

# CORRELATION OF PRIORITY AND LIEN RIGHTS IN THE COLLECTION OF FEDERAL TAXES

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The extent to which priorities exist between the Federal Government's claim or lien for taxes and claims or liens imposed under state law is a matter of far-reaching importance in the administration of the revenue laws. Taxes must be collected and collected promptly. It is not enough that the Federal Government has the power and facility to seek out just about all the property owned by the taxpayer and summarily subject it to the payment of his proportionate share of community expenses.<sup>1</sup> For the collection, problem seems to become acute only when the taxpayer does not have sufficient funds at the time the taxes are due to meet all his obligations. At this point other creditors are apt to rush to enforce their claims. In the ensuing scramble the tax collector often finds himself competing with states and municipalities as well as with private creditors. In such a contest the question of who emerges victor revives in some ways the early and critical controversies between those who sought to maintain the supremacy of the National Government and those who were anxious to sustain undiminished power of the states.<sup>2</sup>

The champions of federal supremacy saw to it that the collector was not left altogether destitute. His first string is reliance on the priority demanded by Section 3466, Revised Statutes.<sup>3</sup> Section 3466 is merely a priority statute,<sup>4</sup> but it demands that the debts of the United States be satisfied first whenever the taxpayer is insolvent and the insolvency has been shown by one of the ways specified, as, for example, attachment, assignment, or other act of bankruptcy. Taxes are debts within the meaning of the section and are subject to its protection.<sup>5</sup>

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The opinions expressed herein are the personal opinions of the author.

1. See INT. REV. CODE § 3690 *et seq.*, 53 STAT. 451 (1939), 26 U. S. C. § 3690 (1940).

2. *County of Spokane v. United States*, 279 U. S. 80 (1929).

3. REV. STAT. § 3466 (1878), 31 U. S. C. § 191 (1940), provides: "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."

4. Section 3466, does not create a lien. *Bramwell v. U. S. Fidelity Co.*, 269 U. S. 483, 488 (1926).

5. *Price v. United States*, 269 U. S. 492 (1926). The United States has no sovereign common law priority. *United States v. State Bank of North Carolina*, 6 Pet. 29

On its face the language of the section admits of no qualifications, but it was both intimated and held in some early cases that since a mortgage and certain other liens could divest title or possession from the debtor, the interests so divested not being in the debtor were not subject to the Government's priority rights.<sup>6</sup> The priority of the United States arises at the time of the definitive act of insolvency.<sup>7</sup> Hence, any claims which a state or private creditor may have at that time will be subordinated to the claim of the United States unless the creditor has a mortgage, a possessory lien, or perhaps a specific perfected non-possessory lien.

Recent contests relating to the application of Section 3466 have been concerned with this last type of lien, the thought being that a specific perfected non-possessory lien rather than an inchoate floating general type of lien could override the priority demanded by Section 3466.<sup>8</sup> Inchoate liens are common creatures of state law. In many ways they are similar to non-lien priority provisions. They are inchoate for the reason that at any point of time something remains to be done to make them specific and perfected. The amount of the lien<sup>9</sup> or the identity of the lienor<sup>10</sup> may not have been definitely settled; steps necessary to enforce the lien may not as yet have been taken;<sup>11</sup> or no particular property may have been segregated from the gross assets of the debtor to which the lien attaches.<sup>12</sup> If at the time the United States acquires its priority rights under Section 3466 the competing lien is characterized by any one of the above factors the claim of the lienor must fall.

Reliance on Section 3466, however, has definite limitations. Section 3466 speaks of debts due from the insolvent. By definition, the

(U. S. 1832). The circuit court in *Price v. United States*, *supra*, had held that the sovereign prerogative extended to federal taxes, although not to other debts. *Liberty Mutual Ins. Co. v. Johnson*, 6 F.2d 752 (C. C. A. 2d 1925). For a discussion of the sovereign prerogative see *Crane, A Royal Prerogative in the United States*, 34 W. VA. L. Q. 317 (1928).

6. *Thelusson v. Smith*, 2 Wheat. 396 (U. S. 1817); *Conard v. Atlantic Insurance Co.*, 1 Pet. 286 (U. S. 1828).

7. *County of Spokane v. United States*, 279 U. S. 80, 93 (1929); *Bramwell v. U. S. Fidelity Co.*, 269 U. S. 483, 488 (1926); *United States v. Oklahoma*, 261 U. S. 253, 260 (1923).

8. See *Illinois v. Campbell*, 67 Sup. Ct. 340 (1946); *United States v. Waddill, Holland & Flinn, Inc.*, 323 U. S. 353 (1945); *United States v. Texas*, 314 U. S. 480, 485-486 (1941); *New York v. Maclay*, 288 U. S. 290, 294 (1933).

9. *United States v. Texas*, *supra* note 8 (amount of state gasoline taxes unsettled).

10. *United States v. Knott*, 298 U. S. 544 (1936) (Trust fund for unknown creditors).

11. *United States v. Waddill, Holland & Flinn, Inc.*, 323 U. S. 353 (1945) (landlord's lien for distress).

12. *Thelusson v. Smith*, 2 Wheat. 396 (U. S. 1817) (general judgment on land); *Illinois v. Campbell*, 67 Sup. Ct. 340 (1946); *United States v. Waddill, Holland & Flinn, Inc.*, *supra* note 11 (property subject to the lien not specified).

claim of the United States, as well as the claims of the competing creditors, to be due from the insolvent himself, must exist prior to the act of insolvency. But debts and expenses may be incurred after the act of insolvency. The Government has never claimed that Section 3466 supersedes expenses of administration<sup>13</sup> and certain charges<sup>14</sup> which are not considered debts of the insolvent. Hence, the Government must look elsewhere if it wishes to override these charges and debts arising after the act of insolvency. Moreover, Section 3466 actually does not give the Government ample protection against even prior claims. Since the acts which call Section 3466 into play often justify an involuntary petition in bankruptcy the Government will lose most of its priority if bankruptcy results and it has to rely solely on Section 3466.<sup>15</sup> For the Bankruptcy Act sets up its own priorities, and Section 3466 does not apply generally to change the order of distribution, but merely gives the United States a fifth priority under Section 64 (a) of the Bankruptcy Act.<sup>16</sup> In general, lien claimants fall under Section 67 of the Bankruptcy Act,<sup>16a</sup> and any lien under Section 67 takes precedence over any unsecured priority claim under Section 64 even though the claimant is the United States, with the possible subordination exceptions of Section 67 (c).<sup>17</sup> Under state laws creating various types of inchoate floating liens the state and other claimants will have valid lien interests recognized in bankruptcy, since inchoate general liens are specifically protected and validated by Section 67.<sup>18</sup> But Section 3466 does not create a lien, and thus an inchoate lien under Section 67 is ahead of any claim for taxes without a lien under Section 64.<sup>19</sup> In order to preserve the revenue in cases where the taxpayer is bankrupt, the Government, therefore, must assert a lien which will be entitled to priority under Section 67 of the Bankruptcy Act over the inchoate general liens recognized by that section.

