Drake Law Review

Vol. No. 10 DECEMBER, 1960 No. 1

FEDERAL TAX LIENS, THEIR PRIORITY AND ENFORCEMENT*

HAROLD W. FELTON**

Problems involving Federal tax liens are submitted to the courts with increasing frequency. Obviously, these questions do not often arise in the case of those who have sufficient assets to pay their debts. The last available dollars of insolvents are usually involved, although they may be the only discernible dollars of the cunning of rogues or of knaves.

It seems as though the pace of the search and the vigor of the contest for these tail-end and insufficient assets are being stepped up.

A discussion of Federal tax liens and the problems of priority respecting them should properly emerge from a foundation of basic principles.

Minerva, the Roman goddess of wisdom and the patroness of the arts and trades, was fabled to have sprung with a tremendous battle cry fully armed from the head of Jupiter.

Such facility is to be expected in Roman mythology and is not unknown in other mythologies. Our American John Henry was born with a hammer in his hand. This presumably indicates that he was forthwith able to start driving steel through rock mountains and hammer his way to fame. But in dealing with such prosaic matters as Federal tax liens, I hope you will agree with me that it will be proper, and probably even desirable, to refrain from springing up with a tremendous battle cry and having to with the closest set of facts.

I hope you will agree with me that we should start at the beginning and save the tremendous battle cries as we are probably not so romantically endowed by being fully armed as was Minerva or even John Henry.

In making this suggestion, I do not mean to infer that you may not have had occasion to come to grips with problems involving a Federal tax lien, but I hope I am not wrong in the assumption that, by and large, a busy general practice has not allowed as much time as you might have liked to become more familiar with Federal tax liens.

The basic principles which are involved are found in the Constitution of the United States, certain traditional concepts, the history of sovereign priority in respect of collection of its debts, the decisions of the Supreme Court, and economic and business realities.

---

* This is one of several papers presented to the Sixth Annual Spring Tax Institute of the Iowa State Bar Ass'n, April 29, 30, 1960. The views expressed are the author's, and should not be considered as being the opinion of the Treasury Department, the Internal Revenue Service, or the Chief Counsel's Office.

** Assistant Regional Counsel, Civil Advisory, New York City Region, Internal Revenue Service; admitted to practice, Nebraska, New York, United States Supreme Court, United States Court of Appeals for the Second Circuit, and United States District Courts of Puerto Rico and of the Southern District, New York.

By definition, a tax is a pecuniary burden imposed by authority, laid upon persons or property for public purposes; a forced contribution of wealth to meet the public needs of a government. It finds its root in the Latin *taxare,* meaning "to touch sharply."

The word lien also finds its root in Latin *ligare,* meaning "to bind" and is a charge upon real or personal property for the satisfaction of some debt or duty; a right in one to control or to hold and retain, or enforce a charge against the property of another until some claim of the former is paid or satisfied; and a tax lien, by definition, is a "statutory charge upon property for taxes due."

The Federal tax lien in stern fact does bind and touches sharply, characteristics not unlike the tax liens of states and local taxing authorities.

But I think there are ways in which lawyers may render a real service to their clients when they are faced with the reality of a Federal tax lien, and, even more importantly, there are methods in the nature of advice and the exercise of caution which can be used by lawyers to protect their clients from the reach of the lien.

II

CONSTITUTIONAL PROVISIONS

Two familiar Constitutional provisions have application to the subject of Federal tax liens.

The first is Article 1, section 8, clause 1, relating to the powers of Congress:

> The Congress shall have Power To lay and Collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

The second Constitutional provision is Article 6, clause 2, commonly known as the supremacy clause:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

III

TAX COLLECTION AS AN ATTRIBUTE OF SOVEREIGNTY

It cannot be overemphasized that the matter with which we are concerned involves a sovereign. This fact requires that many general and common notions of the priority of liens between private creditors be put aside. It is necessary to bear in mind the essentials, which are absolute, in the maintenance of sovereignty. A brief quotation from a Supreme Court decision may be helpful.

> But taxes are the life-blood of government, and their prompt and certain availability an imperious need. Time out of mind, therefore, the sovereign has resorted to more drastic means of collection. The 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.[1]

Still another short quotation may be helpful.

> The power of taxation has always been regarded as a necessary and indispensable incident of sovereignty. A government that cannot, by self-administered methods, collect from its subjects the means necessary to support and maintain itself in the execution of its functions, is a government merely in name.[2]

The case of *Linn County v. Steele*[3] may be alluded to by way of indicating in more detail the nature of a tax lien of a sovereign. There the contest was between the county and a seller under a conditional sales contract who had repossessed. The county claimed that its liens under section 7205[4] and under section 7206[5] were superior to the conditional sales contract lien. The liens were in the name of the person who purchased the property.

The court noted that a real estate tax lien under section 7207 was interpreted to be a first lien although the statute does not expressly so provide, and that the same reasoning was to be applied to the lien for taxes on merchandise, fixtures, etc., assessed as personal property. The court said:

> The language of section 7202 is that the "taxes*** shall be a lien thereon against *all persons* except the state." The language in section 7205 is "shall be a lien thereon and shall *continue a lien thereon.*" The language of section 7206 is "*shall be and remain a lien*** until paid.*" (Italics supplied). If the lien is to be against "all persons" or if the lien is to "continue a lien thereon" or if the lien is to "remain a lien until paid" it must be held by necessary implication that the legislature intended to make said lien paramount and superior to all other liens. To hold that the plain intent of the legislature to have these taxes made a lien upon the specific property and remain a lien thereon in whosesoever hands the same may be found, may be evaded by the simple process of placing a chattel mortgage on all the property or disposing of the same by conditional sales contract, and later foreclosing or repossessing the property, would defeat the very purpose of the law.[6]

Of course, local and state tax liens of this kind must be related to and equated with the liens of the United States which has an overriding constitutional authority which would permit it to provide that Federal tax liens are first and paramount and that the debts due it may enjoy priority.

IV

THE APPLICABLE STATUTES

A. THE PRIORITY STATUTE, REV. STAT. § 3466, 31 U.S.C. § 191, AND PERSONAL LIABILITY OF FIDUCIARIES UNDER REV. STAT. § 3467, 31 U.S.C. § 192.

This undeviating, unyielding, inexorable reality of the basis of sovereignty was firmly in the minds of the framers of our Constitution. And it was firmly in the minds of the members of the first Congress, for that body, on July 31, 1789, enacted legislation which made it possible for

---

[1] Bull v. United States, 295 U.S. 247, 259, 35-1 U.S.T.C. ¶ 9346, 15 A.F.T.R. 1069 (1935).
[2] United States v. Snyder, 149 U.S. 210, 214 (1893).
[3] 223 Iowa 864, 273 N.W. 920 (1937).
[4] Presently Iowa Code § 445.31 (1958).
[5] Presently Iowa Code § 445.32 (1958).
[6] Linn County v. Steele, 223 Iowa 864, 873, 273 N.W. 920, 924 (1937).

the new United States of America to perpetuate and defend itself and devote itself to its proper and peaceful pursuits.

The legislation assured that the debts due the United States would be collected. The date of enactment reveals clearly the primacy given to the subject. It was a date less than four months after the first Congress held its first session on April 6. Washington was inaugurated on April 30. This provision was enacted prior to the date of the creation of the Supreme Court by the Federal Judiciary Act of September 24, 1789.

The provision to which I refer was the source of legislation enacted in 1797, which was amended in 1799, and which has remained unchanged since that time. It is now known as section 3466 of the Revised Statutes.[7] It is a priority statute and not a lien statute, but, together with the cases decided under it, must be considered and understood in any discussion of Federal tax liens.

> Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.[8]

Section 3467 of the Revised Statutes[9] provides for a method of enforcement of section 3466:

> Every executor, administrator, or assignee, or other person, who pays, in whole or in part, any debt due by the person or estate for whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate to the extent of such payments for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

Section 3466 is merely a reflection of the status of debts due the sovereign under common law.

> The right of priority of payment of debts due to the government is a perogative [sic] of the crown well known to the common law. It is founded not so much upon any personal advantage to the sovereign, as upon motives of public policy, in order to secure an adequate revenue to sustain the public burdens, and discharge the public debts. The claim of the United States, however, does not stand upon any sovereign perogatives, [sic] but is exclusively founded upon the actual provisions of their own statutes. The same policy which governed in the case of the royal perogative, [sic] may be clearly traced to these statutes; and as that policy has mainly a reference to the public good, there is no reason for giving to them a strict and narrow interpretation. Like all other statutes of this nature, they ought to receive a fair and reasonable interpretation, according to the just import of their terms.[10]

---

[7] 31 U.S.C. 191 (1958).

