Federal Tax Liens: Evolution and Conflict with State Liens

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INTRODUCTION

From the standpoint of the taxpayer, problems dealing with taxation consist primarily of what is taxable, how is it taxable, and to whom is it taxable with the desired result being to pay the legally justifiable minimum to the government. From the government's point of view, the primary problem is (or should be) to impose taxes among all citizens and residents in a fair and equitable manner. If we assume that this state of perfection has been attained, there is yet another problem—the collection of the tax due from the taxpayer to the government. An important tool in the hands of the government to aid in the collection of taxes is a lien imposed on the property and property rights of delinquent taxpayers. This treatise is limited to the lien of the federal government in such cases. To illustrate that this is a problem of more than passing interest, I invite the reader's attention to the latest bound edition of tax cases published by Commerce Clearing House;\(^1\) in the index of this volume under the heading "Federal Tax Liens," one will see eighty references. This is more than appear under any other heading and is considerably more than the items which appear under any such time-honored classifications as "capital gains" and "business expenses." In this treatise I will discuss the nature and background of the federal tax lien as it has evolved to its present form, and the conflicts which arise between federal tax liens and tax liens created by the states.

EVOLUTION OF FEDERAL TAX LIENS

The basic power of the federal government to assert a tax lien rests in the exercise of its authority under Article 1, section 8 of the United States Constitution which states that, "The Congress shall have Power

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To lay and collect Taxes, Duties, Imports and Excises . . . but all Duties, Imports and Excises shall be uniform throughout the United States. . . .”

In 1866 Congress, pursuant to the above authority, enacted a statute concerning tax liens which was assimilated by the Revised Statutes of 1873 and, as amended from time to time, is still the basic structure of federal tax liens. It was made a part of the Internal Revenue Code of 1939 and a part of the Internal Revenue Code of 1954. Section 6321 of the 1954 Code is simple in statement but broad in scope. It states that:

If any person liable to pay any tax neglects or refuses to pay same after demand, the amount . . . 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.

Section 6322 of the Code defines the period of the lien by providing that:

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.

These two paragraphs grant to the federal government a general lien power, but other sections of the Code pertaining to special taxes may give the federal government additional powers.

It will be noted from the above quoted sections that, before the federal tax lien arises, three conditions must be fulfilled. There must be an assessment, a demand, and a neglect or refusal to pay the tax. However, once the lien arises, the effective date of the lien reverts back to the date of the assessment—the date that the summary record is signed by an assessment officer. The assessment record must identify the taxpayer, the character of the liability assessed, the taxable period, and the amount of the assessment. In a case where the taxpayer files a return that is not accompanied by sufficient payment, the tax assessment will be almost immediate. Where the government imposes a tax liability, as in an income tax investigation, the assessment is not made until the Tax Court makes a final determination of liability. However, if at any intervening administrative level the taxpayer agrees to the amount of liability as determined by the government, he can waive the restrictions which would otherwise preclude the government from making an immediate assessment by ex-

3. INT. REV. CODE OF 1939, § 3670.
4. INT. REV. CODE OF 1954, § 6321. Unless otherwise indicated, all references to the Code or sections refer to the INT. REV. CODE OF 1954.
FEDERAL TAX LIENS

If it is believed that delay in assessment will jeopardize collection, the Commissioner of Internal Revenue has the authority to make an immediate assessment with the demand and refusal being almost instantaneous. This is commonly known as the "jeopardy assessment." After the assessment is made, current law requires that notice be given to the taxpayer. The notice, containing a demand for payment, must be made by the Commissioner of Internal Revenue within sixty days after the assessment. This notice may be made by mail, by leaving the notice at the taxpayer's dwelling place, or by leaving it at his usual place of business. However, regulations provide that the failure to give notice within sixty days does not invalidate the notice. On the other hand notice and demand are for the taxpayer's benefit; and it, too, may be waived. The demand for payment gives the taxpayer ten days in which to make payment. If he makes the payment, the tax lien does not arise. If he does not, because of either neglect or refusal, the tax lien does arise and dates back to the time of the assessment. Once the tax lien arises as outlined above, the government is free to enforce its lien by levying on any and all property and rights to property owned by the taxpayer and to proceed thereafter by distraint. Alternatively, the government may bring suit in the federal district court where the liability for such tax accrued, or where the taxpayer resides, or where the return was filed. The lien has a continuing effect and extends to all property and rights to property acquired during the time span of the lien. It continues until the obligation giving rise to the lien is satisfied. However, the lien may become unenforceable through lapse of time: the Code provides that a levy must be made or proceedings in court must be begun within six years after the assessment date.

In summarizing the above, it can be said that the federal tax lien is a fixed charge imposed by statute upon the property and rights to property of any person who neglects or refuses to pay his tax liability after formal assessment, notice, and demand for payment have been made.