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13. In Brief for United States, pp. 26-7, *County of Spokane v. United States*, 279 U. S. 80 (1929), the Government stated that § 3466 may be open to the construction that the priority exists only over debts owing by the insolvent and not by the receiver.

14. An example is the widow's exemption in Pennsylvania. I. T. 2712, XII-2 CUM. BULL. 138 (1933).

15. See Rogge, *The Differences in the Priority of the United States in Bankruptcy and in Equity Receivership*, 43 HARV. L. REV. 251 (1929).

16. 52 STAT. 874 (1938), 11 U. S. C. § 104 (1940). *Guarantee Title & Trust Co. v. Title Guaranty Co.*, 224 U. S. 152 (1912); *United States v. Sampsell*, 153 F. 2d 731 (C. C. A. 9th 1946). Although § 3466 provides that the priority shall extend to cases where an act of bankruptcy is committed, as soon as bankruptcy results, § 3466 is no longer applicable to give the Government first priority.

16a. 52 STAT. 875 (1938), 11 U. S. C. § 107 (1940).

17. *City of Richmond v. Bird*, 249 U. S. 174 (1919); *In re Knox-Powell-Stockton Co.*, 100 F. 2d 979 (C. C. A. 9th 1939).

18. *United States v. Sampsell*, 153 F. 2d 731 (C. C. A. 9th 1946).

19. *In re Knox-Powell-Stockton Co.*, 100 F. 2d 979 (C. C. A. 9th 1939).

The Government's rights as a lien claimant arise for the most part from Section 3186, Revised Statutes.<sup>20</sup> This section sets up a lien for all types of taxes not otherwise specifically provided for, as, for example, estate<sup>21</sup> and gift<sup>22</sup> taxes which carry their own special lien provisions. The estate tax lien arises on death and is effective without demand, assessment or recording.<sup>23</sup> The Section 3186 lien arises when the assessment list is received, provided that the demand for taxes is made, and requires that a recording notice be filed before it is effective as to certain enumerated classes.<sup>24</sup> Section 3186 creates a lien of sweeping application. It covers all property of the taxpayer, after acquired<sup>25</sup> as well as property exempt under state law,<sup>26</sup> and is designed to prevent any decline in the asset position of the Government. The estate and gift tax liens are restricted to certain property, and the estate tax is expressly made subject to certain charges and expenses accruing after death.<sup>27</sup> Except for this subordinate estate tax feature the liens, once they attach, are vested with the same priorities and attributes.<sup>28</sup> None of the liens specify that the United States has a first lien or shall be paid first, as does Section 3466. At one time this absence of priority language led some courts to conclude that Congress had by its silence sanctioned the individual states to accord the Federal lien whatever subordinate position they desired.<sup>29</sup> It is true that Congress knows how to specify a first lien when it wants to,<sup>30</sup> but it should be evident

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20. Now INT. REV. CODE § 3670 *et seq.* The general tax lien will be referred to hereinafter as § 3186, and the estate tax lien (now INT. REV. CODE § 827) as § 315(a) of the Revenue Act of 1926. For a general discussion relating to the Federal tax lien see Clark, *Federal Tax Liens and their Enforcement*, 33 VA. L. REV. 13 (1947); Rogge, *The Tax Lien of the United States*, 13 A. B. A. J. 576 (1927); Kohlmeier, *Federal Tax Liens under Revised Statutes, Section 3186*, 13 TAX MAG. 191 (1935).

21. INT. REV. CODE § 827.

22. INT. REV. CODE § 1009.

23. *Detroit Bank v. United States*, 317 U. S. 329 (1943).

24. INT. REV. CODE §§ 3721-2.

25. *Glass City Bank v. United States*, 326 U. S. 265 (1945).

26. *Shambaugh v. Scofield*, 132 F. 2d 345 (C. C. A. 5th 1942); *Staley v. Vaughn*, 50 S. W. 2d 907 (Tex. 1932). Some courts pay lip service to the rule, but hold the property exempt because it does not "belong" to the taxpayer. *Jones v. Kemp*, 144 F. 2d 478 (C. C. A. 10th 1944); *Bigley v. Jones*, 64 F. Supp. 389 (W. D. Okla. 1946). For much the same reason it has been held that § 3186 does not attach to a Michigan estate by the entirety for income taxes owed by the husband (*United States v. Nathanson*, 60 F. Supp. 193 (E. D. Mich. 1945)) although the estate tax lien attaches where the tenancy by the entirety forms part of the gross estate. *Detroit Bank v. United States*, 317 U. S. 329 (1943).

27. INT. REV. CODE § 827.

28. *Littleston National Bank v. Penn Tile Works Co.*, 352 Pa. 238, 42 A. 2d 606 (1945).

29. *In re Mt. Jessup Coal Co.*, 7 F. Supp. 603 (M. D. Pa. 1934); *City of Winston Salem v. Powell Paving Co.*, 7 F. Supp. 424 (M. D. N. C. 1934); *In re Wyley Co.*, 292 Fed. 900 (N. D. Ga. 1923); *Berrymont Land Co. v. Davis Creek Co.*, 119 W. Va. 186, 192 S. E. 577 (1937). This doctrine still has its repercussions. *Board of Supervisors of Louisiana State University v. Hart*, 26 So. 2d 361 (La. 1946); *United States v. Sampsell*, 153 F. 2d 731 (C. C. A. 9th 1946).

30. INT. REV. CODE § 2800(e) provides that the tax on distilled spirits shall be a first lien on the spirits distilled, etc.

that a tax lien established by Congress is an exercise of its constitutional power to lay and collect taxes. Once Congress has legislated, the states can not by a subsequent exercise of their legislative or judicial power displace the lien imposed under the supremacy clause of the Constitution, regardless of whether the words "first lien" are present or absent.<sup>31</sup>

#### PRIOR CLAIMS AND LIENS

We now turn specifically to those claims which arise prior to the time the rights of the United States attach, whether the United States comes in as a priority creditor under Section 3466 or as a lien claimant under Section 3186 of the Revised Statutes and 315 (a) of the Revenue Act of 1926.<sup>32</sup> For purposes of Section 3466 it matters not whether the debt to the competing creditor was incurred prior to or after the time when the debtor became indebted to the United States; the United States will take priority so long as both claims exist at the time of the definitive act of bankruptcy, and the competing creditor has not reduced his claim to the form of a mortgage, a possessory lien, or a specific perfected non-possessory lien.<sup>33</sup> This assumes also that the debtor is not thrown into bankruptcy. If that happens Section 3466 becomes virtually useless, since it affords the United States only a fifth priority under Section 64, and falls behind any type of inchoate lien.

