (and thus leaving him to get satisfaction, if he can, through a deficiency judgment creating at best

388. INT. REV. CODE of 1954, § 7425(d)(1). If state law allows a longer period only to the debtor himself, and not to secured creditors, the Government may not avail of it. Temp. Treas. Reg. § 400.5-1(b)(2)(ii), T.D. 6944, 1968 INT. REV. BULL. No. 8, at 40.

389. INT. REV. CODE of 1954, § 7425(d). That the right probably did not exist in such cases under prior law, see First Installment, 298 n.433.

390. INT. REV. CODE of 1954, § 7810.

391. Conversations with Treasury officials indicate that the Internal Revenue Service is thought to lack sufficient skilled personnel who could be entrusted with the power to bid at the sales. Yet the situations in which real estate ought to produce a worthwhile surplus above senior liens, and in which bidding might be considered, could ordinarily be identified in advance by responsible officials (particularly if, as recommended in note 364 *supra*, the advance notice period for nonjudicial sales of realty is extended to 60 days), and any employee attending the sale could then be instructed to bid the price up to a prescribed amount. This is the same kind of judgment that must be exercised later in deciding whether to redeem. Furthermore, when the Government itself initiates the foreclosure of a tax lien, and a sale is made that also discharges senior liens (INT. REV. CODE of 1954, § 7403(c); cf. *United States v. Trilling*, 328 F.2d 699, 703 (7th Cir. 1964)), the practical situation is the same as if the initiative had been taken by the senior lienor under 28 U.S.C. § 2410 (1964), yet Congress has never seen fit to provide a federal redemption right in such cases. In such a sale, just as under Section 2410, the Government cannot bid if it is necessary to put up cash to pay off senior liens. INT. REV. CODE of 1954, § 7403(c).

392. 28 U.S.C. § 2410(d) (1964); INT. REV. CODE of 1954, § 7425 (d)(2). Unlike the change in the redemption period, the prescription of the price applies whether the Government has a tax or non-tax lien (or a mortgage).

393. 28 U.S.C. § 2410(d) (1964) (emphasis added). The provision may be unduly liberal in that it allows the purchaser six per cent interest *without offset* for any net income he enjoys from the property between foreclosure and redemption, while reimbursing him for any loss suffered. But the adjustments provided may work inequitably in individual cases. See p. 1179 & notes 403-08 *infra*.

a *junior* lien on whatever else the debtor may own),³⁹⁴ the new federal law follows the prevailing pattern in those states which provide for redemption after sale.³⁹⁵ It is a sharp departure, however, from the interpretation placed on the previous federal law by courts in non-redemption states,³⁹⁶ one of which declared:

I don't think Congress meant any such inequitable and unconscionable thing as to allow the Government, at any time up to a year after the sale, to come in, offer what was paid at the foreclosure sale, and immediately assume the position of senior lienholder, pushing everyone else into the background and thus, by wiping out the foreclosure bid, gain an advantage which it could never get at the foreclosure sale, or before it, by redeeming without *paying the amount of the mortgage, the interest, the fees, and everything else that might be due to the senior lienor.*³⁹⁷

Mortgagees in non-redemption states have frequently followed the practice, in the absence of competition, of bidding low even if an anti-deficiency law or the mortgagor's financial condition prevented their thereby obtaining a greater aggregate recovery. Low bidding would ordinarily reduce commissions and conveyance taxes, and would avoid artificially creating taxable interest income or profit in what is essentially a salvage operation.³⁹⁸ Now, mortgagees and other senior lienors (including those making nonjudicial sales, which were not affected before) must review and perhaps revise their bidding practices in the light of the new threat. The existence of even a worthless right to a deficiency judgment (for which the mortgagee may choose not to apply) may now entitle the Government to obtain, without fully satisfying the senior debt, the property which represents the mortgagee's only hope of recouping his investment, at least if he does not in some legally effective manner release his right to a deficiency before the sale.³⁹⁹

394. The lien, if any, of the deficiency judgment would be inferior to a tax lien antedating the foreclosure. INT. REV. CODE of 1954, § 6323(a).

395. Poteat, *State Legislative Relief for the Mortgage Debtor during the Depression*, 5 LAW & CONTEMP. PROB. 517, 526 (1938). *Contra*, Collins v. Riggs, 81 U.S. (14 Wall.) 491 (1872); Hart v. Jackson St. Baptist Church, 224 Ala. 64, 66, 139 So. 88, 89 (1932).

396. United States v. Brosnan, 264 F.2d 762, 766 (3d Cir. 1959), *aff'd on other grounds*, 363 U.S. 237 (1960); First Nat'l Bank & Trust Co. v. MacGarvie, 22 N.J. 539, 126 A.2d 880 (1956).

397. First Nat'l Bank & Trust Co. v. MacGarvie, 41 N.J. Super. 151, 156, 157, 124 A.2d 345, 348 (Ch. Div. 1956), *modified & aff'd*, 22 N.J. 539, 126 A.2d 880 (1956) (emphasis added).

398. Helvering v. Midland Mut. Life Ins. Co., 300 U.S. 216 (1937); Treas. Reg. § 1.166-6(b) (1959). See Snapp, *Tax Consequences of Mortgage Foreclosures and Cancellations*, 17 J. TAX. 122 (1962).