[8] Derived from Act of Mar. 3, 1797, ch. 20, § 5, 1 Stat. 515; and Act of Mar. 2, 1799, ch. 22, § 65, 1 Stat. 676.

[9] 31 U.S.C. 192 (1958).

[10] United States v. State Bank of North Carolina, 31 U.S. (6 Pet.) 29, 35 (1832).

A brief reference to a few of the many cases decided by the Supreme Court under section 3466 of the Revised Statutes is necessary, for the rules there expressed and uniformly adhered to by the Supreme Court are reflected in the tax lien decisions. The Supreme Court has consistently held that inchoate liens, that is to say, liens which are not specific and perfected, do not prevail over debts due the Government in priority contests. A leading case is *Thelusson v. Smith.*[11] There it was held that a judgment was inferior to a debt due the United States because the judgment creditor had not seized the property under *fieri facias.*

In another case, the State law provided that a personal property tax was a lien upon all of the real and personal property of the taxpayer if the taxpayer no longer possessed the personal property on which the tax was assessed, and the State law prescribed the procedure for enforcing the lien. The Supreme Court held the lien was inchoate until this procedure had been followed.[12]

A lien of the State of New York for franchise taxes under State law was held to be inferior to the debt due the United States. The Supreme Court held that such State franchise tax lien was not specific nor perfected because the liability was unliquidated and unknown. The state might omit to ascertain the debt, and the doctrine of relation back would not divest the United States of the priority which became fully effective when the receivers were appointed. In citing *Thelusson v. Smith,* the court said:

> The ruling there was that the general lien of a judgment upon the lands of an insolvent debtor is subordinate to the preference established by the statute unless seizure by a marshal or some other equivalent act has made the lien specific and brought about a change of title or possession.[13]

The priority prevailed over a state gasoline tax lien which by state law was declared to be a first and preferred lien against all of the property used in the taxpayer's business. The Supreme Court held that the state lien was neither specific nor constant; the claim was uncertain as the audit might be incorrect, and the final amount was left for determination by the courts.[14]

The priority defeated a landlord's lien, although the state court held that the landlord's right constituted a fixed and specific lien, because

> the tenant was divested of neither title nor possession by the silent existence of the landlord's statutory lien on the date of the assignment. Only after the lien was actually asserted and an attachment or a distraint levied, enabling the landlord to satisfy his claim out of the seized goods, could it be argued that such goods severed themselves from the general and free assets of the tenant from which the claims of the United States were entitled to priority of payment.[15]

B. THE LIEN STATUTES—SECTIONS 6321 AND 6322, INTERNAL REVENUE CODE OF 1954

Turning to the lien statutes, the lien for the tax on distilled spirits, the ten-year estate tax lien imposed by section 6324(a) of the Internal

[11] Thelusson v. Smith, 15 U.S. (2 Wheat.) 396 (1817).
[12] County of Spokane v. United States, 279 U.S. 80, 1 U.S.T.C. ¶ 387 (1929).
[13] New York v. Maclay, 288 U.S. 290, 293 (1933).
[14] United States v. Texas, 314 U.S. 480 (1941).
[15] United States v. Waddill, Holland & Flinn, Inc., 323 U.S. 353, 358, 45-1 U.S.T.C. ¶ 9126 (1945).

Revenue Code of 1954 upon the gross estate of a decedent, and the ten-year gift tax lien imposed by section 6324(b) of the Internal Revenue Code of 1954 which attaches to property comprising a gift in the hands of a donee, are special tax liens applicable in special situations.

The general Federal tax lien secures all Federal taxes which are assessed. It is the lien of general interest and the lien with which we are here concerned. The statutes are simple and direct.

The general Federal tax lien is imposed in these brief words:

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.[16]

The next section, equally brief, describes when the lien arises and the period of its effectiveness:

> Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.[17]

These two sections of law have been in existence in substantially their present form since 1879.[18] Under the present section 6322, the lien arises at the time the assessment is made. This is an administrative act performed by the District Director of Internal Revenue, or his delegate.

To illustrate the reach of the Federal lien statutes, as they existed prior to 1913, one need only refer to two cases. In *United States v. Snyder*,[19] real estate in Louisiana was sold after a tax was assessed against its owner. In an action by the United States to foreclose its lien that was brought after the sale of the property, the purchaser of the real estate contended that the Federal tax lien was ineffctive because it was not recorded as required by the law of Louisiana. The single question presented to the Supreme Court was whether the tax system of the United States is subject to the recording laws of the states. The Court held that it was not, saying:

> If the United States, proceeding in one of their own courts, in the collection of a tax admitted to be legitimate, can be thwarted by the plea of a state statute prescribing that such a tax must be assessed and recorded under state regulation, and limiting the time within such tax shall be a lien, it would follow that the potential existence of the government of the United States is at the mercy of state legislation.
>
> Moreover, it scarcely seems necessary to look beyond the constitution itself for a decisive reply to the question we are now considering. The 8th section of the 1st article declares that "the Congress shall have power to lay and collect taxes, duties, imposts, and excises, . . . but all duties, imposts, and excises shall be uniform throughout the United States." The power to impose and collect the public burthens is here given in terms as absolute as the

---

[16] INT. REV. CODE OF 1954, § 6321 (formerly Int. Rev. Code of 1939, § 3670). References herein to Code sections relate to the Internal Revenue Code of 1954, unless otherwise stated.

[17] INT. REV. CODE OF 1954, § 6322 (formerly Int. Rev. Code of 1939, § 3671).

[18] Section 6321 was derived from REV. STAT. § 3186(a) (1875), as amended by Act. of Mar. 1, 1879, ch. 125, § 3, 20 Stat. 331, Act of Mar. 4, 1913, ch. 166, 37 Stat. 1016, Act. of Feb. 26, 1925, ch. 344, 43 Stat. 994, and Act of May 29, 1928, ch. 852, § 613, 45 Stat. 875.

[19] 149 U.S. 210 (1893).

> language affords. The provision exacting uniformity throughout the United States itself imports a system of assessment and collection under the exclusive control of the general government. And both the grant of the power and its limitation are wholly inconsistent with the proposition that the states can by legislation interfere with the assessment of Federal taxes, or set up a limitation of time within which they must be collected.
>
> . . . the tax system of the United States is regulated by the Federal statutes and practice, and are not controlled by state enactments.[20]

The next occasion upon which the Supreme Court considered the lien statutes was in *Blacklock v. United States*.[21] There, the real estate in question was conveyed by deed of trust to secure an indebtedness when there was a Federal tax lien in being. The Court concluded that the government had the right by distraint to sell such interest in the lands as the delinquent distiller owned at the time the lien attached, and that neither the taxpayer nor anyone asserting rights under the deed of trust had any ground of action against the government.

C. SECTION 6323 OF THE INTERNAL REVENUE CODE

In 1913, a change was made in the Federal tax laws and a new provision was added which left the two existing sections unchanged, but provided that such lien should not be valid against any mortgagee, purchaser or judgment creditor until notice thereof had been filed in a properly designated public office.

In 1939, pledges were added to the classes which were protected, so that the lien was invalid as to them unless notice thereof was filed. In the same year, securities, to a certain extent, were removed from the reach of the lien. It was provided that although notice of lien is filed, the lien shall not be valid with respect to a security as against any mortgagee, pledgee or purchaser of such security without notice or knowledge of the existence of such lien. Judgment creditors, it will be observed, are not protected in respect of securities. In general, a security, within the meaning of this provision, consists of stocks, bonds, negotiable instruments or money.[22]

In *Glass City Bank v. United States*,[23] the Supreme Court held that the Federal tax lien applies to property owned by a delinquent taxpayer at any time during the life of the lien, that is, it applies to after-acquired property and is not limited to property the taxpayer may have owned at the time the notice of lien attached. The Court said:

> . . . Congress impressed a lien upon "all property and rights to property, whether real or personal, belonging" to a tax delinquent. Stronger language could hardly have been selected to reveal a purpose to assure the collection of taxes.[23a]

---

[20] *Id.* at 214

[21] 208 U.S. 75 (1908).

[22] INT. REV. CODE OF 1954, § 6323 (formerly Int. Rev. Code of 1939, § 3672).

[23] 326 U.S. 265, 45-2 U.S.T.C. § 9449 (1945).

[23a] *Id.* at 267.

D. RELEASE OF LIEN AND DISCHARGE OF PROPERTY FROM LIEN

The statutory provisions relating to discharge of property from the effect of the lien and release of the lien should not be overlooked in a consideration of the Federal tax lien. They are contained in section 6325 of the Internal Revenue Code.