There is no provision in Section 3466 that the United States give notice that the taxpayer who might in the future become insolvent is indebted to the United States for taxes. On the other hand Section 3186 requires that the lien which it accords shall be recorded as to certain enumerated classes. As it has been interpreted Section 3466 does not place the United States ahead of purchasers, mortgagees and pledgees so that it might seem to be in accord with the policy which led to the recording requirement of Section 3186. It has therefore been held that Section 3186 was intended to modify the priority demanded by Section 3466 to the extent that a judgment creditor of a deceased insolvent taxpayer was entitled to be paid out of land owned by the taxpayer ahead of the United States claiming under Section 3466.<sup>34</sup>

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31. *Michigan v. United States*, 317 U. S. 338 (1943); *United States v. City of Greenville*, 118 F. 2d 963 (C. C. A. 4th 1941).

32. § 315(a) of the Revenue Act of 1926 created a lien for estate taxes. See note 20 *supra*. It will hereinafter be referred to simply as Section 315(a).

33. Cases cited notes 8-12 *supra*, and note 36 *infra*.

34. In *Meyer's Estate*, 159 Pa. Super. 296, 48 A. 2d 210 (1946) the Pennsylvania Superior Court concluded that § 3466 must be construed as amended by the recording provisions of § 3186, and that it was the intention of Congress to modify the rule in *Thelusson v. Smith*, 2 Wheat. 396 (U. S. 1817), and place a judgment creditor in the same position as a purchaser or mortgagee, thus giving a validity and status to judgment lien creditors not previously possessed.

However, the recording requirement of Section 3186 was designed primarily to protect subsequent purchasers and encumbrancers who purchase or lend money on the strength of the record.<sup>35</sup> A claim under Section 3466 can not be recorded, and by its terms it overrides earlier as well as later claims of equal rank without concern for reliance.<sup>36</sup> Since the effect of holding that Section 3186 has modified Section 3466 is merely to add judgment creditors to the list of those already protected under Section 3466 it is not shocking with regard to land where a general judgment is usually a lien upon land from the time of recording. However, it remains to be seen whether the reasoning will be extended to cases where the subject of the contest is personal property upon which a judgment is not usually a lien until the writ of execution is delivered into the hands of the sheriff.<sup>37</sup>

Section 3466 requires a concurrence of insolvency and the commission of a definitive act. Hence, if the taxpayer performs the act, *e. g.*, he goes into receivership, without being insolvent, Section 3466 will not apply at that time.<sup>38</sup> But if at any time thereafter the taxpayer does become insolvent, Section 3466 will become effective.<sup>39</sup> The claims which it will override, however, are still only those which exist prior to the receivership. This assumes, of course, that the United States priority claim for taxes exists at that time also.

There is no question that ordinarily all unsecured claims fall before the liens specified in Sections 3186 and 315 (a). No affirmative language is necessary to give the liens priority over earlier unsecured claims.<sup>40</sup> A possible exception is the subordination to wage claims to which Section 3186 is subject in bankruptcy when payment is sought from personal property.<sup>41</sup> An ordinary claim arising before but reduced to judgment after death is still only a claim and not a charge against a decedent's estate, and is not entitled to payment ahead of a lien conferred by Section 315 (a).<sup>42</sup>

35. The classes protected are purchasers, mortgagees, pledgees and judgment creditors. See SEN. REP. NO. 1315, 62d Cong., 3d Sess. 1-2 (1912).

36. The court in *Meyer's Estate*, 159 Pa. Super. 296, 48 A. 2d 210 (1946), seemed impressed with the fact that the claim of the United States was for income taxes which had accrued after the judgment was entered of record. Heretofore the time when the respective claims arose was deemed unimportant for purposes of § 3466 priority. For example, in *United States v. Waddill, Holland & Flinn, Inc.*, 323 U. S. 353 (1945) some of the personal property taxes included in the claim of the City of Danville accrued in 1939 while none of the claims of the United States arose until 1940 (Brief for United States, p. 3, *United States v. Waddill, Holland & Flinn, Inc.*).

37. *Claude D. Reese, Inc. v. United States*, 75 F. 2d 9 (C. C. A. 5th 1935); *Williams Patent Crusher Co. v. Reily*, 118 Pa. Super. 64, 180 Atl. 156 (1935).

38. *United States v. Oklahoma*, 261 U. S. 253 (1923).

39. *Hatch v. Morosco Holding Co.*, 61 F. 2d 944 (C. C. A. 2d 1932).

40. See Peppin, *Priority of Tax and Special Assessment Liens*, 23 CALIF. L. REV. 264 (1935).

41. § 67(c) of the Bankruptcy Act, 52 STAT. 875 (1938), 11 U. S. C. § 107 (1940).

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

The fact that under Section 3186 there is an inter-play between the time the assessment list is received and the demand for taxes is made has caused some comment to the effect that the provisions may be ambiguous.<sup>43</sup> An examination of the earlier statutes from which the present Section 3186 is derived removes most of the ambiguity. The lien attaches only to property owned by the taxpayer<sup>44</sup> at the time of the demand; that is, no lien exists until demand in the limited sense that if the property is disposed of prior to demand the lien will not attach.<sup>45</sup> But if the property is still owned by the taxpayer when the demand is made, the lien's priority will date as of the time the assessment list was received.<sup>46</sup>

In view of the recording provisions of Section 3186 and the ten day time limit within which the collector is to make demand after he receives the assessment list,<sup>47</sup> the exact time the lien arises may seem to be of academic and historical interest. However, certain classes of secured creditors are not protected by the recording provisions. A repairman's common law lien, for example, may arise after the assessment list is received but before demand. The *Curry*<sup>48</sup> and *Snyder*<sup>49</sup> cases which occasioned the recording amendment to Section 3186 involved the factual situation in which the receipt of the assessment list and demand both took place prior to the time the innocent grantees purchased the land. The grantees were treated as subsequent purchasers who had to fall before Section 3186. Although our repairman's lien arose before demand, it can not be classified as a prior lien entitled to priority in payment over Section 3186. The Federal Government

43. *MacKenzie v. United States*, 109 F. 2d 540 (C. C. A. 9th 1940). The statement no doubt was prompted by the observation in the Government's brief that since demand is not made until after the assessment list is received, the two provisions may appear to be inconsistent (Brief for United States, p. 7, *MacKenzie v. United States*, *supra*). Although the demand for taxes is to be made only after the assessment list is received, it has been held that where demand for taxes was made but there was no showing the collector actually had received the assessment list, the United States acquired no lien. *Kennebec Box Co. v. O. S. Richards Corp.*, 5 F. 2d 951 (C. C. A. 2d 1925). For a more realistic approach, see *United States v. Ettelson*, 159 F. 2d 193 (C. C. A. 7th 1947).

44. The provision for a federal tax lien was originally enacted in § 9 of the Act of July 13, 1866, 14 STAT. 98, 107 (1866). That section read in part: "And if any person \* \* \* liable to pay any tax, shall neglect or refuse to pay the same after demand, the amount shall be a lien in favor of the United States *from the time it was due* until paid \* \* \* upon all property and rights to property belonging to such person \* \* \*." (Italics supplied).