399. Temp. Treas. Reg. § 400.5-1(c)(2), Examples (2), (3), T.D. 6944, 1968 INT. REV. BULL. No. 8, at 41, treat the portion of the debt allowable as a deficiency as not "satisfied by reason of [the] sale," and hence as excluded from the redemption price, "whether or

It may be questioned whether the new redemption price rule serves any legitimate federal interest. The Government's financial interest is fully protected if it is permitted to acquire whatever value the property may have above the amount owing on senior liens; if there is no such excess value, the Government is not hurt by the underbidding. State redemption laws entitling junior lienors to take over the benefit of the senior lienor's bargain (even when they are not injured) were designed to operate as, and can be justified only as, an added threat to force the senior lienor to bid higher and thus minimize the debtor's deficiency obligation⁴⁰⁰—a problem which other states have chosen to meet, if at all, in their own different ways. Conceivably, if any states have been laggard in protecting debtors against underbidding, there may be a national interest in generalizing this form of protection; but, if so, the matter should be presented to Congress on that basis, and not as a casual incident of federal lien legislation.

While the Government perhaps should enjoy the same advantage that other junior lienors would have in those states with redemption laws, Congress should consider requiring, in *other* circumstances, that the redemption price cover the full amount owing to senior lienors, so that redemption will be availed of only to provide a surplus for the United States where the value of the property exceeds senior liens, and not to obtain a windfall for the Government.⁴⁰¹ (Of course, if the Government *does* redeem for such full amount, the senior lienor's right to a deficiency, whether or not reduced to judgment, should be either discharged or passed to the Government by subrogation.)⁴⁰² If that suggestion is not acceptable, Congress should at least provide that the full amount of the indebtedness shall be included in the redemption price whenever the senior lienor, within a prescribed period after the

not [the mortgagee] seeks a judgment for the deficiency." The threat is perhaps not a serious one in states having anti-deficiency laws which treat the debt as satisfied to the extent of the "fair value" or "true value" of the property, since the Government is unlikely to redeem if it must pay such an amount—which may be even higher than the market value. 4 AMERICAN LAW OF PROPERTY § 16.202 (A. J. Casner ed. 1952); Potrat, *supra* note 395, at 534.

400. Note, 5 U. CHI. L. REV. 625, 627-28 (1938).

401. The windfall may be further enhanced by the extinguishment, without right of redemption under state law, of liens which were junior to the one foreclosed but senior to the federal lien. At least if the federal lien is a tax lien, the windfall ultimately benefits the debtor through credit on his liability. See note 412 *infra*.

402. Full discharge might be justified on the theory that the Government, in redeeming, is not speculating in claims but is signifying its belief that the property has a real value at least equal to the redemption price, of which the debtor should have the benefit. However, that belief may be in error. Since the debtor will get credit for any profit the Government makes on resale, at least if its interest was a *tax* lien, see note 412 *infra*, subrogation to the deficiency claim, assuming it has been duly preserved, may be justified as indemnifying the Government against *loss* on resale.

sale, effectively relinquishes his right to a deficiency judgment or allows it to expire unexercised.

The law should deal more explicitly with the "add-ons" to the redemption price, which raise many problems and potential inequities, particularly in those states where the senior lienor or other purchaser takes immediate possession, free of any redemption right in the debtor or private parties. The manner of accounting for "expenses necessarily incurred" by the purchaser and for the income which is to offset them is left uncertain,⁴⁰³ as are such questions as the standard for determining the "rental value" of the property if it is used by the purchaser rather than rented to others,⁴⁰⁴ and his right to reimbursement for the value of a crop which is growing on the land when redemption occurs.⁴⁰⁵ If the purchaser undertakes capital improvements during the federal redemption period,⁴⁰⁶ there is no provision for payment of their value when the Government redeems.⁴⁰⁷ Nor is there any provision for reimbursing a second mortgagee who forecloses and then is required to pay the amortization on the first mortgage during the federal redemption period—although a court might nevertheless relieve him on some theory of subrogation or equitable lien.⁴⁰⁸

403. Inequity may arise, for example, if the property taxes for an entire year are paid or are deemed to accrue on a date with the 120-day period for redemption from a federal tax lien. The amount must apparently be applied to exhaust income of the 120-day period before anything is added to the redemption price on that account, whereas the income might be enjoyed free of that offset if the redemption period fell at a different time of year. *But see* ILL. REV. STAT. ch. 77, § 28 (Supp. 1967), requiring reimbursement of real estate taxes paid by the purchaser.

404. Since rental value is to be taken into account only "to the extent such property is used by the purchaser," the test is presumably the value of the use to which the property is actually put, rather than the amount of the rental that might be derived from the highest and best use of the property. For state law, *cf.* *Blessett v. Turcotte*, 23 N.D. 417, 136 N.W. 945 (1912).

405. *See* *Dorrough v. Barnett*, 216 Ala. 599, 114 So. 198 (1927) (purchaser allowed to harvest the crop after redemption from him, but charged rent for the post-redemption period).

406. Which, in the case of federal mortgages and nontax liens, is still a full year.

407. Even if the cost of the improvements can be construed to be "expenses necessarily incurred," the interim income from the property must be exhausted before any credit for such expenses is reflected in the price. 28 U.S.C. § 2410(d)(3) (1964). *But see* ALA. CODE tit. 7, § 740 (1960), giving a credit for the value added to the property by permanent improvements made before the offer to redeem (*see* *Rudisill v. Buckner*, 244 Ala. 653, 15 So. 2d 333 (1943)), without offsetting such amount by interim income. *Williams v. Rouse*, 124 Ala. 160, 27 So. 16 (1899). The well-advised mortgagee will bargain for a release of the federal right of redemption before undertaking improvements. Temp. Treas. Reg. § 400.5-1(d)(4) T.D. 6944, 1968 INT. REV. BULL. No. 8, at 42; Rev. Proc. 63-10, 1968 INT. REV. BULL. No. 8, at 48.