The federal tax lien remains a charge on any property which is transferred by the taxpayer to a third person. Further, the tax lien is superior

15. INT. REV. CODE OF 1954, § 6502(a).
to any subsequent lien or encumbrance on the property unless exceptions are provided for by statute. Thus, in 1893, at a time when there were no statutory exceptions, it was decided by the Supreme Court of the United States\(^{17}\) that when a purchaser of real property was without actual or constructive notice of a lien for unpaid tobacco taxes, the purchaser, nevertheless, acquired the property subject to the federal tax lien. It was held that the United States was not subject to the filing requirements specified by state law. Recognizing this to be a hardship on purchasers of property, Congress enacted certain statutory exceptions in 1913.\(^{18}\) The statute provided that the tax lien would not be valid against any mortgagee, purchaser, or judgment creditor\(^{19}\) until notice of the tax lien was filed in the office of the clerk of district court of the district within which the property subject to the lien was situated.\(^{20}\) In 1939, after the Internal Revenue Code of 1939 was adopted, Congress decided that in certain cases even constructive notice (i.e., filing) could work a hardship on certain purchasers and amended the 1939 Code.\(^{21}\) Thus it was enacted that a mortgagee, pledgee\(^{22}\) or purchaser of securities for an adequate and full consideration would not be bound by the federal tax lien even though filed unless there was actual knowledge of the tax lien. This provision is limited only to securities and was enacted to protect brokers and prevent impediments to the negotiability of securities. Congress recognized that it would be impossible for brokers to check all the offices in which notice of a tax lien might be filed.\(^{23}\) The problem concerning securities was brought to light in the case of United States v. Rosenfield.\(^{24}\) There it was held that a stockbroker, without actual knowledge of the tax lien, purchased stock subject to a tax lien which had been properly filed against the seller of the stock. The Internal Revenue Code of 1954 adopted the 1939 Code as amended virtually unchanged. In fact, a reading of the Committee Reports accompanying the Code indicates that Congress was quite satisfied with the law as it had evolved to that point and also with the decisions interpreting the law.\(^{25}\) No changes in the law were made until 1964 when Congress added another exception to the Code and gave protection, even as to filed federal tax liens, to purchasers of automobiles.\(^{26}\)

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20. INT. REV. CODE OF 1954, § 6323(a)(1) provides for filing in office designated by the state governments. This provision was also in INT. REV. CODE OF 1939, § 3672(a).
Thus, the situation today is that once a federal tax lien arises, it is
general and extends to all property and property rights, whether real or
personal, without the requirement of notice through filing. However, the
federal tax lien is not valid as to a purchaser, mortgagee, pledgee, or
judgment creditor unless such person has notice. This notice can be by
actual knowledge or by the tax lien being properly filed. Further, even if
filed, the federal tax lien is not valid in the absence of actual notice, as
against any purchaser, mortgagee, or pledgee of securities or the purchaser
of a motor vehicle.

The Code provides that notice of the federal tax lien must be filed in
the office designated by the state in which the property subject to lien is
situated or with the clerk of the district court for the judicial district
where the property subject to the lien is situated.\textsuperscript{27} The Regulations\textsuperscript{28} state
that notice of the tax lien is to be filed with the clerk of the district court
whenever a state fails to designate an office for filing. In 1929 the State
of Pennsylvania enacted legislation which specified that the place for
filing in the state is the office of the prothonotary of the county where the
property is situated.\textsuperscript{29} This law was repealed in 1963 when Pennsylvania
passed the Revised Uniform Federal Tax Lien Registration Act.\textsuperscript{30} This act specifies that the place for filing as to personal property is the office
of the prothonotary as above. As to real property, the tax lien is to be
filed in the office of the Recorder of Deeds where the property is located.
However, this act contains filing requirements which are unsatisfactory
to the United States Government. The Internal Revenue Service issued
a ruling that the Pennsylvania statute was in conflict with section 6323
of the Code and that federal tax liens should be filed with the clerk of
the district court where the property is located.\textsuperscript{31} In August of 1964 the
Internal Revenue Service issued a further ruling\textsuperscript{32} which stated that, in
addition to the appropriate district court office, notices of tax liens would
also be filed in the state-designated office as set forth in the act of 1963.
However, the ruling states that the filing in the state office is for "conveniences"
only. It can be concluded from this that after the act of 1963,
reliance can only be placed on tax liens filed in the proper federal district
court offices. The 1965 legislature repealed the act of 1963 and passed the
Uniform Federal Tax Lien Registration Act.\textsuperscript{33} This act provides that
federal tax liens are to be filed in the office of the prothonotary of the
county where the property is located. This act will probably meet the stan-

\textsuperscript{27} Int. Rev. Code of 1954, § 6323(a). Throughout this discussion the situs of real
property is the place where located, and the situs of personal property is the residence of
the owner.