The general lien may be released where the liability for the amount assessed plus interest and other additions has been fully satisfied or has become legally unenforceable.[24] It may be released if a bond conditioned on full payment within the time prescribed by law has been accepted.[25]

Property may be discharged from the lien if the taxpayer possesses other property subject to the lien of at least double the amount of the unsatisfied liability and all other liens having priority over the tax lien.[26]

Property may be discharged from the lien when there is an administrative determination that the interest of the United States in the property has no value,[27] and a certificate of discharge of property from the lien may issue where there is paid over to the United States an amount not less than the value of the interest of the United States in the property to be discharged.[28] This latter provision is especially useful, and a discussion of a lien problem with Internal Revenue Service officers in the office of the District Director, or attorneys in the office of the Regional Counsel, will very often result in a solution under this provision.

A partial discharge, or a discharge of property from the tax lien may be obtained in such cases, for example, as where the taxpayer owes $40,000, the fair market value of the property is $30,000, and there is a prior mortgage of $18,000. An application may be made to the District Director for discharge of the property from the tax lien on payment of the dollar value of the interest of the United States in the property. This would be the net amount after allowance of the amount due under the mortgage, and the necessary expenses of sale such as broker's commission, reasonable attorney's fees, appraisal expenses and various other expenses of the seller which may arise.

The certificate of discharge will not be issued unless the taxpayer is divesting himself of title. There is also an administrative provision for a certificate of nonattachment which may be used in a proper case. There may, for example, be a confusion of names. The taxpayer may be John Smith, and a notice of tax lien filed against him may affect the property of other persons by the same name. A certificate of nonattachment may be issued which will clearly and specifically certify that the Federal tax lien did not attach to the property of the John Smith who is not the taxpayer. Such a certificate is obtained by application to the District Director.

These provisions, by the way, relating to release and discharge may be contrasted with a somewhat general lack of similar provisions under State and local laws.

---

[24] INT. REV. CODE OF 1954, § 6325(a)(1).
[25] INT. REV. CODE OF 1954, § 6325(a)(2).
[26] INT. REV. CODE OF 1954, § 6325(b)(1).
[27] INT. REV. CODE OF 1954, § 6325(b)(2)(B).
[28] INT. REV. CODE OF 1954, § 6325(b)(2)(A).

E. ENFORCEMENT OF LIEN AND COLLECTION PROCEDURES

Federal taxes may be collected by suit in a judicial proceeding,[29] and by foreclosure,[30] utilizing, in proper cases, a receiver. They may also be collected by levy.[31] This procedure is simple and direct and is administrative in nature, being effected without resort to court proceedings. The term "levy" includes the power of distraint and seizure by any means and the sale of such property or rights to property, whether real or personal, tangible or intangible.

Under section 6332, when the taxpayer's property is in the hands of a third person, the levy is effected by the service of a notice of levy on such third person, and a penalty is provided in the event such third person does not turn over the property or rights to property which he may possess. The penalty is in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes for the collection of which such levy has been made, together with costs and interest on such sum at the rate of six per cent per annum from the date of such levy.

Another section provides that the United States may be named a party in any civil action in any district court or state court having jurisdiction of the subject matter, to quiet title to or for the foreclosure of a mortgage or other lien upon real or personal property on which the United States has or claims a mortgage or other lien.[32] Section 7424 of the Internal Revenue Code also provides a means for a person claiming a lien to obtain an adjudication, but is rarely used because the procedure is more complicated than that prescribed by section 2410. In these actions the position and priority of the tax lien are, of course, adjudicated.

F. THE LIEN ARISES WHEN THE STATUTE PROVIDES

Two cases are worthy of comment at this point. They relate to the estate tax lien and not to the general tax lien, but they serve to maintain the proper perspective in that they emphasize the fact that the lien arises when the statute provides. In the case of the estate tax lien, it is the date of death; in the case of the general tax lien, it is the date the assessment is made. The provisions for filing the notice relate to the general lien and only to purchasers, pledgees, mortgagees, and judgment creditors. Whatever may be the effect of the notice as to those four groups, the general lien nevertheless arises when the assessment is made. It may in this regard be compared to a great many State and local tax liens as, for example, the Iowa retail sales tax where the statute specifically provides the lien exists as to personal property without the necessity of recording. In New York, the corporate franchise tax lien arises at the beginning of the year although the tax cannot be computed until the end of the year.[33] In some States, mechanics' liens arise when the contract is entered into.

The first case was *Detroit Bank v. United States*,[34] which held that the Federal tax lien, although unrecorded, was superior to a mortgage lien and

[29] Int. Rev. Code of 1954, §§ 7401, 7404.
[30] Int. Rev. Code of 1954, § 7403.
[31] Int. Rev. Code of 1954, § 6331.
[32] 28 U.S.C. § 2410 (1958).
[33] See New York v. Maclay, 288 U.S. 290 (1933).
[34] 317 U.S. 329, 43-1 U.S.T.C. ¶ 9224 (1943).

local tax liens which had accrued after the death of the decedent. There was and is no statute requiring filing of notice of the Federal estate tax lien which arises at the date of the decedent's death.

The decision was based on the *Snyder* case, heretofore referred to, which was decided in 1893, where the rule was announced that in the absence of a Federal statute requiring notice of lien to be recorded, such lien is superior to a subsequent mortgage, and State laws requiring the recording of liens are not applicable to the Federal Government.

The second case, a companion case decided on the same day, was *Michigan v. United States*,[35] which related to local taxes accruing subsequent to the Federal estate tax lien. State statutes provided that local taxes were liens on real property and were a "first lien prior, superior, and paramount."

The Supreme Court held that the Federal priority could not be set aside by state legislation, and said:

> We do not stop to inquire whether this construction of the state statutes is the correct one, for we think the argument ignores the effect of a lien for federal taxes under the supremacy clause of the Constitution. The establishment of a tax lien by Congress is an exercise of its constitutional power "To Lay and collect Taxes." Article 1, § 8 of the Constitution. *United States v. Snyder,* 149 U.S. 210. And laws of Congress enacted pursuant to the Constitution are by Article VI of the Constitution declared to be "the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary nothwithstanding."
>
> "It is of the very nature and essence of a lien, that no matter into whose hands the property goes, it passes *cum onere.*" *Burton v. Smith,* 13 Pet. 464, 483; *Rankin v. Scott,* 12 Wheat. 177, 179, *Howard v. Railway Co.,* 101 U. S. 837, 845. Hence it is not debatable that a tax lien imposed by a law of Congress, as we have held the present lien is imposed, cannot, without the consent of Congress, be displaced by later liens imposed by authority of any state law or judicial decision. *United States v. Snyder, supra.* . . .[36]

V

THE PRIORITY STATUTE AND THE LIEN STATUTE AS KINDRED MATTERS

There is another case which deserves specific and detailed attention. It is *United States v. Security Trust & Savings Bank*,[37] decided in 1950, and an understanding of it will go far toward a solution of tax lien problems.

Real estate had been attached in a suit filed in a state court, but before judgment was obtained, notices of Federal tax lien were filed in respect of assessments which were received after the state court attachment. Under state law, the lien of an attachment on real property became effective upon the recording of a copy of the writ with a description of the property attached. The Supreme Court held that the attachment lien was an inchoate lien, and the liens of the United States were superior thereto. In reaching this conclusion, the court utilized the substantial and consistent and fully established Federal law under section 3466 of the Revised Statutes

---

[35] 317 U.S. 338 (1943).
[36] *Id.* at 340.
[37] 340 U.S. 47, 50-2 U.S.T.C. ¶ 9492 (1950), *reversing* 93 Cal. App. 2d 608, 209 P.2d 657 (1949).

which had come to maturity over a period of a century and a half. The Government argued:

> The Federal Tax Lien Statute was designed to supplement, and serves purposes comparable to Rev. Stat. Sec. 3466, 31 USC Sec. 191, providing for the priority of debts due the United States where a debtor is insolvent, and the tax lien should attach to the same property interests belonging to a tax delinquent as are reached by that statute.

The Supreme Court accepted the argument, stating:

> In cases involving a kindred matter, *i.e.*, the federal priority under R. S. § 3466, it has never been held sufficient to defeat the federal priority merely to show a lien effective to protect the lienor against others than the Government, but contingent upon taking subsequent steps for enforcing it. *Illinois v. Campbell, supra,* 374. If the purpose of the federal tax lien statute to insure prompt and certain collection of taxes due the United States from tax delinquents is to be fulfilled, a similar rule must prevail here. Accordingly, we hold that the tax liens of the United States are superior to the inchoate attachment lien. . . .[38]

Mr. Justice Jackson, in a concurring opinion agreed; and added: "The history of this tax lien statute indicates that only a judgment creditor in the conventional sense is protected."[39]

He traced the history of the lien statutes and their amendments, particularly the section known as section 3672 of the 1939 Internal Revenue Code and said: "My conclusion from this history is that the statute excludes from the provisions of this secret lien those types of interests which it specifically included in the statute and no others."[40]

The fact that the majority of the Court should look, as it did, to cases involving a "kindred matter" appears to be quite natural and proper.