45. *United States v. The Pacific R. R.*, 1 Fed. 97 (C. C. E. D. Mo. 1880). The Government suggested in Brief for United States, pp. 26-7, *Glass City Bank v. United States*, 326 U. S. 265 (1945), that this case might be wrong as *contra* to *United States v. Snyder*, 149 U. S. 210 (1893). However, in *United States v. Snyder*, *supra*, the property was not disposed of until after demand.

46. *Citizens State Bank v. Vidal*, 114 F. 2d 380 (C. C. A. 10th 1940); *Metropolitan Life Ins. Co. v. United States*, 107 F. 2d 311 (C. C. A. 6th 1939).

47. INT. REV. CODE § 3655.

48. *United States v. Curry*, 201 Fed. 371 (D. C. D. Md. 1912).

49. *United States v. Snyder*, 149 U. S. 210 (1893).

can give its lien whatever priority it chooses.<sup>50</sup> In this case it has expressly provided that the lien attaches at the time of receipt of the assessment list. Under normal rules of lien priority relating to "first in time, first in right" the United States would win.<sup>51</sup>

Suppose, however, that the prior lien actually does arise before the assessment list is received. The Government has not been concerned about the role played by prior liens with respect to the federal lien for taxes. Instead, it seems to have confined its energies to subordinating the position of prior liens only in Section 3466 proceedings. Even here, moreover, it has, as yet, made no concerted effort to override the priority of mortgages or true possessory liens,<sup>52</sup> although it has suggested that the rationale of the old cases might be examined anew in view of the changes in many states from the title to the lien theory of mortgages.<sup>53</sup> The attack has been directed mainly against the propriety of allowing a specific, perfected [non-possessory] lien to defeat the priority demanded by Section 3466.<sup>54</sup> In the main, the argument has resolved itself into a factual step by step analysis which leads to the conclusion that something short of payment always remains to be done to enforce any type of lien.<sup>55</sup> But on the assumption that a specific, perfected lien can exist, the argument follows a well-defined, even stereotyped pattern.<sup>56</sup> In insolvency proceedings some claimants are certain to suffer. There is no reason why lien holders should be preferred over the United States. Since the priority accorded claims of the United States is for the purpose of securing revenue for the public

50. *County of Spokane v. United States*, 279 U. S. 80 (1929).

51. *United States v. City of Greenville*, 118 F. 2d 963 (C. C. A. 4th 1941).

52. In *United States v. Texas*, 314 U. S. 480 (1941), the Government did not seek to disturb the rights of the prior mortgagee. In *Brief for United States*, p. 6, *New York v. Maclay*, 288 U. S. 290 (1933), the Government observed that it was settled by the decision of the Supreme Court that a mortgage defeats the priority of § 3466. See also *Brief for Respondent*, p. 20 *et seq.*, *Illinois v. Campbell*, 67 S. Ct. 340 (1946).

53. *United States v. Guaranty Trust Co.*, 33 F. 2d 533 (C. C. A. 8th 1929).

54. This reflects a gradual development of the Government's position. In 9 Ops. ATT'Y. GEN. 28, 29 (1857), it was said: "By the later cases (*Conard v. Atlantic Insurance Co.*, 1 Pet. 386 (U. S. 1828); *Brent v. Bank of Wash.*, 10 Pet. 596 (U. S. 1837)) it seems to be well settled that the priority of the United States will not reach back over any lien, whether it is general or specific." By the time of *County of Spokane v. United States*, 279 U. S. 80 (1929), the Government would admit only that *Conard v. Atlantic Ins. Co.*, *supra*, and *Brent v. Bank of Wash.*, *supra*, might perhaps give some support for the contention, that a prior lien superseded § 3466 (*Brief for United States*, p. 18, *County of Spokane v. United States*, *supra*). In *United States v. Waddill, Holland & Flinn, Inc.*, 323 U. S. 353 (1945) attaching creditors possessory liens and non-possessory maritime liens were thought probably to be entitled to payment ahead of § 3466 (*Brief for United States*, pp. 10-12, *County of Spokane v. United States*, *supra*). The two Illinois cases, *Illinois v. United States*, 328 U. S. 8 (1946) and *Illinois v. Campbell*, 67 Sup. Ct. 340 (1946), brought about the direct attack.

55. As the court observed in *Meyer's Estate*, 159 Pa. Super. 296, 48 A. 2d 210 (1946), under this reasoning even a mortgage is not perfected, since it too must be foreclosed to secure payment.

56. *Brief for Respondent*, p. 22, *Illinois v. Campbell*, 67 Sup. Ct. 340 (1946).



benefit, the United States has a stronger argument for prior payment of its claims against an insolvent estate than does a lien holder whose interest is purely private. And even where a state holds the lien, its interest, although of a public nature, is subordinate to the wider public interest involved in a claim of the United States.

Instead of answering this policy argument, the Supreme Court has continued to observe that it has never expressly determined the priority to be given to specific perfected state liens under Section 3466.<sup>57</sup> In view of the language of the earlier Supreme Court cases, which intimated that the court had never held that a prior perfected lien did not override Section 3466,<sup>58</sup> the change in emphasis in the recent cases to connote that there is doubt that such a lien does take priority over Section 3466, must be taken with caution. The question may be academic, though, since all the recent lien cases in the Supreme Court were held to involve inchoate unperfected liens inferior to Section 3466.

The position of both the Government and the Supreme Court with respect to the rank of the true possessory lien, *e.g.*, a pledge, under Section 3466 is not entirely clear. The Court has distinguished specification and segregation of the exact property subject to the lien from actual possession, and has intimated that the former would be sufficient, when coupled with identity of the lienor and certainty of amount, to classify the lien as specific and perfected.<sup>59</sup> This suggests that specific perfected liens may be either possessory or non-possessory. Since the cases in which the Court left open the rank of specific perfected liens involved liens of a non-possessory type, the Court probably considers the true possessory lien more in the category of a mortgage.<sup>60</sup> The policy argument of the Government, however, would apply to a possessory lien as well as to a specific perfected non-possessory lien. For that matter, it would apply equally well to a mortgage. Clearly the Federal Government can displace prior private liens in collecting taxes due it. No one has suggested that such an interpretation of Section 3466 would be unconstitutional, as taking A's property to pay the tax of B. So long as ownership of the property remains in the taxpayer, creditors take their chances on a sovereign prerogative.<sup>61</sup>

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57. *Illinois v. Campbell*, *supra* note 56; *United States v. Waddill, Holland & Flinn, Inc.*, 323 U. S. 353 (1945).

58. *Conard v. Atlantic Insurance Co.*, 1 Pet. 386 (U. S. 1828); *Brent v. Bank of Wash.*, 10 Pet. 396 (U. S. 1837).