\textsuperscript{28} Treas. Reg. § 301.6323-1(a) (1965).

\textsuperscript{29} Act of May 1, 1929, P.L. 426.


ards of the Internal Revenue Service since it, in effect, re-enacts the law of 1929. However, this cannot be stated with certainty until a ruling is issued to that effect.

STATE CREATED LIENS V. FEDERAL TAX LIENS

The federal tax lien affects the same person and the same property which is subject to state-created liens. By the dictates of constitutional law, since the statute creating the federal tax lien comes within the authority of Congress in accordance with Article 1, section 8, it necessarily follows that such statute comes within the supremacy clause of Article 6 of the Constitution. The Supreme Court has, therefore, concluded that the determination of when a state-created lien takes precedence over the federal tax lien is a matter for the federal courts. The federal courts have determined that sections 6321 and 6322 (and its predecessors) do not create property rights. Therefore, the federal government must review state law to see whether or not the delinquent taxpayer has property rights to which the federal tax lien can attach. After it is determined that property rights exist, the federal law governs the consequences arising therefrom.

In deciding the precedence of competing liens, the Supreme Court of the United States has adopted the fundamental legal principle on this subject—"first-in-time is first-in-right." This rule is based on the equitable doctrine that a lien prior in time gives rise to a claim which is satisfied out of the property to which it attaches before any later claims shall be satisfied. This was enunciated by Chief Justice Marshall in 1827:

The principle is believed to be universal that a prior lien gives a prior claim, which is entitled to prior satisfaction, out of the subject it binds, unless the lien be intrinsically defective, or be displaced by some act of the party holding it, which shall postpone him in a court of law or equity to a subsequent claimant.

While the above principles of law have been set forth clearly, there has been considerable controversy in their application, as the following discussion will show.

The conflict between federal tax liens and state-created liens is concentrated on three key issues, as listed below, each of which will be discussed in turn:

35. United States v. Bess, 357 U.S. 51 (1958); Fidelity & Deposit Co. v. N.Y. Housing Auth., 241 F.2d 142 (2d Cir. 1957).
1. whether the state-created lien is sufficiently choate to take precedence over the federal tax lien;
2. whether the state has created property rights, and whether such rights have the necessary requirements to come within one of the exceptions of section 6323—i.e., mortgagee, pledgee, purchaser, or judgment creditor;
3. the manner in which circuity of liens is resolved.

**Choateness of State Liens**

The state-created lien must be perfected (choate) in accordance with a federal standard at the time the federal tax lien becomes effective if it is to take precedence over the federal tax lien. A lien is deemed perfected for federal purposes only "when the identity of the lienor, the property subject to the lien, and the amount of the lien are established" and nothing more remains to be done.40

This principal has been rigidly applied by the Supreme Court, and cases on this subject show frequent reversals of both state and lower federal court decisions.41 In the case of *United States v. Liverpool & London & Globe Insurance Co.* a state lien, which arose after a writ of garnishment was issued and served, was held inferior to a subsequent federal tax lien. A levy on the property had not been made at the time of the federal tax lien, and the state-created lien was therefore inchoate. Even the attorney's fees, which would have been allowed under state law, were held inferior to the federal tax lien. In *United States v. Scovil* the lien which arose out of a landlord's distress for rent was held inferior to a federal tax lien. This lien was inchoate at the time the writ was issued because the tenant had five days in which to put up a bond and free the property from the lien of distraint. In *United States v. Waddill, Holland & Flinn, Inc.* the landlord's lien was held to be inchoate because the property covered by the lien was not specified. In *United States v. Acri* an attachment was made on property pending a verdict in a wrongful death action. Under Ohio law this is a perfected lien and is described as an "execution in advance." Subsequent to this, a federal tax lien arose which was prior to the judgment of the action. The federal district court determined that the perfected lien under the law of the State of Ohio which arose prior to the federal tax lien should prevail. This

43. 348 U.S. 218 (1955).
44. 323 U.S. 353 (1945).
45. *Supra* note 34.
46. *Id.* at 213.
decision was overruled by the Supreme Court. The Court set forth the principal that the State attachment lien was inchoate for federal purposes because, at the time the attachment was made, the fact and amount of the lien were contingent upon the outcome of the suit for damages.

A state lien for unpaid unemployment compensation taxes fared no better in the State of Illinois. This state lien also failed to meet the requirements of specificity sufficient to satisfy the Supreme Court that a federal tax lien should be superseded. The property on which the State of Illinois had its lien had not, at the time the federal tax lien attached, been transferred to the state's possession. The Court decided that as long as subsequent steps were necessary to enforce the lien, it was inchoate as far as the federal government was concerned.