Section 3466 of the Revised Statutes had stood as a monument for over a century and a half. It gave the United States a priority in the payment of debts due it in the case of insolvent persons indebted to the United States; decedents' estates with assets insufficient to pay the debts of the deceased; voluntary assignments; absconding, concealed or absent debtors; and in cases in which an act of bankruptcy is committed.

This existing, recognized body of law which had developed in respect of section 3466 was utilized by the Court in resolving the lien case before it. In the lien cases, as in the priority cases under section 3466, the debtor's financial condition ordinarily is such that the creditors find themselves in conflict, contending over the last insufficient asset, even though there may have been no formal finding of insolvency, no decedent's estate, no voluntary assignment and, perhaps, no act of bankruptcy.

It would indeed have been a strange result if a mere debt due the United States under Revised Statutes section 3466 should enjoy a position and a priority superior in quality and character to, and more effective than, the more formal tax obligation denominated as a lien by section 6321.

In the light of the constitutional provisions requiring uniformity in the levy and collection of federal taxes and in the light of the basic Congressional principle of uniformity in its tax scheme, it would seem that the

---

[38] *Id.* at 51.
[39] *Id.* at 52.
[40] *Id.* at 53.

Court had no alternative but to reject the notion that the relative priority of liens under state laws contending with the federal tax lien should be determined on the basis of the manifold and manifest vagaries of the laws of the several states and territories.

VI

THE "FIRST IN TIME, FIRST IN RIGHT" PRINCIPLE

In 1954, the Supreme Court made it clear that the principle "first in time, first in right," applied in federal tax lien cases, and that competing choate liens which were prior in time to the federal tax lien were prior in right.

The case was *United States v. City of New Britain*[41] and held that local liens for real estate taxes and water rents which were levied on specific real estate were choate liens and enjoyed priority over the federal tax lien to the extent they were prior in time. The court said:

> Thus, the priority of each statutory lien contested here must depend on the time it attached to the property in question and became *choate*. (Emphasis supplied).[42]

In brief summary, the cases decided under section 3466 of the Revised Statutes are authorities to be used in the resolution of Federal tax lien problems, and the principles in the priority cases are applicable to lien cases.

In summary also, the consistent and uniform rule of choateness applies to the lien cases as well as the priority cases. The "first in time, first in right" principle applies. A choate lien in the Federal sense will defeat the Federal tax lien as well as the United States priority if it is first in time. If it is not choate and is not first in time, it will not prevail.

VII

SPECIFIC PROBLEMS

A. LANDLORDS

On January 10, 1955, the Supreme Court decided *United States v. Scovil*,[43] which involved the relative priority of a landlord's distress for rent under the laws of South Carolina, and a Federal tax lien.

The Supreme Court decided the case under section 3672 of the 1939 Code (the predecessor of section 6323), and not under section 3466 of the Revised Statutes as it might have done because a receiver had been appointed. It decided that the landlord had a lien other than a mortgage, pledge, or judgment lien, and that section 3672 afforded no protection to liens other than those named in that section. The court observed that the landlord's distress lien was not perfected in the Federal sense. This lack of perfection was based on a provision of the South Carolina law to the effect that the tenant might put up a bond and free the property from the distress lien, and thus reacquire any interest the landlord may have had in the property, and that, therefore, the distress lien was only a caveat of a more perfect lien to come. The decision called into play and

[41] 347 U.S. 81, 44 A.F.T.R. 798 (1954).
[42] *Id.* at 86.
[43] 348 U.S. 218, 55-1 U.S.T.C. ¶ 9137 (1955), *reversing* 224 S.C. 233, 78 S.E.2d 277 (1953).

relied on the old cases under section 3466 as well as the more recent lien cases.

The landlord had argued that he should be considered a purchaser, and hence protected by section 3672. The argument was rejected by the court which said: "A purchaser within the meaning of § 3672 usually means one who acquires title for a valuable consideration in the manner of vendor and vendee."[44]

It may be well to recall that in *United States v. Waddill, Holland & Flinn, Inc.*,[45] in 1945, the Supreme Court had held under section 3466 that the priority of that section defeated a landlord's lien.

B. ATTACHMENT AND GARNISHMENT CREDITORS

The *Security Trust & Savings Bank* case[46] was followed in *United States v. Acri*[47] which arose in Ohio and involved an attachment lien. The tax lien arose and the notice was filed after the attachment but before the judgment. The Ohio courts had held that an attachment lien was an "execution in advance and a lien perfected at the time of attachment."[48] The Supreme Court held the attachment lien to be inchoate, saying: "We hold here that the attachment lien in Ohio is for federal tax purposes an inchoate lien because, at the time the attachment issued, the fact and the amount of the lien were contingent upon the outcome of the suit for damages."[49]

Again the old principles developed under section 3466 of the Revised Statutes were utilized, that is, the relative priority of a Federal lien is always a Federal question to be determined by the Federal Courts, and the state's characterization of its liens, while good for all state purposes, does not bind the Federal Courts.

Another case decided on January 10, 1955, was *United States v. Liverpool & London & Globe Insurance Co., Ltd.*[50] This case involved the question of priority of a lien of garnishment and arose in Texas. The garnishment was served upon a fire insurance company which owed money under its policy. It was served before the Federal tax lien arose and before notice of it was filed. However, the judgment was not secured and entered until after the filing of the notice of lien. The insurance company paid the money it owed into the registry of the court and asked for $500.00 attorneys' fees. The Supreme Court pointed to the *Acri* and *Security Trust & Savings Bank* cases, and held the tax lien to be superior to that of the garnisher. Regarding the application for attorneys' fees, the court, in denying them, said:

> If the garnishment lien is not prior to the Government liens, and we have held that it is not, certainly fees allowed in that proceeding are not prior to the Government liens, and the authorization of the payment of the attorney's fees prior to the Government liens was error.[51]

---

[44] *Id.* at 221.
[45] 323 U.S. 353, 45-1 U.S.T.C. ¶ 9126 (1945).
[46] United States v. Security Trust & Sav. Bank, 340 U.S. 47, 50-2 U.S.T.C. ¶ 9492 (1950).
[47] 348 U.S. 211, 55-1 U.S.T.C. ¶ 9138 (1955), *reversing* 209 F.2d 258 (6th Cir. 1953).
[48] Rempe & Son v. Ravens, 68 Ohio St. 113, 67 N.E. 282 (1903).
[49] 348 U.S. at 214.
[50] 348 U.S. 215, 55-1 U.S.T.C. ¶ 9136 (1955), *reversing* 209 F.2d 684 (5th Cir. 1953).
[51] *Id.* at 217.

C. MECHANICS' LIENS

Four mechanics' lien cases have been decided by the Supreme Court. They are *United States v. Colotta*,[52] *United States v. White Bear Brewing Company*,[53] *United States v. Vorreiter*,[54] and *United States v. Hulley*.[55] In the *Colotta* case, which arose in Mississippi, the Supreme Court of Mississippi held that the mechanic's lien which arose prior to the Federal tax lien was specific, choate, and perfected, and it rejected the argument that it was inchoate until perfected by judgment. It also rejected the argument that it was no more than a *lis pendens* notice that the right to perfect a lien existed. The reversal of the Supreme Court of Mississippi was effected by a three-line *per curiam* opinion.

The *White Bear* case arose in Illinois, and the mechanic lienor had filed his suit to foreclose his lien prior to the time the Federal tax lien arose and notice was filed. Another *per curiam* opinion reversed the lower courts. Two Justices dissented, and in the dissenting opinion said:

> The Court apparently holds that under 26 U.S.C. § 3670 a lien that is specific and choate under state law, no matter how diligently enforced, can never prevail against a subsequent federal tax lien, short of reducing the lien to final judgment.[56]

The *Vorreiter* case arose in Colorado. The tax lien was assessed in Texas where the taxpayers resided. The work in Colorado had been completed and mechanics' lien statements filed under the state law prior to the time the tax lien notice was filed in Colorado. The Colorado statute provided that the mechanics' liens related back to the time of the commencement of the work and were superior to all intervening liens as well as to prior liens of which the lienor did not have notice. The State Supreme Court held that the Colorado Mechanics' Lien Law was a part of the Property Law of the State, and that the mechanic lienor had a property interest in the taxpayer's property, and that to give priority to the United States would unjustly enrich the United States to the extent the value of the property was increased by the work performed and the material supplied. As in the other mechanics' lien cases, a *per curiam* opinion reversed the judgment, citing the *Security Trust & Savings Bank* case. The *Hulley* case was also disposed of by a *per curiam* opinion on November 10, 1958.