59. See cases cited note 57 *supra*.

60. This also seems to be the position taken by the Government in *United States v. Waddill, Holland & Flinn, Inc.*, 323 U. S. 353 (1945), where specific perfected possessory liens were classified separately from specific perfected non-possessory maritime liens, or the liens acquired by attaching creditors. Brief for United States, pp. 10-12, *United States v. Waddill, Holland & Flinn, Inc.*

61. See Peppin, *supra* note 40.

But whatever its rank under Section 3466, the priority of the prior lien,<sup>62</sup> be it possessory or not, is well established under Section 3186, so long as it is definite in amount and perfected in nature, and has attached to specific property.<sup>63</sup> Even before the recording provisions of Section 3186 the procedure under Section 3207, Revised Statutes,<sup>64</sup> gave some indication that there could be liens on property entitled to payment ahead of those of the United States. Although Section 3207 did not set up the order in which encumbrances were to be paid, it contemplated that prior lien claimants would be satisfied before the United States.<sup>65</sup> Since the 1913 amendment requiring recording as against subsequent purchasers, judgment creditors, pledgees, and mortgagees, Section 3186 can not logically be held good as to prior lien claimants who loaned their money when there was nothing in the record to show that the United States was going to become a lien creditor for taxes. A probable exception lies in prior liens which under state law are invalid as to subsequent lien creditors because of failure to record. A prior unrecorded mortgage would thus fall before Section 3186;<sup>66</sup> but since its invalidity can be of avail only to subsequent lien creditors or purchasers, it would continue to supplant the priority rights of the United States under Section 3466.

62. Brief for United States, pp. 7-8, *United States v. Texas*, 314 U. S. 480 (1941), contains the statement that whether the federal lien for taxes is superior to specific liens held by other creditors generally depends upon which lien is first in time. A prior mortgage is superior to § 3186 (*United States v. Sampsell* 153 F. 2d 731 (C. C. A. 9th 1946); *Ormsbee v. United States*, 23 F. 2d 926 (S. D. Fla. 1928)) although the federal lien has been held to supplant an earlier perfected ship mortgage. *The Melissa Trask*, 285 Fed. 781 (D. C. D. Mass. 1923); see also *Fridlund, Federal Taxes and Ship Mortgages*, 38 HARV. L. REV. 1060 (1925).

63. In *United States v. City of Greenville*, 118 F. 2d 963 (C. C. A. 4th 1941) and *United States v. Reese*, 131 F. 2d 466 (C. C. A. 7th 1942), the Government did not seek to displace the priority of prior state and municipal liens even though, under the position taken by the Government, the federal lien under Section 3186 does not have to be recorded to be valid against a state or municipality. See Brief for the United States, p. 19, *United States v. Sampsell*, *supra* note 62. *United States v. San Juan County*, 280 Fed. 120 (W. D. Wash. 1922); *Hopkins v. Eureka Coal Co., P-H FED. TAX SERV.* ¶ 162,496 (C. C. Kanawha Co., W. Va. 1944); *State v. Wynne*, 113 S. W. 2d 325 (Tex. Civ. App. 1938), *rev'd. on other grounds*, 134 Tex. 455, 133 S. W. 2d 951 (1939) support this position. On the other hand, the Circuit Court of Appeals for the Sixth Circuit has ruled that a state is a purchaser or judgment creditor protected by the recording provisions of Section 3186. *United States v. City of Detroit*, 138 F. 2d 418 (1943), *affirming* 42-2 U. S. T. C. ¶ 9702 (E. D. Mich. 1942). Although the question was disposed of in a *per curiam* opinion, the point was specifically raised on brief. Brief for the United States, p. 23.

64. Now INT. REV. CODE § 3678.

65. For a discussion of Section 3207 and the effect on it of the Act of 1931, 46 STAT. 1528, 28 U. S. C. § 901 (1940), see Clark, *supra* note 20; X-1 CUM. BULL. 526 (1931).

66. *United States v. Underwood*, 118 F. 2d 760 (C. C. A. 5th 1941); *Exchange Nat. Bank of Tulsa v. Davy*, 13 F. Supp. 226 (N. D. Okla. 1936). It has been held that actual notice by a subsequent mortgagee of the unrecorded federal tax lien does not give the Government priority. *United States v. Beaver Run Coal Co.*, 99 F. 2d 670 (C. C. A. 3d 1938); *cf. United States v. Woodside*, 40-2 U. S. T. C. ¶ 9492 (W. D. S. C. 1940).

The estate tax lien requires no recording. It arises on death without assessment, demand, or recording.<sup>67</sup> Can it be said that it too falls before prior liens? The answer is not completely free from doubt. In *Michigan v. United States*,<sup>68</sup> some of the property had been mortgaged prior to the decedent's death. The Government conceded and the lower court held that the mortgage was entitled to priority in payment over the estate tax lien of Section 315 (a).<sup>69</sup> Yet the Supreme Court went out of its way to leave open the question of the priority of the specific perfected lien to the same extent that it is unsettled, or settled, under Section 3466. Probably for this reason the argument was advanced in *Decker's Estate*<sup>70</sup> that a pledge falls before Section 315 (a). The argument was rejected, apparently on the strength of the Government's earlier concession in *Michigan v. United States*. Since pledged property was involved in the *Decker* case, giving the lienor possession, the situation technically does not fall within the sphere left open by reference to the Section 3466 cases in *Michigan v. United States*.

A seemingly plausible argument can be advanced that prior liens should give way to Section 315 (a). A prior lien against a decedent's estate many times plays a double role. It not only is a lien on the property but it may represent a claim which reduces the amount of the net estate subject to tax. Section 315 (a) attaches to the gross estate. In a sense the prior lien is not very different from ordinary claims which under local law usually become liens on the decedent's estate. These ordinary claims also reduce the amount of the tax for which the estate tax lien is security. But they must be relegated to a secondary position, if the provision attaching the estate tax to the gross estate is to have much meaning. Property pledged or subject to a lien as security for a debt on which the decedent was personally liable is still part of the gross estate<sup>71</sup> and might, therefore, be said to fall behind Section 315 (a). On the other side of the picture is the fact that once Section 315 (a) attaches it is vested with just about the same priorities as Section 3186 except as to administration expenses and charges against the estate.<sup>72</sup> If Section 3186 falls before prior liens, Section 315 (a) probably does also.

#### SUBSEQUENT CLAIMS AND LIENS

The role of subsequent claims and liens is deceptively simple. Off-hand it would seem obvious that claims or liens which arise after the

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67. *Detroit Bank v. United States*, 317 U. S. 329 (1943).

68. 317 U. S. 338 (1943).

69. Brief for the United States, p. 6, *Michigan v. United States*.

70. 355 Pa. 331, 49 A. 2d 714 (1946).