This conflict between state-created liens and federal tax liens on the issue of choateness is best illustrated by the mechanic's lien. In a broad sense, a mechanic's lien is a lien for material as well as labor and designates the liens of contractors, subcontractors, laborers and materialmen. It arises from the furnishing of labor or material in the erection of buildings or making improvements on realty. It arises by operation of law and is not created or obtained by legal proceedings. Various states have different provisions as to when the mechanic's lien is effective. In some it arises at the time the debt accrues, in others when the building or improvement is completed, and in others after the work has commenced. The essential principle upon which the mechanic's lien rests is that of unjust enrichment. For that reason, states show a preference for the mechanic's lien, and persons entitled to this lien are given time after the job is completed to file their claim and have their lien become effective as of a prior date in accordance with state law. In United States v. White Bear Brewing Co., Inc. the mechanic had completed the work, recorded his claim, filed suit to foreclose his mechanic's lien, and served summons, all prior to the time when the federal tax lien arose. The Supreme Court reversed the Seventh Circuit Court of Appeals, holding that the mechanic's lien was not sufficiently choate to be superior to a subsequent federal tax lien. In United States v. Colotta it was also held that the mechanic's lien was inchoate even though the work giving rise to the lien was performed prior to the time the federal tax lien arose. In

48. 57 C.J.S. Mechanic's Liens § 1 (1948).
49. Emanuel v. Underwood Coal & Supply Co., 244 Ala. 436, 14 So. 2d 151 (1943).
50. Supra note 48.
51. Supra note 48 at § 139.
the Court's view, the mechanic's lien was inchoate and imperfect until reduced to judgment—reversing the lower court's decision.\textsuperscript{56}

The conclusion can be reached from these cases that until the mechanic lienor obtains a judgment, he can never prevail over a federal tax lien. Therefore, even if he is cautious enough to check with the Internal Revenue Service to see whether or not there is a tax lien against the owner of the property, he will nevertheless be exposed to a tax lien arising afterwards.

Thus, a state-created lien arising by garnishment, landlord's distress, attachment, mechanic's lien, and state taxes, each valid under the law of its state, has been held to be junior to a subsequent federal tax lien because the lien was not choate in accordance with federal standards. Possessory common law liens, the artisan's lien for example, have fared better in the conflict with federal tax liens.\textsuperscript{57} However, the possessory lienor must also meet the requirements of specificity in establishing the identity of the lienor, the property subject to the lien, and the amount of the lien.

It should not be concluded from the above discussion that a federal tax lien will yield to a state lien only when the latter is specific and property subject to the lien is reduced to possession. This was the position of the federal government in \textit{United States v. State of Vermont}.\textsuperscript{58} The State enacted legislation giving itself a general lien on "all property and property rights" for the non-payment of the state income tax.\textsuperscript{59} The United States, whose lien was subsequent to the State of Vermont, argued that Vermont's lien was inchoate because it was general; that different standards of choateness are applicable to the United States than to the states. The Supreme Court rejected this argument and held that the lien of the State of Vermont was choate in accordance with federal standards since nothing more had to be done to perfect the lien in accordance with state law. As a result of this recent decision, it would appear that the states are in a position to protect themselves from the encroachment of federal tax liens by enacting the proper legislation.

The arguments used to dissuade the Supreme Court from its adamant position have rested largely on the principles that the creation of a lien is basically a property right, that the determination of priority is within the state's jurisdiction, and that Congress in enacting the general lien statute did not intend for the federal government to take priority. In \textit{United States v. Vorreiter},\textsuperscript{60} before the Supreme Court of Colorado, the

\begin{itemize}
\item \textsuperscript{56} 224 Miss. 33, 79 So. 2d 474 (1955).
\item \textsuperscript{57} United States v. Taylor Machinery Co., 8 Am. Fed. Tax R. 2d 5055.
\item \textsuperscript{58} 377 U.S. 351 (1964).
\item \textsuperscript{59} 32 V.S.A. § 578. This legislation is modeled after and uses the same language as the lien provision of the 1954 Code.
\item \textsuperscript{60} 134 Colo. 543, 307 P.2d 475 (1957), rev'd, 355 U.S. 15.
\end{itemize}
court summarizes the position pertaining to state property rights as follows:

The contention of the federal government, if applied to liens in Colorado, would upset long established rules of property in this state. "It is also well settled that where a course of decisions, whether founded upon statute or not, have become rules of property as laid down by the highest courts of the state, by which is meant those rules governing the descent, transfer, or sale of property, and the rules which affect the title and possession thereto, they are to be treated as laws of that state by the federal courts," Bucher v. Cheshire R. Co., 125 U.S. 555, 8 S. Ct. 974, 978, 31 L. Ed. 795.61 [Emphasis added.]