But it should be added that two additional cases have been presented to the Supreme Court which involves mechanics' lien problems. The theory adopted in one of these cases, *United States v. Durham Lumber Co.*,[57] was that the Government did not prevail over a subcontractor, not because of any inchoateness of the subcontractor's mechanics' liens but on the theory that the taxpayer-contractor had no interest in the retained fund until he had completed the contract, and the contract was not completed until the subcontractors had been paid. Hence, the taxpayer had no property or property interest in the fund to which the tax lien could apply. The other

---

[52] 350 U.S. 808, 55-2 U.S.T.C. ¶ 9680 (1955), *reversing* 224 Miss. 33, 70 So. 2d 474 (1955).
[53] 350 U. S. 1010, 56-1 U.S.T.C. ¶ 9440 (1956), *reversing* 227 F.2d 359 (7th Cir. 1955).
[54] 355 U.S. 15, 57-2 U.S.T.C. ¶ 9956 (1957), *reversing* 134 Colo. 543, 307 P.2d 475 (1957).
[55] 358 U.S. 66, 58-2 U.S.T.C. ¶ 9926 (1958), *reversing* 102 So. 2d 599 (Fla. 1958).
[56] United States v. White Bear Brewing Co., 350 U.S. 1010, 1011 (1956).
[57] 257 F.2d 570, 2 A.F.T.R.2d 5397 (4th Cir. 1958).

case is *Aquilino v. United States*[58] which arose in New York and was decided in favor of the Government on the authority of the mechanics' lien cases heretofore referred to.[59]

It is true a mechanic lienor may have contributed to an increase in the value of the property. It is also true that this may not be the case. The increase in value, if any, is not necessarily equal to the value of the labor and materials. A mechanics' lien may arise out of an ill-advised or grotesque application of labor and materials or of demolition or other activities which may in no manner improve or increase the value. The nonpayment of taxes in connection with a job may be considered as increasing the value of the property quite as realistically. A taxpayer's total resources remain undiminished to the extent of his failure to pay taxes he owes and there appears to be little persuasive reason why the tax lien should not apply to such resources.

In considering the problem of mechanic lienors, it may be well to recall that creditors of an owner, contractor or subcontractor who see fit to extend credit by advancing labor or materials may use all necessary precaution by investigating their prospective debtor's financial standing and they may be, and indeed usually are, fully and adequately protected by a surety bond. The bonding company in turn may similarly investigate the contract and financial standing of its prospective principal before electing to take the risk. Further, it has the opportunity to protect itself by charging sufficient fees to fully compensate itself in its business covering a number of risks.

These means are not available to the Government which as an unwilling creditor may only rely on its tax lien.

The experience of a surety company should permit it to fix the premiums on all of its bonds to enable it to absorb losses on particular jobs.

Indeed, the unwarranted (as it turns out) extension of credit may be the very reason for the taxpayer's delinquency in the payment of Federal taxes. This type of easy credit and financial adventuring may have enabled a marginal or an uneconomically operated business, or one with an improvident contract, to thrust an additional tax burden on the general taxpaying public, to the extent of the delinquent taxes of the principal on the bond. The surety company's failure to service the obligation and promptly ascertain and correct defaults under the contract may further increase the burden on the general taxpaying public. Needless to say, it also prevents an economically sound contracting business from doing the job under a well considered and profitable contract and under conditions which will result in the payment of its taxes.

---

[58] 3 N.Y.2d 511, 146 N.E.2d 774, 1 A.F.T.R.2d 761 (1957).

[59] On June 20, 1960, the Supreme Court affirmed the decision in the *Durham Lumber* case, 363 U.S. 522, 5 A.F.T.R.2d 1703, utilizing the principle that property rights are to be determined by state law, and that a general contractor has property or a property interest in the amounts owed by the property owner for whom work has been performed only to the extent that the amounts owed exceed the amounts owed by the contractor to his subcontractors. On the same date, the *Aquilino* case was remanded to the New York Court of Appeals, 363 U.S. 509, 5 A.F.T.R.2d 1698, in order that the New York court might ascertain the property interests of the contractor-taxpayer in the fund under state law. In a dissenting opinion the point is made that the Government's lien is asserted against the chose in action which the general contractor allegedly holds against the owner of the real estate on which the improvements were made in respect of amounts due from the owner under the construction contract.

Mechanics' liens were neither recognized at common law nor allowed in equity. They are entirely dependent on statute. It is probably safe to say that the mechanics' lien laws, while sharing many similarities, are different in each of the 50 states.

In respect of their relationship to Federal taxes, on purely logical grounds or even social grounds, it is difficult to understand why one who sells lumber which is used in constructing an addition to a furniture factory, or which is used in its repair, should enjoy a mechanics' lien while one who sells lumber to the same purchaser on the same day at the same price is entitled to no such lien if the lumber is used in the manufacture of furniture.

Similarly, it is difficult to find a real and meaningful distinction in the case of a sand pit operator who has a lien for the value of the sand he sells which is used in the construction, alteration, or repair of a building, but has no lien for the value of the same kind of sand he sells on the same day at the same price and to the same person if it is used in the manufacture of cement blocks. The same is true if he sells to a dealer in sand.

In many minds, it is difficult to rationalize a distinction between the carpenter who works on the construction, alteration or repair of a furniure factory, and the next day works on the construction, alteration or repair of furniture in the furniture factory. Yet, in the one case, he ordinarily will have a mechanics' lien, and in the other case he will not.

The same may be said of the man who shovels sand in the construction, alteration or repair of a cement block factory, and the man who shovels sand in the construction of cement blocks.

If there is a social reason for giving the laborer a lien as one who is perhaps not able adequately to protect himself, it would seem that it should apply in both instances. However, it may be added that the mechanic's lien—tax lien cases do not ordinarily involve unpaid claims of laborers. One may speculate that this is the effect of protection given them by unions and by surety bonds.

Yet, under the doctrine announced by the Supreme Court, they are all treated alike. Each one is protected if he promptly recognizes the fact which is available to him, that is, simply and clearly that he has not been paid, obviously an inescapable fact. He has a clear and present remedy if he fears the impact of a tax lien whether of the Federal Government or of state or local governments, that is, to refuse to extend further credit and reduce his claim to judgment.

D. MORTGAGEES AND PLEDGEES

Section 6323 protects mortgagees as well as pledgees, purchasers, and judgment creditors. Of a purchaser, the Supreme Court has said "a purchaser within the meaning of § 3672 [now § 6323] usually means one who acquires title for a valuable consideration in the manner of vendor and vendee."[60] Further, the Surpreme Court has said a judgment creditor as used in section 6323 means a judgment creditor "in the usual, conventional sense of a judgment of a court of record, since all States have such courts."[61]

[60] United States v. Scovil, 348 U.S. 218, 221, 55-1 U.S.T.C. ¶ 9137 (1955).
[61] United States v. Gilbert Asosciates, 345 U.S. 361 (1953).

Thus, one may well conclude that the mortgagees and pledgees protected by Section 6323 are mortgagees or pledgees in the conventional sense. The determination of whether a person falls within these classes is made by reference to the realities and facts in a given case rather than to the technical form or terminology used to designate such a person.[62] Security interests such as are represented, for example, by trust deeds which are in the nature of mortgages, would be protected under Section 6323 if they are executed prior to the time the notice of tax lien is filed, to the extent they are bona fide, given for a full and present consideration in money or money's worth, are due at a certain time in a certain amount, are established as liens by the State law, and are properly perfected, executed, filed, recorded, or re-recorded as required by State law.

In the case of a pledge, it would appear that there should also be a bailment or possession by the pledgee as "the fundamental idea of the pledge is possession by the pledgee."[63]

Insofar, however, as such interests are conditional, contingent, indefinite, inchoate, or are not for a present, full and adequate consideration in money or money's worth, or insofar as they are not liens under State law, are not perfected, or are improperly executed or recorded, they cannot be considered to have the priority as mortgages or pledges.

An indenture purporting to be a mortgage and labeled or designated as such which does not contain the essential characteristics of a conventional mortgage is not within the purview of Section 6323.[64]

The case of *United States v. R. F. Ball Construction Company*[65] involved consideration of a contractual lien which was in the form of an assignment for security, but which was denominated as a mortgage by the lower courts. The question presented was whether an assignment by a subcontractor to his performance bond surety of all sums due or to become due for the performance of the subcontract, as security for any indebtedness, or liability thereafter incurred by the subcontractor to the surety, constituted the surety a "mortgagee" of those sums within the meaning of 1939 Code section 3672.