71. See U. S. Treas. Reg. 105, § 81.38, relating to the treatment of unpaid mortgages for estate tax purposes.

72. *Littleston Nat. Bank v. Penn Tile Works*, 352 Pa. 238, 42 A. 2d 606 (1945).

rights of the United States for taxes are fixed must come in for payment behind the United States. With regard to Section 3466, if an earlier claim is reduced to judgment after the definitive act of insolvency Section 3466 is the victor.<sup>73</sup> The same is true for a creditor's claim reduced to judgment after a decedent's death. Section 315 (a) is first satisfied.<sup>74</sup> And if an earlier claim is reduced to judgment after Section 3186 is recorded, Section 3186 comes out ahead.<sup>75</sup>

The reason for this federal superiority is made eminently clear by *Michigan v. United States* and *United States v. City of Greenville*.<sup>76</sup> A state may provide that its lien for taxes or its lien used for the benefit of its private citizens shall be a "first lien" in all cases whatsoever. If at the time the rights of the United States attach, no state lien exists, but thereafter a state lien is imposed entitled to first priority under state law, this is only an attempt by the state to displace by a subsequent exercise of its taxing, legislative, or judicial power the priority or lien of the United States established by Congress under its constitutional authority to pay and collect taxes. Under the supremacy clause of the constitution, the attempt must fail. Thus, as was the situation in *Michigan v. United States* and *United States v. City of Greenville*, if real property is taxed by a state or municipality for years subsequent to the time the lien of the United States arises or, as was the situation in *Littlestown National Bank v. Penn Tile Works Co.*,<sup>77</sup> if an earlier claim is reduced to a lien after the lien of the United States attaches, no effort to make the state lien a "first lien entitled to be paid first" can be successful. Nor is it material that the United States may be relying on Section 3466 which does not create a lien. The important fact is that a subsequent exercise of state power is brought into play to override the fixed rights of the United States, and this can not be done.

This statement in and of itself is easily understandable. Unfortunately, however, the problem does not end here. Certain liens and expenses which arise after the lien or priority rights of the United States have attached do command priority in payment. Section 3466 speaks of debts due from the debtor. If, after the act specified in the section occurs, *e. g.*, the creation of an equity receivership, debts arise, these are not debts of the insolvent but of the receiver. On its face Section 3466 does not apply to such claims. Hence, Section 3466 is

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73. The rights of the United States are determined as of the time of the act of insolvency. *United States v. Oklahoma*, 261 U. S. 353 (1923).

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

75. The doctrine of relation back cannot classify a private creditor as a judgment creditor before notice of the tax lien was filed for purposes of invalidating the federal lien. *MacKenzie v. United States*, 109 F. 2d 540 (C. C. A. 9th 1940).

76. 118 F. 2d 963 (C. C. A. 4th 1941).

77. 352 Pa. 238, 42 A. 2d 606 (1945).

generally considered to come behind administration expenses,<sup>78</sup> whether it is used against a living insolvent or is called into play because of the death of the debtor.<sup>79</sup> Section 315 (a) is expressly made subject to administration expenses.

The question naturally arises as to what are administration expenses for purposes of Section 3466 and Section 315 (a). A state may impose a property tax on property in the hands of the administrator or the receiver. For purposes of Section 315 (a) such a tax has been held to be an administration expense which not only reduces the estate tax itself, but also takes priority over the lien.<sup>80</sup> Taxes are also considered administration expenses under Section 3466;<sup>81</sup> they are not debts due from the insolvent. Does this mean that a subsequent exercise of the state taxing power can, under certain circumstances, displace the federal priority or estate tax lien? In *County of Spokane v. United States*<sup>82</sup> the priority of Section 3466 was upheld against state and municipal taxes imposed on the property in the hands of the receiver. But the Government admitted that if the taxes were considered administration expenses it would hesitate to say that the Section 3466 lien should be paid first.<sup>83</sup> In *Michigan v. United States* state and municipal *ad valorem* taxes were imposed on the property for taxable years after the death of the decedent. No contention was made that they were administration expenses; apparently the estate was no longer in the process of administration at the time the taxes were levied, although the estate tax had not been paid. Hence, the priority of Section 315 (a) was upheld.

It is difficult to reconcile the treatment of current taxes as administration expenses for purposes of taking priority over Section 3466 and Section 315 (a) with the inability of the states to displace the priority or lien rights of the United States by a subsequent exercise of their taxing power. Although the fund or property to which Section 3466 attaches should rightfully bear the expenses necessary to preserve it, actually the United States can not be taxed by the states. The *ad valorem* tax in no way benefits the property. If administration expenses are to be satisfied before Section 3466 the type of ex-

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78. *Kennebec Box Co. v. Richards Corp.*, 5 F. 2d 951 (C. C. A. 2d 1925); *In re Wyley*, 292 Fed. 900 (N. D. Ga. 1923).

79. Certain charges also are entitled to priority in payment over § 3466. See *United States v. Weisburn*, 48 F. Supp. 393 (E. D. Pa. 1943); *Harrison v. Deutsch*, 294 Ill. App. 3, 13 N. E. 2d 511 (1938).

80. *Brown v. Commissioner*, 74 F. 2d 281 (C. C. A. 10th 1934); *United States v. Security-First Nat. Bank*, 30 F. Supp. 113 (S. D. Calif. 1939); *but see Hill v. Grisom*, 299 Fed. 641 (E. D. N. C. 1924).

81. *United States v. Eggleston*, 25 Fed. Cas. 979, No. 15,027 (C. C. D. Ore. 1877). See also *Central Vermont Ry. Co. v. Marsch*, 59 F. 2d 59 (C. C. A. 1st 1932).

82. 279 U. S. 80 (1929).

83. Brief for the United States, pp. 26-27, *County of Spokane v. United States*.

pense falling into that category must be rigidly defined. It may be that for this purpose administration expenses should be restricted either to expenses which actually benefit or increase the fund,<sup>84</sup> or to the type of expense which the United States would have to bear were it administering the fund itself. Much the same argument seems applicable to Section 315 (a). Estates may be in the process of administration for a long period of time. The Government has not always been successful in contending that the assets of the estate should have been distributed to the legatees for purposes of the revenue laws, and the estate considered no longer in administration.<sup>85</sup> If all state and municipal taxes imposed during this period are administration expenses, neither Section 315 (a) nor Section 3466 will be worth very much.<sup>86</sup>

With respect to Section 3186 the situation is somewhat reversed. Ordinarily a lien holder does not have to pay expenses of administration except in so far as they actually benefit the property<sup>87</sup> This would be true for Section 315 (a) were it not for the express provision subordinating the lien to expenses of administration. The imposition of taxes under state law after Section 3186 has attached benefits the property in no way, and is merely a subsequent exercise of the state's taxing power which can not displace the lien of the United States. Consideration of this basic fact will all but eliminate the problem of administration expenses in Section 3466 situations. For the rights of the United States as a lien claimant are not lost just because the United States can invoke Section 3466. Section 3466 applies where the debtor is insolvent and specific acts have been committed. Although one of the enumerated acts of insolvency has been committed, the United States can still assess the tax, make demand and claim a lien thereafter. For example, the specified act under Section 3466 may be the creation of an equity receivership. But the creation of such receivership under state law can not affect the right of the United States to acquire its lien, for a state can not say that at a certain point of time the lien of the United States can not attach. This would be tantamount to saying that certain property is exempt from the Federal lien.<sup>88</sup> Hence, in Section 3466 cases if the United States makes use of its lien rights there should be little controversy with respect to such ad-

84. See *Filipowicz v. Rothensies*, 43 F. Supp. 619 (E. D. Pa. 1942) (attorney's fees for creating fund).

85. *Frederich v. Commissioner*, 145 F. 2d 796 (C. C. A. 5th 1944).