The second argument, that Congress did not intend for the federal government to take priority over state created liens, is advanced in the opinion of the Court of Appeals for the Seventh Circuit in United States v. White Bear Brewing Co., Inc.62 In White Bear, Justice Storey is quoted as follows:

... the right of priority of payment of debts due to the government, is a prerogative of the crown well known to the common law ... The claim of the United States, however, does not stand upon any sovereign prerogative, but is exclusively founded upon the actual provisions of the statute.63 [Emphasis added.]

Justice Storey is saying, in effect, that if Congress intended that the federal government should have priority over state-created liens, it would have clearly stated this in the statute. For example, federal priority is expressed in clear terminology in legislation involving debtor insolvency.64

Statutory Exceptions: Mortgagee, Pledgee, Purchaser, Judgment Creditor

A claimant whose state lien does not meet the difficult (though not impossible65) requirements of choateness under federal standards may prevail over a federal tax lien if he comes under one of the enumerated exceptions of section 6323 of the Internal Revenue Code; provided, of course, that his claim becomes effective prior to the time the federal tax lien is filed. Namely, the claimant must assert his rights as mortgagee, pledgee, purchaser, or judgment creditor. The issue of whether or not a claimant has fulfilled this requirement is a question of federal law, and

61. Id. at 546, 307 P.2d 475 (1957).
65. In United States v. City of New Britain, 347 U.S. 81 (1954), the Supreme Court recognized, without discussing, local tax liens on real property.
it has been determined that these words are to be used in the ordinary sense.\(^6\) The requirements are not met merely because a state law is enacted that designates a status as such. There are numerous cases where, under state law, the claimants were within the exceptions enumerated above, only to have the federal courts decide to the contrary. That the exceptions are taken quite literally and without deviation is illustrated by the case of *United States v. Oakland Sales, Inc.*\(^7\) In that case, a federal tax lien attached to property which was subsequently destroyed by fire. The claim of the insurance adjuster, whose services resulted in the fund which was available for distribution, was held to be junior to the tax lien. The Court declared that the insurance adjuster did not qualify as mortgagee, pledgee, purchaser, or judgment creditor. The Regulations\(^6\) state that the determination is made by reference to realities and facts in a given case rather than to technical form or terminology used to designate such person, adding that even though persons are otherwise designated by the law of the state they are still entitled to the protection of section 6323 (a) of the Code. In other words, federal law determines who is a mortgagee, pledgee, purchaser, or judgment creditor for the purpose of defeating an unfiled federal tax lien whether he is or is not so designated by the state in question.

In *United States v. Ball Construction Co., Inc.*,\(^6\) a subcontractor assigned to his performance bond surety his rights to certain sums which would become due on the performance of his contract. The purpose was to give the surety security for any indebtedness or liability thereafter incurred by the subcontractor to the surety in the event that the surety had to indemnify the owners for the subcontractors non-performance. Texas law describes a mortgage as a "pledge of property either real or personal, or a chose in action, as security for the performance of an obligation."\(^7\) The lower court decision held that since the federal tax lien did not arise until long after the assignment was made as collateral security and long after the bonding company had executed its obligation under the bond, the federal tax lien was inferior. The Supreme Court reversed, with four Justices dissenting, and held that the subcontractor had not executed a valid mortgage under federal law. Another example of the rigidity of federal law on this subject is the fact that the claimant was an attorney who brought interpleader proceedings because he could not determine, with safety to himself, the one entitled to the fund due the subcontractor. He asked an interpleader fee of $500 which would have been allowed out of the fund if state law prevailed. This fee was

\(^{66}\) United States v. Hawkins, 228 F.2d 517 (9th Cir. 1955).
\(^{67}\) 207 F. Supp. 175 (W.D. Pa. 1962).
\(^{69}\) 355 U.S. 587 (1958).
denied precedence over the tax lien, the Supreme Court stating that the
decision in United States v. Liverpool & London & Globe Insurance Co.71
prevailed.

Once it is determined that a mortgage does exist so as to defeat the
rights of the federal tax lien, the amount due on the mortgage cannot be
expanded. For example, the mortgagee cannot pay real estate taxes or
attorney’s fees that have accrued and add them to the amount of the
mortgage in order to defeat the federal tax lien by the additional amount.
In United States v. Buffalo Savings Bank72 the state court ordered the
mortgagee to pay real estate taxes due on the property as part of the
expense of foreclosure. The Supreme Court reversed as to the amounts
expended for real estate taxes, with Justice Douglas dissenting. In United
States v. Pioneer-American Insurance Co.73 the taxpayer was obligated
to pay “reasonable attorney’s fees” in the event of default under the
terms of his bond and mortgage. Under circumstances in which the
mortgagee had a prior claim to the federal tax lien, he could not add
the attorney’s fees to his mortgage. The Supreme Court held that the
amount due the attorney was inchoate until finalized by a court decree.
The decision would have been the same for two reasons if a definite per-
centage had been used rather than a “reasonable amount.” First, the
definite percentage would require official approval of the court; secondly,
the work performed by the attorney in foreclosing on the mortgage would
not be completely performed until after the federal tax lien had become
effective.