The assignment was made on July 21, 1951. On April 30, 1953, a sum became due under the subcontract, but was not paid because of outstanding claims of materialmen against the subcontractor. Thereafter, the Federal tax liens were filed. Still later, during the coexistent period of the bond and the assignment, the subcontractor incurred indebtedness to the surety which was independent of the subcontract. The mechanics' liens were paid, and, thus, the assignment covered only the indebtedness incurred independent of the subcontract which was bonded.

In an interpleader action by the contractor, the district court and the court of appeals held that the surety became a mortgagee of the fund under the assignment within the meaning of section 3672. The Supreme Court, in a short *per curiam* opinion reversed, announcing that the instrument involved, being inchoate and unperfected, did not bring into play the provision of section 3672. It cited the *Security Trust & Savings Bank* and the *New Britain*

---

[62] Rev. Rul. 56-592, 1956-2 CUM. BULL. 945. See also TREAS. REG. § 301.6323-1 (1955).
[63] RESTATEMENT, SECURITY § 1, *Comment* (1941).
[64] See references in n. 62, *supra*.
[65] 355 U.S. 587, 58-1 U.S.T.C. ¶ 9327 (1958), *reversing* 239 F.2d 384 (5th Cir. 1956).

cases and declared the claim of the interpleader for its costs was controlled by *United States v. Liverpool & London & Globe Insurance Company, Ltd.*[66]

Four Justices dissented. They felt that the assignment was a mortgage in the ordinary and common law sense. They pointed out that the state law of Texas, where the case arose, made such assignment a valid mortgage and that while the relation of a state-created right to Federal laws for the collection of Federal credits is a Federal question, the state's classification of state-created rights must be given weight. In the circumstances, the dissenting Justices believed that such an assignment of all sums due, or to become due, as security for the payment of an identified but contingent and unliquidated obligation was "in legal effect a mortgage, completely perfected on its date, in all respects choate, and valid between the parties; and inasmuch as it antedated the filing of the federal tax liens it was expressly made superior to those liens by the terms of § 3672(a)."[67]

The Court had previously determined that a judgment creditor under section 3672 must be a judgment creditor in the conventional sense at the time the notice of lien was filed.[68] It had also given the usual, conventional meaning to "purchaser" under section 3672.[69] The view of the majority that an assignee for security of an undetermined, contingent amount, who had contemporaneously advanced no money, was not a "mortgagee" within the meaning of section 3672, appears to be in harmony with its previous holdings.

Similarly, the decision of the majority is consistent with the position that such an assignment for security, where the amount secured is unknown and contingent and not reduced to possession, is not a specific, perfected or choate lien, and appears to conform with the previous decisions[70] and announced principles.

Mortgages contemplating future advances may deserve comment. In the case of an open-end mortgage where the future advance is optional, the mortgage to the extent of advances made after the notice of tax lien is filed will be inferior to the tax lien.[71] This is so because in respect of the advances made after the notice of tax lien is filed, the mortgage is conditional and contingent; in a word, inchoate. The amount is not known or established, and the circumstances of the advance are uncertain when the notice of tax lien is filed. Where, however, the mortgage is made before the notice of Federal tax lien is filed but the advances to be made thereunder are obligatory, the mortgage, to the extent of such obligatory advances, will enjoy priority over the Federal tax lien.

Purchase money mortgages which may be executed after a notice of Federal tax lien is filed will enjoy priority over the tax lien. This is so because while the taxpayer may acquire legal title to the property, the beneficial interest in whole or in part is owned by or remains in the seller. In effect, a purchase money mortgage is a limitation on the title which a mortgagor takes rather than an encumbrance on the title conveyed. This may be so even where the mortgage is executed to a third person and

[66] 348 U.S. 215, 55-1 U.S.T.C. ¶ 9136 (1955).
[67] 355 U.S. 587, 594 (1958).
[68] United States v. Gilbert Associates, 345 U.S. 361 (1953).
[69] United States v. Scovil, 348 U.S. 218, 55-1 U.S.T.C. ¶ 9137 (1955).
[70] United States v. Security Trust & Sav. Bank, 340 U.S. 47, 50-2 U.S.T.C. ¶ 9492 (1950); New York v. Maclay, 288 U.S. 290 (1933).
[71] Rev. Rul. 56-41, 1956-1 CUM. BULL. 562.

not the vendor if the mortgage was executed as a part of the same transaction as the purchase, and the mortgage and the deed are given contemporaneous operation in order to carry out the purpose and intention of the parties. Similarly, a prior filed notice of tax lien will not prevail over the seller's interest under a properly executed and recorded valid and effective conditional sale agreement. This, by the way, is in sharp contrast to the rule which often prevails in the case of many state tax liens where a conditional seller's rights may be inferior to unrecorded, unassessed and uncomputed local tax liens.[72]

E. STATE AND LOCAL TAXES

There has been considerable litigation involving the relative priority of debts due the United States and local tax liens. In all cases except one, the local tax liens have been held to be inchoate by the Supreme Court, and, hence, in a position inferior to that of the United States. The case that involves a choate local tax lien is *United States v. City of New Britain.*[73]

The liens involved were for delinquent real estate taxes and water rents, and it should be observed that the property involved was the specific real estate which was taxed.

A fund was created by a judgment sale in a mortgage foreclosure proceeding. A prior judgment was of record. The Federal tax liens, the real estate tax liens, and the water rent liens arose from time to time at various dates over a period of several years.

The law of Connecticut, where the case arose, provided that real estate tax liens should take preference over all transfers and encumbrances affecting the property subject to the lien. The water rents, by state law, were given "precedence over all other liens or encumbrances except taxes." The local courts agreed that the local liens were specific and perfected and that as the funds were not available to pay all claims in full, the city's liens, the mortgages, the judgment lien and the United States' liens were to be paid in that order.

The Supreme Court held, on the basis of the rules established in the cases under Section 3466 and the *Security Trust & Savings Bank* case, that the characterization of the local tax liens as specific and perfected is not conclusive on the Federal Government, but it accepted "the holding as to the specificity of the City's liens since they attached to specific pieces of real property for the taxes assessed and the water rent due," and added that "the liens may also be perfected in the sense that there is nothing more to be done to have a choate lien—when the identity of the lienor, the property subject to the lien and the amount of the lien are established."[74] As between these liens and the Federal tax liens, it announced the legal principle "the first in time is the first in right."

This is the first occasion on which the Supreme Court concluded that local tax liens were specific and perfected, and applied to such liens the doctrine "the first in time is the first in right." In comparing this case with

---

[72] International Harvester Credit Corp. v. Goodrich, 350 U.S. 537 (1956), *affirming* 308 N.Y. 731, 124 N.E.2d 339 (1954); Linn County v. Steele, 223 Iowa 864, 273 N.W. 920 (1937).

[73] 347 U.S. 81, 54-1 U.S.T.C. ¶ 9191 (1954), *vacating* and *remanding sub. nom.* Brown v. General Laundry Svc., 139 Conn. 363, 94 A.2d 10 (1952).

[74] *Id.* at 84.

other cases involving tax liens and priorities, it may be of some importance to observe that the Supreme Court noted these liens were on specific realty and that the United States was "free to pursue the whole of the debtor's property wherever situated. The State, having a lien only upon property within its boundaries, may not reach beyond the state line to fasten its lien upon other property."[75] The contingency or possibility of removal of personalty from the state may, to some extent, result in a conclusion of lack of specificity, lack of perfection and inchoateness, whereas, obviously, real estate cannot be removed and real estate taxes are definitely fixed as to amount, and the identity of the lienor is established, as is the property subject to the lien.

In a contest between Federal and local tax liens, therefore, the test of priority is whether the local tax lien is choate or inchoate as well as whether it is first in time.

There is nothing unusual about the laws relating to Federal tax liens and the Federal priority. They are ordinary, even commonplace, as may be seen by the examples of state priority statutes in the cases hereinbefore referred to.[76] Every sovereign enacts such laws. It is safe to say that every one of the States has done so. Very few people enjoy paying taxes, and just as the elements of force and burden are implicit in the notion of taxes, so also priority is implicit in the notion of tax collection.

Certainly, the state of Iowa has taken these ordinary, normal, traditionally accepted steps to assure itself of priority in the payment of the tax debts due it. If the purpose and intention of the states and municipalities are understood and accepted, there should be no difficulty in maintaining the same reactions in the case of the United States. It is not an uncommon notion that the tax dollar paid to the United States of America purchases the greatest bargain in the world. I will do no more than recall to mind some of the laws of Iowa with which you are all familiar.