408. In contrast, ALA. CODE tit. 7, § 732 (1958), includes in the price "any other valid lien or incumbrance paid or owned by [the] purchaser." *Stewart v. Stephenson*, 243 Ala. 329, 10 So. 2d 159 (1942). *See also* ILL. REV. STAT. ch. 77, § 28a (1967). In the absence of such a provision, an equitable lien was allowed in *Keel v. Vinyard*, 48 Idaho 49, 279 P. 420 (1929). Query, whether an equitable lien could be enforced against the Government, once it takes title. *See* note 340 *supra*. It is understood that the administrative practice, at least in the Internal Revenue Service, is to allow credit for such payments.

Where the federal interest is a tax lien extinguished by a nonjudicial sale, the law for the first time provides the procedure to be followed in effecting redemption,⁴⁰⁹ and its effect in putting the United States in the purchaser's shoes⁴¹⁰ (rather than merely reviving its lien, as under some state laws⁴¹¹) and in discharging the taxpayer's liability to the extent of any profit enjoyed by the Government on resale of the redeemed property.⁴¹² But the law is silent, as it has ever been, concerning the comparable questions of procedure and effect in the case of judicial sales.⁴¹³ Whether tax liens or others are involved, the new law provides no clue as to how, or whether, the Government is required to make tender of the redemption price within the prescribed period where the price involves such uncertain elements as the "fair" or "true value" of the property (in anti-deficiency states), the rental value, and the purchaser's interim expenses and income.⁴¹⁴ Yet it is hardly conceivable that the Government could or would make an open-ended tender of its willingness to pay whatever amount might be determined by a court to be required.⁴¹⁵

F. Remedies of Junior Lienors and Subsequent Purchasers

A junior lienor or a purchaser who acquired property in the face of an existing federal tax lien cannot, of course, enjoin a levy and sale,⁴¹⁶ even though their effect will be to extinguish his rights in the property.⁴¹⁷ The law does, however, give him a specific remedy by suit

409. State procedure is to be followed if it exists. If there is none, or if the state officer refuses to honor the redemption, the federal tax collector is to issue and record a certificate of redemption. INT. REV. CODE OF 1954, § 7425(d)(3)(A)—(B). States whose laws fail to provide for the recording of such certificates should amend such laws (as has been done in GA. CODE ch. 67-26, *as amended*, April 14, 1967), since otherwise they will be recorded only in the federal court.

410. INT. REV. CODE OF 1954, § 7425(d)(3)(C).

411. See 4 AMERICAN LAW OF PROPERTY § 16.177 (A. J. Casner ed. 1952); Durfee & Doddridge, *supra* note 384, at 845-47.

412. INT. REV. CODE OF 1954, § 6342(a). State laws vary on whether a redeeming junior lienor must credit the debtor with the excess of the value over the amount paid for redemption. 4 AMERICAN LAW OF PROPERTY § 16.177 (A. J. Casner ed. 1952); Durfee & Doddridge, *supra* note 384, at 847-49.

413. 28 U.S.C. § 2410(c)—(d).

414. Under state laws providing comparable "add-ons," an accounting may be demanded of the purchaser near the end of the redemption period, and tender is excused if illegal or exaggerated claims are made. *Wilkes v. Hood*, 237 Ala. 72, 185 So. 748 (1939); *Aust v. Rosenbaum*, 74 Miss. 893, 21 So. 555 (1897). In *First Nat'l Bank & Trust Co. v. MacGarvie*, 22 N.J. 539, 126 A.2d 880 (1956), where the Government's tender was insufficient because of an error of law, the court allowed it 30 days after the mandate in which to tender the proper amount.

415. Held sufficient, under state law, in *Clarke v. Cowan*, 206 Mass. 252, 92 N.E. 474 (1910); *Sedlak v. Duda*, 144 Neb. 567, 13 N.W.2d 892 (1944).

416. INT. REV. CODE OF 1954, § 7426(b)(1).

417. INT. REV. CODE OF 1954, § 6339(c).

against the United States to reach any surplus proceeds above prior liens.⁴¹⁸ The rights in surplus proceeds become complicated when property is seized and sold under two or more tax liens, some prior and some inferior to an intervening nonfederal lien on the same property or to an intervening purchaser. The Government has asserted the right to apply the proceeds to all its liens, claiming that the intervening lien or interest did not attach to the proceeds but followed the property into the hands of the purchaser at the sale. The courts have correctly held, however, that the sale under the senior federal lien extinguishes all interests junior to it, and that such interests, including the junior federal liens, attach to the proceeds in order of priority.⁴¹⁹ On the other hand, if the tax collector, having several liens, sells property in which there are *no* intervening interests, he is free to apply the proceeds to the most junior tax liens. The Government is, and should be, entitled to so marshal its securities that its *senior* liens may be satisfied from those properties in which there are intervening interests, and its junior liens from property which is free of such claims.⁴²⁰

There are other situations, however, in which the Government, being in the privileged position of having a general lien on *all* the property of its debtor,⁴²¹ is able to obtain *full* satisfaction from one asset just as well as from another, and its selection of property on which a third party has a junior lien, or which he has purchased since the federal lien attached, may reduce the third party to the status of an unsecured creditor without any benefit to the revenue. In such circumstances, the injured parties have invoked the equitable doctrine of marshaling of assets, under which "a creditor having two funds to satisfy his debt, may not by his application of them to his demand, defeat another creditor, who may resort to only one of the funds."⁴²²

418. INT. REV. CODE of 1954, § 7426(a)(2)—(b)(3). For the procedural frustrations suffered before the 1966 amendment, see *First Nat'l Bank v. United States*, 265 F.2d 297 (3d Cir. 1959); *Oil City Nat'l Bank v. Dudley*, 198 F. Supp. 849 (W.D. Pa. 1961).