A purchaser is defined in the Regulations as “a person who, for a
valuable present consideration, acquires property or an interest in prop-
erty.”74 This is the ordinary and general usage of the word and has been
so interpreted by the federal courts. An Alaska law75 (which was passed
by Congress when Alaska was a territory) which declares that an attach-
ment lienor is deemed to be a “purchaser” was not sufficient to defeat a
subsequent federal tax lien.76 The court of appeals decided that the word
“purchaser” was not used in the ordinary and general way. In United
States v. Scovill77 an attempt was made to include a distress lien in the
definition of a “purchaser.” In United States v. Kings County Iron
Works,78 there was an attempt to have a subcontractor’s lien on funds
coming into the hands of the contractor deemed to be a “purchase” of

73. 374 U.S. 84 (1963).
75. 55-6-67 A.C.L.A. 1949.
77. 348 U.S. 218 (1955).
78. 224 F.2d 232 (2d Cir. 1955).
such funds. These met a similar fate. The Regulations\textsuperscript{79} also state that the consideration in a purchase must be an adequate and full consideration in money or money's worth. A relinquishment of dower, curtesy, or a statutory estate in lieu thereof is not consideration in money or money's worth.

Although the Code uses the word "judgment creditor," the definition is supplied by the Regulations. A judgment creditor is described as

\ldots a person who has obtained a valid judgment in a court of record and of competent jurisdiction for the recovery of specifically designated property or for a certain sum of money and in the case of a judgment for the recovery of a certain sum of money who has a \textit{perfected lien for such judgment on the property involved}.\textsuperscript{80} [Emphasis added.]

Thus, the doctrine of choateness discussed previously in connection with the priority of state-created liens applies equally to liens which arise out of a judgment even though judgments are in the special class. The creditor must not only obtain the judgment, but he must also obtain a choate lien on the debtor's property, if his lien is to take precedence over a federal tax lien. Where a judgment creditor merely enters his judgment on the docket, the registration is insufficient to overcome the federal tax lien if state law requires an execution levied on the property before the lien becomes effective.\textsuperscript{81} The judgment must come from a court of competent jurisdiction and does not include the determination of a quasi-judicial body or an individual acting in a quasi-judicial capacity, such as state taxing authorities.\textsuperscript{82} For example, in the State of California where by statute decisions of the Board of Equalization were characterized as having the "force, effect and priority" of judgments, it was held irrelevant that the legislature gave the Board the status of a judgment creditor under federal law. Such "judgments" were held inferior to federal tax liens.\textsuperscript{83} The leading case on this issue, \textit{United States v. Gilbert Associates, Inc.},\textsuperscript{84} arose in the jurisdiction of New Hampshire. In that state a tax assessment is "in the nature of a judgment,"\textsuperscript{85} the state court determined that the town of Walpole had a valid judgment superior to a federal tax lien. In addition to deciding that the lien held by the town was not choate, the Supreme Court decided that Walpole was not even a judgment creditor. Justice Frankfurter dissented, stating that if the assessment has the

\textsuperscript{79} Treas. Reg. § 301.6323-1(b)(1) (1965).
\textsuperscript{80} Treas. Reg. § 301.6323-1(a)(2)(i)(b) (1965).
\textsuperscript{81} Miller v. Bank of America, 166 F.2d 415 (9th Cir. 1948).
\textsuperscript{82} Treas. Reg. § 301.6323-1(a)(2)(i)(b) (1965).
\textsuperscript{83} MacKenzie v. United States, 109 F.2d 540 (9th Cir. 1940).
\textsuperscript{84} 345 U.S. 361 (1953).
\textsuperscript{85} \textit{Id.} at 363.
normal attributes of a judgment, then Walpole should be a judgment creditor. He further stated that the action taken by the taxing authorities has the same effect as would be given a judgment of a court of record.

Property Rights

Another area of conflict is the determination of property and property rights upon which the federal tax lien is imposed. As stated previously, the Supreme Court has proclaimed that state law governs property rights. In dealing with sale of seized property, the Regulations state that only the "right, title, and interest of the delinquent taxpayer in and to the property seized" shall be offered for sale. It has been held that a right to recover damages for personal injuries is a property right subject to the federal tax lien. In a New York case the tax lien was asserted to defeat the amount due a hospital for treating a person injured in an accident. At the time of the accident, the federal government had a tax lien filed against the injured party. The hospital asserted that the right of action was not the property right to which the federal tax lien could attach and also that, according to the law of New York, the hospital had a lien on the right of action as well as on the proceeds resulting from the injury. In effect, the hospital argued that the tax lien could only be effective as to the proceeds over and above the hospital's claim. The court ruled that the right to recover damages is a property right subject to the federal tax lien. If the tax lien were not filed, the hospital might have argued that it received an assignment of the claim by operation of law, placing the hospital in the class of persons protected by section 6323 against unfiled tax liens. However, if it advanced the theory that it had a lien on the proceeds, the hospital would fail because it could not meet the test of choateness.