Section 680.6[77] provides that where the assets of a person are in the hands of a receiver, all taxes "whether levied under the laws of the State or ordinances of municipal corporations shall be entitled to priority and be paid first in full by the receiver, and claims therefor need not be filed with said receiver." Section 680.7 provides for a first priority for taxes entitled to preference under the laws of the United States, and second, state and local taxes.

Section 681.12 relating to assignments for the benefit of creditors provides that state and municipal taxes "shall be entitled to priority and paid in full by the assignee, and claims therefor need not be filed with him." Under Iowa law the United States does not in any way appear to enjoy a priority as in the case of receivers, although section 3466 of the Revised Statutes generally bridges the gap and requires priority in payment nevertheless.

In decedent's estate cases, a priority is recognized in favor of the debts due the United States.[78]

The retail sales tax under section 422.56 provides for a lien "prior and paramount over all subsequent liens upon any personal property within this

---

[75] *Id.* at 85.

[76] See the cases referred to in notes 12, 13, 14, 35, 61 and 73, *supra*.

[77] IOWA CODE § 680.6 (1958). Further references to sections of the Iowa Code are to this edition.

[78] IOWA CODE §§ 635.65-635.67 (1958).

state, or right to such personal property, belonging to the taxpayer *without the necessity of recording.*" (Emphasis supplied.) But there is a recording requirement as to the retail sales tax lien insofar as it attaches to real estate. Under section 423.17, all of the provisions of section 422.56 relating to the retail sales tax apply to the Iowa Use Tax.

Section 496.16 provides that the fees and penalties of corporations under chapter 496 shall be a lien upon any property of the corporation against all persons, whether the property is in the possession of the said corporation or otherwise.

Section 445.28 provides that the "taxes upon real estate shall be a lien thereon against all persons except the State." If this section is similar to comparable sections under other state laws, it is not affected by any statute of limitations, nor is there any provision for an administrative discharge or release of such lien.

It may be appropriate to observe that there is a six-year statute of limitations in respect of Federal tax collection, which, of course, may be extended. In the case of state and local taxes, although there are exceptions, ordinarily and conventionally there is no statute of limitations, and the state tax obligation continues indefinitely. One of the exceptions would be the Iowa law relating to personal taxes under section 445.29 where the lien exists for ten years if the taxes are entered on the personal property tax lists.[79]

By way of further example, the New York State Highway Use Tax statute imposes a lien which arises at the time the highway is used. In *International Harvester Credit Corp. v. Goodrich,*[80] the lien was held by the United States Supreme Court to be valid and enforceable against trucks sold to the operator under conditional sales contracts which were repossessed and resold prior to the time the tax assessment was made.

The lien which arose at the time of the use of the highway was held to apply to the trucks, even though the use was not merely the use of the specific repossessed trucks and other trucks during the same period of operation. The highway use tax incurred by reason of the operations prior to the time the operator purchased the trucks was also held to be a valid lien against the trucks purchased under the conditional sales agreements.

As to the lien for the tax incurred by reason of the operation of the vehicles during the period between their purchase and repossession, the Court said:

> Such liens are simple illustrations of the State's exercise of its prerogative right to impose a statutory lien for delinquent taxes upon the taxpayer's property.[81]

As to that portion of the lien which related to operation of other trucks prior to the purchase under conditional sales contracts, the Court held such lien to be enforceable, saying that the conditional vendors might obtain assurance that the vendees were not in arrears in their taxes. It may be added that the statute would not permit the State of New York to supply information as to tax delinquency.

---

[79] 3 COOLEY, TAXATION § 1239 (4th ed. 1924); 34 AM. JUR. *Limitations on Actions* §§ 393, 396-397 (1941); 51 AM. JUR. *Taxation* § 991 (1944); 84 C.J.S. *Taxation* §§ 595-96 (1954).

[80] 350 U.S. 537 (1956).

[81] *Id.* at 544.

The opinion of the Appellate Division of the New York Supreme Court[82] reveals the realities of the exercise of the sovereign power in respect of priority of liens. It also reveals the attitude in respect of such matters which may be considered somewhat common to the states, and which may be considered to contrast sharply with the relatively generous posture of the Federal Statutes.

There it is made clear that the New York State sovereign priority exists independently of statute; that while under the common law of England the sovereign does not prevail over a specific lien created by the debtor before the sovereign undertakes to enforce its right, the legislature of New York may, and has, extended the prerogative right so as to give certain taxes priority over prior encumbrances; and that the annual franchise tax takes priority over encumbrances on corporate property is an example of this extension.

It is there also stated that, "The power to declare the lien of the tax paramount to all prior liens and encumbrances and to the rights of a holder of the legal title of the motor vehicle is beyond question."[83]

As already pointed out, state laws for the collection of monies due to the state are often far more stringent than the lien and levy statutes under which the United States collects the revenues due to it. In the light of these facts, the procedures by which the Government of the United States collects its taxes may be considered as fair and liberal. That they are essential should be obvious.

F. CIRCULAR PRIORITY

A circular priority condition exists when at least three lienors are involved in circumstances where one has priority over the second who has priority over the third, and the third has priority over the first.

The universal and proper zealousness on the part of states and local taxing authorities to assure priority in payment of their taxes has bred a situation that has required the attention of the courts for a number of years,[84] and which was resolved by the decision in *United States v. City of New Britain.* The circular priority problem arises in the classic situation where a mortgage is first in time and has priority over the Federal tax lien, and the

---

[82] 284 App. Div. 604, 132 N.Y.S.2d 511 (3d Dept. 1954).

[83] *Id.* at 607, 132 N.Y.S.2d at 514. It is appropriate in discussing federal tax liens to recall that in less than the past three decades the national debt has risen from less than twenty billion dollars to more than two hundred eighty billion dollars. The debts of all the fifty states aggregate only 12.6 billion dollars. The debts of all local taxing authorities totaled 38.3 billion dollars in 1958. At the same time, the federal debt was 232.7 billion dollars. Gorman, *Survey of Current Business*, DEPT. COMMERCE, OFFICE OF BUSINESS ECONOMICS BULL. 8, 12 (May, 1959). The total expenditure of all state and local governments for 1958 was 42.5 billion dollars; for the same period the total expenditure of the Federal Government was 87.3 billion dollars, and of this amount grants in aid to the states and local governments were 5.2 billion dollars. *Id.* at 7, Table III-3.

In the fiscal year ended June 30, 1959, 2,656,000 delinquent account assemblies were issued for delinquent taxes of $1,195,919,000, which is to say, tax liens in a serious collection status existed in this amount. In that year, 2,960,000 delinquent accounts were disposed of, involving $1,465,137,000. At the close of the year, 1,202,000 delinquent accounts were outstanding involving $1,206,005,000. 1959 COMM. INT. REV. ANN. REP. No. 55, at 23. These are very important sums which are collected from recalcitrant tax delinquents only by virtue of the remedies available in the enforcement of the Federal tax lien statutes. Interpretations which would permit the collection process to be defeated by inchoate double-barreled scatter-gun devices such as were attempted, for example, in the *Ball* case, note 65, *supra*, would reduce the total collections, and to that extent the general public would necessarily be asked to pay the difference, without the protection of the *Ball* case. It is not difficult to imagine the flood which would occur of "assignments," of "all sums due or to become due" the debtor as security for "any indebtedness or liability hereafter incurred."

[84] Feigenbaum, *The Bankruptcy Triangle: Creditor-Debtor-Commissioner*, 30 TAXES 448 (1952).

Federal tax lien by the application of the doctrine "first in time, first in right" has priority over a local tax lien, but the local tax lien, by virtue of a special state priority statute enjoys precedence over the mortgage in derogation of the "first in time, first in right" principle. It may arise in any number of situations, but it comes into flower because a state statute or municipal ordinance creates a super-priority.

The solution adopted by the Supreme Court in the *New Britain* case enforces the "first in time, first in right" principle under section 6323. That is, the mortgage is first, the Federal tax lien is second, and the state tax is third. But because the Federal law has no concern with the priorities the state establishes, while the priority of the mortgage is recognized under the Federal law, the amount due the state under the state law is deducted from the amount due the mortgagee.

It will be observed that the loser in these circular priority situations is the mortgagee, notwithstanding the fact that he is protected by the Federal law. His loss is occasioned by the state law which creates the super-priority.

G. ATTORNEY'S FEES

It may not be inappropriate to comment upon attorney's fees. Reference has been made to an attorney's fee problem in the *Liverpool and London and Globe Insurance Company* case where the Court refused to deduct attorney's fees from the amount due from an interpleading insurance company upon which the Government had a lien in a garnishment case.