419. *Sutcliffe v. Joey Drilling & Exploration Inc.*, 261 F. Supp. 417 (D. Kan. 1966); *Commercial Credit Corp. v. Schwartz*, 130 F. Supp. 524 (E.D. Ark. 1955). *But cf.* *United States v. Ralph*, 57-1 U.S. Tax Cas. ¶ 9583 (S.D. Cal. 1957). The statement in *United States v. Pollack*, 370 F.2d 79, 81 (2d Cir. 1966), that *Joey Drilling* was "wrongly decided" is difficult to understand, since the case appears factually distinguished from *Pollack*, see note 420 *infra*, even if its language may be too broad. INT. REV. CODE of 1954, § 6342(a)(3), provides for applying the proceeds (after certain charges) on "the liability in respect of which the levy was made," and § 6342(b) then calls for distribution of the balance to the person "legally entitled thereto." But if that language is subject to the construction that *all* federal liens are to be satisfied ahead of intervening interests, it should be amended.

420. *United States v. Pollack*, 370 F.2d 79 (2d Cir. 1966); *United States v. American Casualty Co.*, 63-2 U.S. Tax Cas. ¶ 9617 (S.D. Fla. 1963).

421. INT. REV. CODE of 1954, § 6321.

422. *Sowell v. Federal Reserve Bank*, 268 U.S. 449, 456-57 (1925). In *Meyer v. United*

The courts have been willing to apply that doctrine in federal tax lien cases only where both the encumbered and the unencumbered properties were before the court, as in suits to foreclose tax liens on several properties⁴²³ or in bankruptcy and other collective insolvency proceedings.⁴²⁴ They have refused to interfere with the tax collector's discretion when he proceeds against particular properties in which others have junior interests, saying that "to require the Government to pick out and foreclose only those liens which will create the least hardship on third parties, would impose a considerable burden on the revenue collection process."⁴²⁵ Assuming the correctness of that premise, however, justice would seem to require that the courts or Congress develop an alternative remedy. The third party might be permitted to restrain resort to the property in which he is interested if he gives his bond to make good any loss or added expense occasioned by requiring the tax collector to pursue other properties.⁴²⁶ A better alternative, less cumbersome and certainly less burdensome to the third party, might be to let the tax collector take whatever property he chooses, but to subrogate the displaced junior lienor or purchaser to the priority which the federal tax lien had in the other property which was not taken,⁴²⁷ with appropriate balancing of the equities where that property too is encumbered.⁴²⁸

States, 375 U.S. 233, 237 (1963), the Supreme Court noted that it "has never applied the doctrine of marshaling to federal income tax liens Nor has the Congress seen fit to lay down any rules with reference to the application of the doctrine" Although finding it inequitable to apply the doctrine in the circumstances presented, *see* Second Installment, 614, the Court did not exclude its possible applicability in other situations.

423. *United States v. Pollack*, 233 F. Supp. 775, 778 (E.D.N.Y. 1964), *aff'd on other grounds*, 370 F.2d 79 (2d Cir. 1966); *United States v. Lord*, 155 F. Supp. 105 (D.N.H. 1957); *United States v. Paul*, 41 F. Supp. 41, 47 (E.D. Mich. 1940), *aff'd on other grounds*, 127 F.2d 64 (6th Cir. 1942), *aff'd*, 317 U.S. 329, 338 (1943); *cf. United States v. Westmoreland Manganese Co.*, 134 F. Supp. 898, 949 (E.D. Ark. 1955), *rev'd on other grounds sub nom. United States v. Latrobe Constr. Co.*, 246 F.2d 357 (8th Cir.), *cert. denied*, 355 U.S. 890 (1957).

424. *In re Marvin's, Inc.*, 51-2 U.S. Tax Cas. ¶ 9423 (N.D. Tex. 1950). One questionable decision preferred junior liens on real estate and left the Government to its lien on unencumbered personalty, although the effect, because of the subordination of non-possessory liens on personalty to administration expenses, 11 U.S.C. § 107(c) (1964), was that the prior federal claim was not fully satisfied. *In re Ann Arbor Brewing Co.*, 110 F. Supp. 111 (E.D. Mich. 1952) (bankruptcy). Marshaling is never properly applied if it prejudices the senior lienor. 55 C.J.S. *Marshaling Assets and Securities* § 4 (1948).

425. *Kovacs v. United States*, 355 F.2d 349, 351 (9th Cir.), *cert. denied*, 384 U.S. 941 (1966) (in which the equities were such that the concurring judge declared, "I concur in the foregoing simply because I think my oath requires me to do so." 355 F.2d at 352); *United States v. Herman*, 310 F.2d 846, 848 (2d Cir. 1962); *United States v. Stutsman County Implement Co.*, 274 F.2d 733 (8th Cir. 1960); *United States v. Cohen*, 271 F. Supp. 709 (S.D. Fla. 1967); *Kelley Kar Co. v. United States*, 56-1 U.S. Tax Cas. ¶ 9481 (S.D. Cal. 1956); *American Nat'l Ins. Co. v. Vine-Wood Realty Co.*, 414 Pa. 263, 199 A.2d 449 (1964).

426. *Cf. Stowe v. Powers*, 19 Wyo. 291, 304-05, 116 P. 576, 580 (1911).