86. Subsequently imposed municipal taxes were held inferior to Section 315(a) in *Bowes v. United States*, 127 N. J. E. 132, 11 A. 2d 720 (1940).

87. *Byrer v. Bushong*, 108 F. 2d 594 (C. C. A. 4th 1940); *Miners Savings Bank of Pittston, Pa. v. Joyce*, 97 F. 2d 973 (C. C. A. 3d 1938). A possible explanation for *The River Queen*, 8 F. 2d 426 (E. D. Va. 1925), in which a subsequent mortgage was held to be superior to the federal tax lien, may lie in the fact that the mortgage was given for the furnishing of supplies and materials which preserved the property itself.

88. See cases cited note 26 *supra*.

ministration expenses as subsequently imposed state taxes. Except insofar as the subsequently imposed state taxes are a condition to the acquisition of additional property to which the lien of Section 3186 would attach *e. g.* a franchise or income tax on subsequently acquired income, the state taxes are powerless to displace the priority of Section 3186 and eat into the property originally subject to the lien. A correlation of lien and priority rights thus will defeat subsequent as well as prior claims.<sup>89</sup>

Bankruptcy presents about the same opportunity for the United States to avail itself of the use of Section 3186. State and municipal taxes imposed after bankruptcy come in as administration expenses of the trustee in bankruptcy.<sup>90</sup> But the Section 3186 lien for taxes owed by the bankrupt himself would be subordinate only to that part of the trustee's taxes which specifically benefits the lien. This is so since the rule is well established in bankruptcy that lien holders pay no part of the costs of administration except those from which they secure benefit.<sup>91</sup> Of course, with respect to the personal property of the bankrupt, the lien is expressly subordinated by Section 67 (c) of the Bankruptcy Act to the ordinary expenses of administration and wage claim priorities of Section 64 of the Act. This would not be true if the lien were used in a Section 3466 case.

Section 3186 can not properly arise after bankruptcy as it can after the insolvency acts of Section 3466 are committed. Section 67 (b) of the Bankruptcy Act speaks of perfecting the Federal lien for taxes after bankruptcy if it has arisen before. This means that if the assessment list is received prior to bankruptcy the demand can take place thereafter to perfect a lien. But for taxes owed by the bankrupt prior to the filing of the petition for which the assessment list is not received until after bankruptcy, no lien can be acquired and the United States takes as an unsecured creditor under Section 64 (a) of the Bankruptcy Act. Federal taxes imposed after bankruptcy are treated as administration expenses.<sup>92</sup> Apparently no priority rights exist among the various administration expenses.<sup>93</sup>

An interesting aspect of the problem arises in attempting to accommodate the conflicting rights of the United States as a priority or lien

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89. However, in *In re Holmes Mfg. Co.*, 19 F. 2d 239 (D. Conn. 1927), the court held that administration expenses were entitled to priority in payment over both Section 3466 and Section 3186.

90. *In re Lambertville Rubber Co.*, 111 F. 2d 45 (C. C. A. 2d 1940); *In re Hume-ton*, 83 F. 2d 187 (C. C. A. 2d 1936). See Wurzel, *Taxation During Bankruptcy Liquidation*, 55 HARV. L. REV. 1141 (1942).

91. *In re Kings County Real Estate Corp.*, 67 F. 2d 895 (C. C. A. 2d 1933); *Miners Savings Bank of Pittston, Pa. v. Joyce*, 97 F. 2d 973 (C. C. A. 3d 1938).

92. *United States v. Killoren*, 119 F. 2d 364 (C. C. A. 8th 1941); *Security-First Nat. Bank of Los Angeles v. United States*, 153 F. 2d 563 (C. C. A. 9th 1946).

93. *In re Lambertville Rubber Co.*, 111 F. 2d 45 (C. C. A. 2d 1940).

claimant, the state as a tax claimant, and a prior mortgagee as a private creditor—the so-called circuitry problem.<sup>94</sup> At one time it was reasoned that since a prior mortgage was preferred to Section 3466, any claim entitled to payment before the mortgage was also entitled to payment ahead of Section 3466.<sup>95</sup> In accordance with this reasoning if, under state law, state taxes displaced a prior mortgage which was superior to the rights of the United States under Section 3466, the state taxes would be entitled to payment before the United States, even though the taxes may have been imposed after the rights of the United States attached and without the aid of the mortgage would have fallen before Section 3466. On the other hand, the position of the Government was that Section 3466 was to be subordinated only to the mortgage. This could be done by setting apart the amount necessary to pay the mortgagee before paying Federal taxes and then satisfying the state tax out of the fund so set apart.<sup>96</sup>

The priorities puzzle was eventually presented to the Supreme Court in *United States v. Texas*<sup>97</sup> and apparently settled to the satisfaction of the Federal Government. There a receiver was appointed for a gasoline distributor at the suit of a chattel mortgagee. Texas and the United States intervened with claims for state and Federal gasoline taxes. The Texas District Court held that the mortgage was to be satisfied first, then the United States under Section 3466 and finally the claims of Texas. But pursuant to a ruling of the Texas Supreme Court which held that the Texas statute gave its lien first rank over prior mortgages and the United States claim, the order of distribution was entered to be Texas, the mortgagee, then the United States.<sup>98</sup> Certiorari was granted on the petition of the United States, which did not seek to disturb the superior rights of the mortgage. The only question before the United States Supreme Court was the relative priority of the claims of the United States and Texas. The court held that the United States was entitled to priority over Texas. And it did so both in light of the binding construction of the Texas Supreme Court of its local statute that the state lien was to be preferred

94. Aside from the question of the supremacy of the federal lien and priority rights, the courts have been struggling over the "circuitry of liens" and "priorities puzzle" for more than 2½ centuries. Benson, *Circuitry of Lien—a Problem in Priorities*, 19 MINN. L. REV. 139 (1935); Note, 38 COL. L. REV. 1267 (1938). The Fifth Circuit's treatment of the problem where city taxes were involved in *City of New Orleans v. Harrell*, 134 F. 2d 399 (C. C. A. 5th 1943), is criticized in 4 COLLIER ON BANKRUPTCY 13 (Supp. 1944).

95. *Ferris v. Chic-Mint Gum Co.*, 14 Del. Ch. 232, 124 Atl. 577 (1924); see also *Board of Supervisors of Louisiana State University v. Hart*, 26 So. 2d 361 (La. 1946).

96. *County of Spokane v. United States*, 279 U. S. 80 (1929).

97. 314 U. S. 480 (1941).

98. *State v. Nix*, 134 Tex. 476, 133 S. W. 2d 963 (1939).



over the mortgage, and on the assumption that the mortgage was entitled to priority over the United States.

The Government did not assert in *United States v. Texas* that because Section 3466 was preferred to the state taxes which in turn were superior to the mortgage, Section 3466 was entitled to be paid first. This is a possible result and one not foreclosed by *United States v. Texas*.<sup>99</sup> It could also serve as an indirect attack upon the preferred position now accorded to mortgages over the priority demanded by Section 3466.