The insurance company was engaged in business, and the attorney's fee was another of the many items of expense involved in doing business. It may be observed, however, that the insurance company could have avoided this particular item by not filing the interpleader action, and by paying over pursuant to the Government's levy the amount it owed to the taxpayer. There is abundant authority that double liability would not have been incurred for it has been held " . . . Payment to the Government pursuant to the levy and notice is a complete defense to the debtor against any action brought against him on account of the debt."[85]

Two cases involving attorney's fees which arrive at contrary conclusions have been decided in the New York area. *United States v. Goldstein*[86] was decided by the United States Court of Appeals for the Second Circuit, and holds that an attorney's charging lien is inchoate and hence inferior to the Federal tax lien. The other, *In re Washington Square Slum Clearance*,[87] decided by the New York State Court of Appeals, reached an opposite conclusion, holding that an attorney with a retainer agreement is an assignee of a portion of the cause of action and hence in the position of a purchaser.

Despite the government's legal rights vis-a-vis attorney's liens, methods have been worked out generally to recognize the position of attorneys where they have created a fund, and it has been possible to acquiesce in their receipt of a reasonable fee. The paucity of decided cases relating to attorney's

[85] United States v. Eiland, 223 F.2d 118, 121, 47 A.F.T.R. 1190 (4th Cir. 1955). *Accord:* Hoye v. United States, 277 F.2d 116, 5 A.F.T.R.2d 1133 (9th Cir. 1960); United States v. Bank of Nevada, 251 F.2d 820, 1 A.F.T.R.2d 706 (9th Cir. 1957), *cert. denied*, 356 U.S. 938 (1958). See also S.M. 3804-A, V-1 CUM. BULL. 110 (1926).

[86] 256 F.2d 581, 1 A.F.T.R.2d 1523 (2d Cir. 1958), *cert. denied*, 358 U.S. 830 (1958).

[87] 5 N.Y.2d 300, 157 N.E.2d 587 (1959), *cert. denied sub. nom.* United States v. Coblentz, 363 U.S. 841 (1960).

fees indicates that the problem, by and large, has been handled satisfactorily to the members of the bar.

H. CONTRACT PURCHASERS

Practicing attorneys will be called upon not infrequently to pass upon the relative rights of purchasers of real estate under contracts of purchase, who have taken possession of the property but have not received a deed, and the rights of the United States under a notice of Federal tax lien filed because of taxes unpaid by the seller of the real estate.

A case involving contract purchasers is *Leipert v. R. C. Williams & Co.*[88] There buyers had entered into contracts which were unrecorded, and had not received deeds when the notice of Federal tax lien was filed. The contracts provided that the relation of the parties "shall be that of landlord and tenant"; that on default, the seller might enter the premises and remove property "as for nonpayment of rent." It was provided that the contract should not be recorded, and if it was recorded, it should be null and void, and that the buyer would not transfer or encumber the property until the full contract price was paid.

When a suit to quiet title was brought, it presented an opportunity for a judicial decision in an area where none was available. On the facts, unique to that case, which are not common in conventional contracts to purchase, it was held that the liens of the contract purchasers were inchoate and hence inferior to the tax lien.

However, in another case, *Niagara County Savings Bank v. Reese*,[89] which involves a conventional set of facts, a persuasive decision concludes that a contract purchaser of land acquires equitable title to real property and is a purchaser within the meaning of present section 6323(a).

It may be added that in the ordinary and conventional case involving contract purchasers, the Internal Revenue Service agrees that they stand in the position of purchasers under section 6323(a). Ordinarily, in cases of this type, an application to discharge property from the lien can produce a satisfactory result without the necessity of litigation.

VIII

PRACTICAL CONSIDERATIONS

Knowledge of the effect of Federal tax liens supplies the means for attorneys to protect their clients.

A creditor should satisfy himself as to the financial condition and reliability of his prospective debtor if he wishes to protect himself from a possible intervening tax lien. One of the most effective tools is a certified financial statement. This will clearly indicate the financial condition of the prospective debtor, and the creditor may require specific detailed analysis of the debtor's tax situation. If he wishes to take a long chance for a long profit, he can at least do it with his eyes open and with full knowledge of the effect of a possible intervening tax lien. Incidentally, he will also be

[88] 161 F. Supp. 355, 57 U.S.T.C. ¶ 10,044 (S.D. N.Y. 1957).
[89] 12 Misc. 2d 489, 179 N.Y.S.2d 453, 3 A.F.T.R.2d 1485, 59-2 U.S.T.C. ¶ 9508 (County Ct. 1958).

better able to protect himself from the impact of possible intervening state and local tax liens.

In the case of *International Harvester Credit Corp. v. Goodrich*, previously referred to in connection with the discussion under *"E—State and Local Taxes,"* the Supreme Court opinion emphasizes this point. There, in discussing the problems of sellers under conditional sales agreements who found that the state statute imposed a highway use tax lien upon trucks sold under conditional sales agreements for the taxes due from the purchaser, the court said:

> This statutory lien does not destroy the efficacy of conditional sales financing. Practically, it suggests that the conditional vendors secure assurance from their carrier-customers that the latters' highway use taxes are not in arrears.[80]

The Government is an unwilling tax creditor. It does not have these means of protecting itself. It cannot select its tax debtor after examination of his financial condition. It has no choice in the extension of credit for taxes. The debt is created ex parte by the taxpayer's failure or neglect to pay the taxes owed.

Creditors should be reminded not to sleep on their rights. They may very well and very properly conclude that a person who fails to satisfy his debts may very possibly be in the process of incurring a tax debt which will result in a lien. They will be protected if they place themselves in the position of a purchaser, pledgee, mortgagee, or judgment creditor in the conventional meaning of those words as indicated in the judicial decisions.

The discharge of property from lien procedure is very often rewarding and can be used to give relief to persons affected by these tax liens.

The application of procedures to effect the discharge of property from the effect of Federal tax liens depends upon the specific facts involved, and an elaborate discussion does not appear desirable. However, it may be said that in any lien case, Internal Revenue Service officers and attorneys in the office of the Regional Counsel may be in a position to aid in a resolution of lien problems and, I may add, will be happy to be of service.

---

[80] International Harvester Credit Corp. v. Goodrich, 350 U.S. 537, at 546 (1956).

TITLE PROBLEMS IN CONNECTION WITH FEDERAL TAX LIENS*

JESSE E. MARSHALL**

As will be seen from the title, my task in this Institute is to discuss not federal taxes, their size or how they are acquired, but their effect on real estate titles. Although it may be somewhat elementary, it would seem appropriate to preface this talk with a brief discussion on how titles are established. In the United States the predominate method of evidencing titles is through recording Acts. In order to determine the validity of marketability of real estate titles, abstracts of the records are prepared and are examined by attorneys. It may be assumed that practically all Iowa lawyers in general practice are competent to examine abstracts of title, but are not tax specialists. Fortunately, insofar as federal tax liens are concerned, the title examiner about nine times out of ten is examining title either for a purchaser or for a mortgagee. This limits the needs for exact and special knowledge of federal tax liens to those which have, or may have, priority over the claims of these two classes of clients. If it seems elementary in this audience to discuss abstracts of title and examination and opinions thereon, I am reminded of the case of the attorney who was arguing an appeal in the Supreme Court. He spent a great deal of time in what appeared to be elementary propositions and was finally stopped by one of the Justices who said, "Mr. Jones, it would seem that you ought to assume that this court knows something about these elementary propositions." The arguing attorney said, "Your Honor, that is just the mistake I made in the lower court and I don't want to make it again here in this court."

In an earlier day, attorneys generally made examinations of title by direct search of the records or from abstracts which they, themselves, prepared. In a great majority of cases, this is no longer true and abstracts are made by "abstracters" who are specialists in their profession. An abstract is just what the term indicates. It is a summary of all the material parts of the public records. An abstract begins with what is called a caption. The caption gives an exact description of the real estate under examination and the opening date of the search. Ordinarily, the opening date is the original entry and Patent from the United States Government. There follow "entries", which are brief statements of the material parts of the records. The abstract then closes with the abstracter's certificate. This certificate is the abstracter's contract with his customer. It states the extent of his search and the closing date thereof.

When the abstract has been prepared and certified, it is delivered to the customer or to the customer's attorney and the attorney then preapres an opinion thereon for which he assumes liability. The attorney's opinion begins with a description of the real estate in the abstract under examination and shows the opening and closing date, usually setting out the number of the entries contained in the abstract. It is a very good practice for an attorney to make some indication on the opening and closing entries of

*This is one of several papers presented to the Sixth Annual Spring Tax Institute of the Iowa State Bar Ass'n, April 29-30, 1960.

** Member, Sioux City, Iowa, bar.