427. *Cf. Womans Hospital v. Sixty-Seventh St. Realty Co.*, 265 N.Y. 226, 192 N.E. 302 (1934). There is a close relationship between marshaling (which prevents injustice, but is

A junior lienor or subsequent purchaser of the taxpayer's property might improve his position if he were permitted to contest the merits of the tax on which the prior federal tax lien is based. We have seen that the taxpayer himself, when the Government seeks a judicial foreclosure of a lien on his property, may raise the merits of the tax as a defense,⁴²⁹ and the outcome, of course, will inure to the benefit of those with junior interests. Even if the taxpayer has no equity in the particular property, he may be induced to contest the tax by the prospect of a personal judgment which would preclude his later litigating the issues in another forum where he may have more at stake.⁴³⁰ If that inducement is ineffective (because the taxpayer is propertyless, or has absconded, or is simply unwilling for personal reasons to place his tax in issue), the courts hold that the third party cannot raise the issue, but must be content with the subordinate position which he voluntarily or inadvertently accepted when he acquired his interest.⁴³¹

It has been suggested that this may be the only feasible rule.⁴³² It is said that otherwise the Government might have to litigate the merits in a number of suits involving adverse claimants to different properties, who were not parties to the earlier suits and were not bound by them. But that would be so only if the taxpayer was not personally served in the earlier case, because a personal judgment against him (whether or not he put the merits in issue) would bind those claiming through

not an absolute right) and subrogation (which remedies the injustice when it has occurred). See *Broadway Nat'l Bank v. Hayward*, 285 Mass. 459, 189 N.E. 199 (1934). See also Note, 35 A.L.R. 1307 (1925). Subrogation to the Government's tax claim (but not to its summary remedies) is not unheard of, I.T. 1859, II-2 Cum. BULL. 228 (1923), although it has never been decided whether such subrogation carries with it the Government's lien rights. *Maryland Cas. Co. v. Charleston Lead Works*, 24 F.2d 836 (E.D.S.C. 1923); cf. *In re Neely*, 10 F. Supp. 654 (S.D.N.Y. 1935). No reason is apparent why it could not (at least if the merits of the tax are excluded from consideration in any controversy between the subrogated party and rival claimants to the other property, as discussed at pp. 1183-84 *infra*).

428. Cf. *White Co. v. Hammond Stage Lines*, 180 La. 962, 974, 158 So. 353, 357 (1934); *James Stewart & Co. v. National Shawmut Bank*, 291 Mass. 534, 556, 196 N.E. 169, 180 (1935); *Union Central Life Ins. Co. v. Cherry*, 39 Ohio App. 293, 177 N.E. 486 (1931).

429. P. 1147 & note 218 *supra*.

430. See p. 1148 & note 221 *supra*.

431. *Pipola v. Chicco*, 274 F.2d 909 (2d Cir. 1960), *aff'g* 169 F. Supp. 229 (S.D.N.Y. 1959); *Graham v. United States*, 243 F.2d 919, 922 (9th Cir. 1957); *United States v. Pearson*, 258 F. Supp. 686 (S.D.N.Y. 1966); *Rutledge v. Riddell*, 186 F. Supp. 552 (S.D. Cal. 1960). Although one premise of the Second Circuit's affirmance of *Pipola*, namely, that the taxpayer himself could not defend on the merits, was overruled in *United States v. O'Connor*, 291 F.2d 520, 526 (2d Cir. 1961), the actual holding was not impaired. See *Falik v. United States*, 343 F.2d 38, 41-42 (2d Cir. 1965); *Quinn v. Hook*, 231 F. Supp. 718, 721 (E.D. Pa. 1964), *aff'd per curiam*, 341 F.2d 920 (3d Cir. 1965). See also note 442 *infra*.

432. See 84 A.B.A. REP. 677 (1959), which considered the problem but made no recommendation. In *Pipola v. Chicco*, 169 F. Supp. 229, 232 (S.D.N.Y. 1959), *aff'd*, 274 F.2d 909 (2d Cir. 1960), the district court asserted that the contrary rule "would make a shambles of the provisions of the Act intended to enforce collection of taxes due from taxpayers."

him.⁴³³ It is also said that third parties are ordinarily not in a position to litigate the taxpayer's liability effectively, since they would require access to information normally kept confidential.⁴³⁴ But means exist whereby third parties can obtain such information for use in litigation in proper cases,⁴³⁵ and it may be appropriate to require the taxpayer to make such disclosure in order that the title he had purported to sell may be defended or that his assets available for creditors may not be depleted by his inaction. Although the defense may be less effective than if the taxpayer had voluntarily elected to make it, that seems an insufficient reason to deny the third party the right to try. Therefore, consideration might be given to letting adversely affected third parties contest the merits of the tax, at least in cases initiated by the Government in which the taxpayer is a party and will be concluded by the judgment.⁴³⁶

When a tax is collected by levy, or by an *in rem* proceeding which does not result in a personal judgment against the taxpayer, he remains free to recover the proceeds later by claim for refund. It would not seem appropriate to permit those whose junior interests were extinguished by the levy or decree to initiate such a refund claim, unless some procedure could be devised by which duplication would be prevented and the taxpayer could be bound.⁴³⁷ But if the taxpayer does establish his right to a refund, equity requires that the money should not become general assets of his estate but should be held as a con-

433. *United States v. Lake City Malleable, Inc.*, 258 F. Supp. 241, 244-45 (N.D. Ohio 1966); *United States v. McGuire*, 42 F. Supp. 337, 339 (D.N.J. 1941).

434. See INT. REV. CODE of 1954, §§ 6103(a), 7213(a)(1); 18 U.S.C. § 1905 (1964); Treas. Reg. § 301.6103(a)-1 (1965); cf. *Cooper v. Hallgarten & Co.*, 34 F.R.D. 482 (S.D.N.Y. 1964).

435. Treas. Reg. § 301.9000-1 (1967); *United States ex rel. Carthan v. Sheriff*, 330 F.2d 100 (2d Cir. 1964); *Rhodes v. Edwards*, 178 Neb. 757, 135 N.W.2d 453, *cert. denied*, 382 U.S. 943 (1965).

436. The question then arises whether persons who are not parties to the litigation, but whose junior interests in *other* property would be adversely affected by the judgment (see authorities cited note 433 *supra*), should be permitted to intervene. Practical and equitable considerations must be balanced.