In Aquilino v. United States, the subcontractor, because of his property right, fared much better than the subcontractors who relied on the state-created mechanic's lien. In the Aquilino case the government had a tax lien against the subcontractor's general contractor and attempted to assert its lien against the amount owing from the owner of the property to the general contractor. The issue was whether the owner should pay the amount owing to the government because of its lien against the general contractor or to the subcontractor. The subcontractor prevailed, because under New York law the general contractor's right to the proceeds was a trust for the benefit of the subcontractors. The government could attach

87. In the Matter of Estate of Walton, 247 N.Y.S.2d 21; CCH 1964 STAND. FED. TAX REP. (64-2 U.S. Tax Cas.).
89. 363 U.S. 509 (1960).
its lien only to the beneficial interest of the general contractor which was the amount over and above the amount due the subcontractors. A similar result was reached in *United States v. Durham Lumber Co.*, where, under North Carolina law, the unpaid subcontractor has a direct independent cause of action against the owner which defeats the general contractor's property right in the amount due. Justice Harlan stated in his dissenting opinion that if the subcontractors had sought to enforce their claim by lien, "there is no question that the government's lien would prevail."91

Where under state law insurance proceeds are not property of the insured, they are not subject to a federal tax lien against the insured. However, the federal government will not recognize a state law which exempts insurance funds which are the property of the insured. Thus, in *United States v. Bess*, the Court decided that the federal tax lien did not attach to insurance proceeds in the hands of the beneficiary to the amount in excess of the cash surrender value of the policy; it did attach to the cash surrender value of the policy. The insured was deemed to have had property rights in the cash surrender value prior to his death and at the time when the federal lien attached; the lien followed the property into the hands of the beneficiary. It is interesting to note that in a companion case decided at the same time the government did not prevail as to either the insurance proceeds or the cash surrender value. The government in that case did not assert a tax lien but, instead, sought to recover from the beneficiary as transferee of the insured's property. It was held that since a lien did not attach to the cash surrender value while the insured was alive, it was no longer his property at his death to which a lien could attach. In a case where a corporation comptroller assigned his future earnings to his wife in repayment of a loan, it was held that he did not have property or rights to property subject to a federal tax lien. There are many lower court decisions which have decided that property held by tenants by the entireties is not subject to a tax lien against one spouse. However, this area of the law is so marked by reversals that one cannot be sure until the Supreme Court decides the matter.

The decision in *Meyer v. United States*, indicates that in addition to property rights the Supreme Court will recognize a state's equitable doc-

91. Id. at 516.
94. INT. REV. CODE OF 1954, § 6901-6904.
95. United States v. Long Island Drug Co., 115 F.2d 983 (2d Cir. 1940).
trines. In this case the deceased pledged insurance policies to a bank as collateral security for a loan giving the bank the right to satisfy its claim out of the "net proceeds of the policy when it becomes a claim by death." When the insured died, the insurance company paid the bank the amount of the loan and the balance to the beneficiary. The federal government had a tax lien on all of the deceased's property, which included the cash surrender value of the property. Admittedly its claim was junior to the bank. However, since the bank could proceed against the cash surrender value as well as the remaining insurance proceeds, the federal government sought to invoke the equitable doctrine of marshalling. By so doing, both the bank and the federal government would be satisfied to the detriment of the widow. The State of New York refused to invoke the doctrine of marshalling in this case because New York law exempts the insurance benefits of a widow from the claims against her deceased husband. The Supreme Court ruled, with three dissenting Justices, that the doctrine of equitable marshalling should be governed by state law.

Circuity of Lien Rights

The conflict which has arisen between state-created liens and federal tax liens and its solution by the federal courts have created problems of circuity. The states have seen fit to protect certain persons: for example, mechanics and materialmen for work and materials advanced, municipalities for taxes and water rents, and common law possessory lienors. Consequently, by state law they are shown preference in the creation of state liens. On the other hand, the persons who are at a disadvantage according to state law, such as mortgagees, purchasers, and judgment creditors, are the ones whom the federal government has seen fit to exempt from the federal tax lien under certain circumstances. For example, under state law a mechanic or materialman will be given a certain number of months after a job is completed in which to file his claim. The lien will revert back to a prior time and will take precedence over a mortgagee whose claim has arisen in the meantime. If a federal tax lien arises subsequent to the mortgage, the federal government will recognize the superiority of the mortgage but not the mechanic's lien unless it has been reduced to judgment. This results in a circuity of lien claims which has been resolved by federal law. Since under federal law the mortgagee takes precedence over the tax lien, the federal government will satisfy the tax lien to the extent of funds available after the amount necessary to satisfy the prior mortgage has been deducted. However, this does not mean that the mortgagee is satisfied if the remaining funds are insufficient to satisfy both the mortgagee and the mechanic lienor. Since under state law the mechanic's lien takes precedence, it is satisfied prior to the