437. See *Tomlinson v. Smith*, 128 F.2d 808, 811 (7th Cir. 1942). The Second Circuit, in *Pipola v. Chicco*, 274 F.2d 909, 914 (2d Cir. 1960), suggested that the purchaser, when his junior interest was extinguished by the tax lien, might have standing to sue for refund. But the cases cited for the point, *United States v. Halton Tractor Co.*, 258 F.2d 612 (9th Cir. 1958), and *Bladine v. Chicago Joint Stock Land Bank*, 63 F.2d 317 (8th Cir. 1933), involved collections in violation of the plaintiffs' priorities, not the merits of the tax. Perhaps closer in point is *Stahmann v. Vidal*, 305 U.S. 61, 66 (1938), where the merits of the tax were permitted to be questioned by one from whom it had been collected, but who the Government asserted was not the statutory "taxpayer." The Court said, "Whether or not the tax was imposed upon the petitioners, they are, according to the accepted principles, entitled to recover unless they were volunteers, which they plainly were not because they paid the tax under duress of goods." 305 U.S. at 66. It would cause great confusion, however, if each person whose *junior* interest in the taxpayer's property was extinguished by a senior federal lien were permitted, as an involuntary payor *pro tanto*, to proceed independently to contest the merits by claim and suit for refund.

structive trust subject to the junior liens and interests of third parties which were extinguished by the levy or decree.⁴³⁸ A procedure should be adopted by which such parties, without involving the Government in any controversy they may have with the taxpayer, could cause a trust to be impressed on the fund before it is paid over to the taxpayer.⁴³⁹

438. See *Pennsylvania Turnpike Comm'n v. McGinnes*, 169 F. Supp. 580 (E.D. Pa. 1958), *rev'd*, 268 F.2d 65 (3d Cir. 1959), *cert. denied*, 361 U.S. 829 (1959); 179 F. Supp. 578 (E.D. Pa. 1959), *aff'd per curiam*, 278 F.2d 330 (3d Cir. 1960), *cert. denied*, 364 U.S. 820 (1960). That plaintiff claimed ownership of a refund of taxes which the taxpayer had paid with funds alleged to have been fraudulently obtained from plaintiff. Although the district court found that the refund would be subject to a constructive trust in the taxpayer's hands and "at least to an equitable lien" while in the tax collector's hands, the ultimate decision was that there was no jurisdiction to restrain him from paying over to the taxpayer. *Houston v. Ormes*, 252 U.S. 469 (1920), which permitted comparable restraint of a federal officer, was distinguished as peculiar to situations in which personal jurisdiction of the officer and of the principal claimant (here the taxpayer) could be obtained in the District of Columbia. In *Big Farm Tire Co. v. Boland*, 60-2 U.S. Tax Cas. ¶ 9700 (E.D. Va. 1960), where the taxpayer was contesting the merits of a jeopardy assessment in the Tax Court concurrently with a suit in which the Government was adjudged to have a prior lien on a certain note, the district court held in abeyance the disbursement of the note proceeds to the tax collector to await the outcome in the Tax Court, thereby protecting the junior lienor's interest in the fund in the event the tax should not be sustained.

439. The Special Committee on Federal Liens considered, but did not act upon, a proposal by which the District Director could pay the refund into court and interplead the claimants. The draft, which would add a new Section 6408 to the Internal Revenue Code of 1954, read as follows:

If the claim of any person having a lien upon or other interest in property of the taxpayer is unsatisfied, either in whole or in part, by reason of the United States having a prior lien upon such property under this title (or by reason of such person having made a payment for discharge of property from such prior lien of the United States), such person shall have a lien upon the right of the taxpayer (subject to the provisions of section 6402(a)) to a refund of any overpayment of the tax with respect to which the prior lien of the United States was imposed. The lien of such person upon such rights to refund shall have the same priority which his lien or interest had in the property from which the lien of the United States was satisfied. If the tax was satisfied from two or more properties, upon or in which different persons had liens or interests, the refund shall be equitably apportioned among such persons. This section shall impose no obligation upon the Secretary or his delegate to pay a refund to any person other than the taxpayer, unless at least 60 days before such refund is made such other person actually delivered to the District Director of Internal Revenue to whom (or to whose predecessor in office) the tax was paid a written notice of his claim of lien. If any such notices have been delivered, as provided herein, the refund shall not be paid to the taxpayer but shall be paid into the court in which a suit for such refund is pending, or (if no suit is pending) into the district court of the United States for the district in which is located the office of the District Director of Internal Revenue by whom the refund is to be made; and the taxpayer and all persons who have duly delivered such notices shall be interpleaded. This section shall confer no right of action upon any person against the United States; nor shall it confer any right of action against any officer or employee thereof, in the event that the refund is mistakenly paid over to the taxpayer, unless such action is willful and intentional.

A helpful analogy may be found in H.R. 6442, 77th Cong., 2d Sess. (1942), which was sponsored by the Treasury as a means of relieving it of having to participate in litigation between adverse claimants in the limited circumstances where claims against the United States may be assigned or subjected to equitable liens. It would have required the person asserting an assignment or lien to bring suit against the principal claimant and to obtain an order restraining the latter from receiving the payment, which order would be served on the United States (which would not be made a party to the suit). See *Hearings on H.R. 6642 Before Subcomm. No. 3 of the House Comm. on the Judiciary*, 77th Cong., 2d

A junior lienor who brings suit to foreclose his own lien has the same right as a senior lienor to join the United States as a party defendant,⁴⁴⁰ although there may be little point in it (unless priorities are in dispute),⁴⁴¹ since he cannot thereby obtain an adjudication of the merits of the tax and thus affect the amount of the prior lien.⁴⁴² Whether or not the United States is joined, a senior federal lien (filed before the proceeding) cannot, without the Government's consent,⁴⁴³ be discharged from the property by a judicial sale,⁴⁴⁴ even if state law would discharge such liens.⁴⁴⁵ However, if a junior creditor brings suit to set aside a fraudulent conveyance by the debtor, and the Government fails to intervene, it has been held that the senior federal tax lien does not attach to the property recovered.⁴⁴⁶

Sess. (1942). In a pending case, in which a preliminary issue was disposed of in *Hughes & Co. v. United Plumbing & Heating, Inc.*, 68-1 U.S. Tax Cas. ¶ 9280 (6th Cir. 1968), a judgment creditor of the taxpayer had obtained from the district court an order restraining the District Director from paying over to the taxpayer any tax refund which might be determined to be due. The District Director complied by paying the refund into court, and it is the taxpayer who is raising the sovereign immunity issue.

440. 28 U.S.C. § 2410 (1964). See pp. 1169-70 *supra*.

441. In unusual circumstances, joinder of the United States may even be prejudicial, since unknown federal liens which are superior to the plaintiff's lien even though not filed before the proceeding will be extinguished if the United States is not joined. INT. REV. CODE OF 1954, § 7425(a), but will apparently survive if it is joined. 28 U.S.C. § 2410(b)-(c) (1964). Amendment should be considered, as discussed in a related connection, p. 1170 *supra*.

442. P. 1183 *supra*. The House version of the bill which became the antecedent of 28 U.S.C. § 2410 (1964) would have permitted only senior lienors to join the United States, but the Senate extended that right to junior lienors, saying, "The Government ought not to desire to occupy a dog-in-the-manger position with respect to its liens, neither taking steps to enforce them nor permitting others interested to test their validity and priority." S. REP. NO. 351, 71st Cong., 2d Sess. 2 (1930). The conferees, accepting the Senate view on this point, noted that "[c]ases may often arise where a junior lien holder needs to be informed as to the validity, amount, etc. of a prior lien," H.R. REP. NO. 2722, 71st Cong., 2d Sess. 3 (1931), which might support the view that he is not limited to disputing the priority of the liens. But it is the procedural validity of the prior lien, not the merits of the tax on which it is based, that he may question. See *Falik v. United States*, 343 F.2d 38, 42 (2d Cir. 1965), citing Note, *Conclusiveness of the Merits of a Tax Assessment and the Congressional Policy of Summary Tax Collection*, 71 YALE L.J. 1329, 1337-41 (1962).

443. The Government may consent to sale free of its senior lien, whether it is joined, 28 U.S.C. § 2410(c) (1964), or not. INT. REV. CODE OF 1954, § 6425(b)(2).

444. 28 U.S.C. § 2410(c) (1964) (U.S. a party); INT. REV. CODE OF 1954, § 7425(a)(1) (U.S. not a party).

445. *United States v. Peterson*, 204 F. Supp. 683 (E.D. Pa. 1962). The court "recognize[d] that this result may shock real estate lawyers and title searchers steeped in the old and firmly established principle of Pennsylvania law that a judicial sale divests real estate of all other liens on it except those preserved by statute," but it regarded the contrary result as "even more shocking." 204 F. Supp. at 685. No change in this regard is recommended.

446. In *In re Swan-Finch Oil Corp.*, 67-2 U.S. Tax Cas. ¶ 9718 (S.D.N.Y. 1967), it was held that, under the Uniform Fraudulent Conveyance Act, the transfer is not set aside completely but only to the extent of the creditor's claim, and the transfer remains valid against the debtor and others claiming through him. A like result was reached, even though the Government had intervened, in *United States v. Fidelity & Deposit Co.*, 214 F.2d 565 (5th Cir. 1954), on the ground that state law gave the junior creditor a lien on

A nonjudicial sale, or a sale under confession of judgment, cannot discharge a duly filed senior federal tax lien on the property sold, even if the junior lienor complies with the new requirements for giving notice to the tax collector.⁴⁴⁷ Therefore, the sale will be made subject to and without disturbing the senior federal lien,⁴⁴⁸ and the purchaser, of course, will discount the price accordingly. Yet it has been held that the proceeds of the sale, although reflecting only the net value of the junior lienor's interest, become the property of the taxpayer and are subject to valid liens, of which the senior federal lien must be first satisfied.⁴⁴⁹ That inequity should be corrected by Congress.⁴⁵⁰

We have seen that when a senior nonfederal lien on real estate is foreclosed by judicial or nonjudicial sale, the United States as a junior lienor has a right of redemption.⁴⁵¹ Under some state laws, when a junior lienor has redeemed, the property may in turn be redeemed from him by those with liens junior to his.⁴⁵² The federal law fails to

the property from the time he instituted suit, whereas the earlier tax lien could not attach to the property which had been transferred before it arose. *But cf.* *United States v. Texoma Drilling Co.*, 62-2 U.S. Tax Cas. ¶ 9818 (N.D. Tex. 1962), in which the federal tax lien and judgment liens of the plaintiffs were awarded priority in the recovered property in the order in which they had arisen, subsequent to the transfer.

447. Temp. Treas. Reg. § 400.4-1(b)(1) T.D. 6944, 1968 INT. REV. BULL. No. 8, at 34. Section 7425(b) of the statute is open to the construction that even a senior federal tax lien may be discharged, subject to the Government's right to the proceeds, if due notice of such a sale is given and if state law (e.g., the Pennsylvania law involved, before the 1966 Act, in *United States v. Peterson*, 204 F. Supp. 683 (E.D. Pa. 1962)) has that effect on senior liens. *See PLUMB & WRIGHT* 236-37. The Treasury thinks otherwise, however, and until it is successfully challenged the statement of rule (c) at page 293 of the First Installment must be qualified accordingly. Apparently the Treasury would also question rule (a) and note 431, so far as it is stated that a federal tax lien which is *not filed* more than 30 days before the sale but which is *senior* in priority to the lien being enforced by sale (e.g., a landlord's lien or a state non-property tax lien) may be discharged by the sale. The purchaser at the sale may enjoy the more limited protection of § 6323(a) if the federal tax lien remains unfiled until he has perfected his rights as against subsequent purchasers without actual notice. § 6323(h)(6). But he may be entrapped if he relies on the 30 days of grace provided in § 7425(b).