mortgagee. This presents the interesting situation in which the state-created lien (in this case the mechanic's lien) will be satisfied only if there is a mortgagee in existence which comes ahead of the federal tax lien. In the above illustration, if there was no mortgagee in existence, the federal tax lien would rank ahead of the mechanic's lien and probably defeat his entire interest.

To illustrate, let us assume that there is a federal tax lien of $10,000, a claim of a mortgagee who ranks ahead of the federal tax lien in the amount of $10,000, and a mechanic's lien amounting to $10,000 which under state law ranks ahead of the mortgagee. If the fund for distribution amounts to $10,000, the money would go to the mechanic lienor for the reasons indicated above. If the facts are changed so that there is no mortgagee, the fund would go to the government. Thus, the presence or absence of the mortgagee determines to whom the fund goes, with the mortgagee in either case receiving nothing.

This problem was resolved in United States v. City of New Britain, 100 where mortgages and judgments ranked ahead of the federal tax lien; a state lien for taxes ranked ahead of the mortgage and judgments under state law. The Supreme Court stated that Congress intended to assert its lien on the funds in excess of the amount necessary to pay the mortgage and judgment creditors, and that it was a matter of state law as to whether the state received its taxes and water rents prior to the mortgagee and judgment creditor.

Since the purpose of a state statute which grants the mechanic lienor preference is to prevent the unjust enrichment of another who has received the benefits of the mechanic's labor and material, giving precedence to a federal tax lien over a prior mechanic's lien in effect gives the benefit of the mechanic's labor and material to the government. The Supreme Court has asserted the superiority of the federal tax lien in many cases. This assertion, being based on the supremacy of the laws of the federal government, is rooted in firm tradition. However, can any logical reason be advanced as to why a mortgagee who advances money should be given preference to a federal tax lien, while a person who advances labor and money for materials is not?

CONCLUSION

The conclusion can be reached that if any of the decisions are deemed unjust, the correction can be remedied only by Congress, who thus far has shown a reluctance to amend the lien provisions. However, Congress did provide remedial legislation following the cases of United States v.
Snyder\textsuperscript{101} and United States v. Rosenfield.\textsuperscript{102} It is interesting to note that it was the American Bar Association\textsuperscript{102} who was influential in obtaining legislation following the Snyder decision. Five years after that decision, a committee was formed to call the attention of Congress to the implications of the Snyder case and urge remedial legislation. The American Bar Association has again come to the fore in this area: in 1958 a special committee under the name “Committee on Federal Liens” was organized.\textsuperscript{104} The work of this committee has culminated in proposed legislation which attempts to solve the problems which have arisen in this area.\textsuperscript{106} The recommended legislation greatly expands and codifies the existing few sections of the Code pertaining to liens. As to the class protected against unfiled tax liens, the proposed law adds “mechanic’s liens.” It also changes “mortgagee” to “security interest” so that all forms of financing arrangements will be covered. As to the class protected even as to filed liens, the proposed legislation adds purchasers at retail in the ordinary course of trade or business, and also has provisions which protect attorney’s fees and liens arising out of unpaid real estate taxes.\textsuperscript{106}

For the time being, however, one must accept the law as it is. Thus, the scope of this treatise has been to show the evolution of tax liens to its present state and to illustrate the problems which have arisen in the conflict between the federal tax lien and state-created liens. However, this treatise will have served a useful purpose if the reader has been made aware of the following principles and procedures: a) that federal tax liens are omnipresent; b) that as to securities: mortgages, pledges, and purchases, only purchasers of automobiles are immune to federal tax liens; c) that only mortgagees, pledgees, purchasers and judgment creditors are protected against unfiled tax liens; and d) that in the State of Pennsylvania filed liens must be checked at the office of the clerk of the district court where the property is situated even though the lien may also be filed at an office designated by the state.

\textsuperscript{101} 149 U.S. 210 (1893).
\textsuperscript{102} 26 F. Supp. 433 (E.D. Mich. 1938).
\textsuperscript{103} 21 A.B.A. REP. 108, 261 (1898); 22 A.B.A. REP. 53, 448 (1899).
\textsuperscript{104} A study group pertaining to this subject was also formed by the Treasury Department.
\textsuperscript{105} Proposed legislation was introduced in the 88th Congress and in H.R. 11256 of the present (89th) session of Congress.