448. INT. REV. CODE OF 1954, § 7425(b)(1).

449. *Harris Equip. & Serv. Co. v. Samson Trailer Mfg. Corp.*, 190 A.2d 212 (N.J. Dist. Ct. 1963), relying on *United States v. Blackett*, 220 F.2d 21 (9th Cir. 1955) (in which the result was similar but the present question does not appear to have been placed in issue). *See PLUMB & WRIGHT* 237.

450. The "dog-in-the-manger" quotation, *supra* note 442, is pertinent here. Although, when the shoe is on the other foot, the Government acknowledges no obligation to facilitate a senior lienor's pursuit of chattels which the tax collector has sold subject to prior liens (*see* note 339 *supra*), it successfully argued in *Harris Equip. & Serv. Co. v. Samson Trailer Mfg. Corp.*, 190 A.2d 212 (N.J. Dist. Ct. 1963), that it should not "be compelled to pursue chattels which are mobile and very difficult of identification, into the hands of others who choose to purchase them at an execution sale." That does not, however, justify taking the net proceeds of the junior lienor's sale where the Government can in fact trace the property and is as well able to enforce its lien as before. At most, where the sale does make tracing difficult or impossible, the problem might be shifted to the junior lienor, with rights of subrogation to the Government's lien.

451. Pp. 1174-80 *supra*.

452. 4 AMERICAN LAW OF PROPERTY § 16.177 (A. J. Casner ed. 1952).

make clear whether, in such a state, the holder of a lien junior to a tax lien is permitted to redeem from the United States.⁴⁵³

A person having a junior interest other than a lien or mortgage is unlikely to derive much benefit from the Government's consent to be named a defendant, unless he can frame his action as one to quiet title. The consent is strictly limited to quiet title suits, foreclosures of liens and mortgages, partition and condemnation suits, and actions of interpleader or in the nature of interpleader.⁴⁵⁴ Thus, it has been held that the United States may not be joined in a suit for *specific performance*, brought by a contract purchaser of real estate, in which the plaintiff seeks an adjudication of all liens and an order for distribution of the tendered payment to those entitled.⁴⁵⁵ The American Bar Association vainly urged that the consent be broadened to embrace any action "involving the determination of rights in or liens upon any real or personal property or any obligation" (including, among others, an action to subject a decedent's real estate to the payment of debts).⁴⁵⁶ It is not just in the types of cases enumerated in the statute that the Government, as a Senate committee said 38 years ago, "ought not to desire to occupy a dog-in-the-manger position with respect to its liens, neither taking steps to enforce them nor permitting others interested to test their validity."⁴⁵⁷

VI. Conclusion

The Federal Tax Lien Act of 1966 was a major first step toward

453. With respect to nonjudicial sales discharging tax liens, INT. REV. CODE of 1954, § 7425(d)(3)(C) provides that redemption gives the United States "all the rights, title and interest in and to such property acquired by the person from whom the United States redeems such property by virtue of the sale of such property." Inferentially, if the senior lienor's interest was subject to redemption by lienors junior to the federal lien, the interest acquired by the United States is also. But the law is silent where the sale was a judicial sale. In *United States v. John Hancock Mut. Life Ins. Co.*, 364 U.S. 301, 309 (1960), the Government acknowledged that the owner, at least, might in turn redeem from the United States pursuant to state law.

454. 28 U.S.C. § 2410(a) (1964). All but the first two were added by the Federal Tax Lien Act of 1966.

455. *Shaw v. Rippel*, 224 F. Supp. 77 (E.D. Ill. 1963). Perhaps the portion of the requested relief which affected the United States could be construed as a plea for interpleader, to which consent has now been given. 28 U.S.C. § 2410(a)(5) (1964). An action to declare a forfeiture of property under state law is another to which the Government's consent does not extend. That defect in the law would be no impediment to such actions if, as was held under prior law, federal liens could thereby be extinguished irrespective of the Government's participation in the action. *United States v. Bleasby*, 257 F.2d 278 (3d Cir. 1958). But the 1966 legislation, INT. REV. CODE of 1954, § 7425(a), seems to allow the Government to prevent extinguishment without joinder in cases in which joinder is impermissible, by filing a claim before the distribution of proceeds of a judicial sale of property.

456. 84 A.B.A. REP. 736-37, 740 (1959).

457. S. REP. NO. 351, *supra* note 442.

bringing equity and reason to a too long neglected area of the law. Congress thereby demonstrated its receptiveness to reform of the law of federal liens and priorities when the deficiencies of the law are made clear. We may hope that a comparable showing in the areas herein considered may evoke a similarly sympathetic response.

Piecemeal attack on the problems, whenever sufficient interest is aroused in particular areas, seems preferable to undertaking another omnibus bill, attempting to "reform the world" of federal liens and priorities at one stroke. Such an ambitious venture would, at the very least, encounter years of delay while it was studied in depth, first by its sponsors, then by the executive branch, and finally by Congress; and it might well fall of its own weight, as the tax lien legislation very nearly did.

The proposals herein are not represented as final solutions. I have consciously gone beyond my depth in many specialized areas of the law in an effort to lay the groundwork for further study and discussion and ultimately for more concrete recommendations by scholars and practical lawyers skilled in those areas, working with those in and out of government who are familiar with the difficulties faced by the tax collector.

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