The rule of *United States v. Texas* should apply also to the federal lien of Section 3186. If property is mortgaged before the lien of the United States attaches and in later years state taxes are imposed which, under state law, are entitled to be paid before the mortgage, but which under *Michigan v. United States* and *United States v. City of Greenville* are to be paid after the United States, the state taxes should not be allowed to hide behind the protection of the mortgage.<sup>100</sup> And this is so even though the state taxes are paid as part of the mortgage debt. In many cases the mortgagee pays the taxes to preserve his security, and on foreclosure is reimbursed for such expenditures before subsequent liens are paid. If such taxes when paid by the mortgagee become part of the mortgage debt to take priority over Section 3186, this is merely an indirect way to allow subsequently imposed state taxes to displace the lien of the United States. The authorities which have allowed such procedure must be re-examined in the light of the more recent developments in the field.<sup>101</sup>

### INCHOATE UNPERFECTED LIENS

A recent source of controversy involves various types of liens imposed under state law which attach before the United States acquires any rights under Section 3466 or Section 3186, but which require

99. This was the exact solution of the state court when *United States v. Texas* was sent back to it on remand, for it said, *State v. Nix*, 159 S. W. 2d 214, 215 (Tex. Civ. App. 1942):

"It has thus been determined by the State Supreme Court that Dailey's (the mortgagee) \* \* \* claim is inferior to that of the State of Texas, and the U. S. Supreme Court has held that the State's claim is inferior to that of the Federal Government. The funds in the treasury of the trial court are insufficient to satisfy the judgment in favor of the Federal Government and no necessity arises for apportioning any deficit after payment of the judgment due the Federal Government. \* \* \*

"\* \* \* That part of the judgment giving priority to the State of Texas over the judgment in favor of the Federal Government will be reformed and priority will be given to the latter over the former. \* \* \*

"In this appeal, both Howard Dailey and the State have lost as against the Federal Government; the State has prevailed over Dailey. \* \* \*"  
100. *Hopkins v. Eureka Coal Co.*, P-H FED. TAX SERV. ¶ 162,496 (C. C. Kanawha Co., W. Va. 1944).

101. *Sherwood v. United States*, 5 F. 2d 991 (E. D. N. Y. 1925).

further steps for perfection after the rights of the United States arise—the inchoate, floating, or unperfected type of lien. For Section 3466 these are no problem. If the state lien does not divest the insolvent of title or possession of the property, Section 3466 will overreach the earlier attachment and take priority.<sup>102</sup> Even if certain non-possessory perfected liens can supersede the priority demanded by Section 3466, the Supreme Court has yet to allow a state lien to be classified as duly perfected and specific for this purpose. In all cases the lien has been merely a caveat of a more perfect lien to come, either because it was uncertain as to the amount, identity of the lienor, or property subject thereto.

However, section 3466 is not always applicable and United States priority often depends on the attributes of the liens created by Section 3186 and Section 315 (a). We have already seen that a state can not displace the priority of the Federal lien by a subsequent exercise of its taxing, legislative, or judicial power and accord its own later liens priority in payment over the earlier United States lien.<sup>103</sup> Thus, although the state liens are made “first liens” in all cases whatsoever, they still must rank behind Section 3186 and Section 315 (a) if they attach after the Federal liens have arisen. Suppose, however, that instead of providing that the state lien shall be a “first” lien, a state statute in imposing an *ad valorem* property tax, provides that the lien shall attach on the first day of the taxable year, at which time the United States has no lien for Federal taxes; but that the amount of the tax is not determined and the tax assessed until after Section 3186 attaches and notice is properly filed. If the United States were claiming under Section 3466, the United States plainly would win, since the state lien was inchoate as to amount at the time the rights of the United States arose. Is there any difference if the United States is claiming as a lien claimant under Section 3186 rather than as a non-lien priority creditor under Section 3466?<sup>104</sup>

The case set forth above is *United States v. Reese*.<sup>105</sup> The court, more by reliance on than by analogy to Section 3466, held that the state of Illinois could not displace the priority of the Federal lien under Section 3186 by relating the state lien back to the date of attachment prescribed by the state statute. Much the same problem was involved in *United States v. Sampsell*.<sup>106</sup> The state of California admittedly had inchoate floating liens uncertain as to amount at the time the United

102. See cases cited notes 6 to 12 *supra*.

103. *Michigan v. United States*, 317 U. S. 338 (1943) and *United States v. City of Greenville*, 118 F. 2d 963 (C. C. A. 4th 1941).

104. In *Gerson, Beesley & Hampton v. Shubert Theatre Corp.*, 7 F. Supp. 399 (S. D. N. Y. 1934), the court held that inchoate state liens for taxes were inferior to Section 3466, but superior to Section 3186.

105. 131 F. 2d 466 (C. C. A. 7th 1942).

106. 153 F. 2d 731 (C. C. A. 9th 1946).

States liens arose. Thereafter the amount of the California taxes was determined and by state law the liens were related back to a tax day prior to the time Section 3186 attached. In the meantime the taxpayer was adjudicated a bankrupt. The court held in favor of state priority. It refused to follow *United States v. Reese*, claiming that there the court had failed to consider the applicable provisions of the Bankruptcy Act and had based its decision on statutes (Section 3466) not applicable to bankruptcy proceedings.<sup>107</sup> It then proceeded to consider the "applicable" provisions and concluded that the Bankruptcy Act sets up its own system of priorities for lien claimants. What the court seems to have overlooked, however, is that under that system, the priority of competing liens when once recognized as valid for purposes of bankruptcy is determined by applicable state or federal law and not by anything contained in the Bankruptcy Act itself.<sup>108</sup> Hence, if Section 3186 is ahead of prior inchoate liens in an ordinary contest outside of bankruptcy, it is also ahead of them in bankruptcy.<sup>109</sup>

Examining the problem afresh we see that the analogy of the priority of the federal lien to the priority demanded by Section 3466 is a very real one and one which was expressly recognized by the Supreme Court in *Michigan v. United States*. This case did not involve an inchoate state lien subsequently perfected but a subsequently imposed state lien. Yet the Supreme Court clearly pointed out that the problem of the subsequently imposed state lien involved the same considerations as the Section 3466 inchoate lien cases. In both instances a subsequent exercise of state power seeks to displace federal rights which have already attached. If it is an interference with the federal lien for a state to call its subsequently imposed state liens a first lien in all cases whatsoever, it is just as much an interference for the state to say that its lien arises on a day prior to the time the state tax is assessed and determined.

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107. *United States v. Reese* was not a bankruptcy case. It involved a suit by the United States under Section 3207 to enforce a lien against property which had belonged to the taxpayer at the time the federal lien arose, but which thereafter had been seized in execution and sold by a judgment creditor. At the time of the suit the taxpayer was a bankrupt, and his only connection with the case was that he had been the former owner of the property subject to the lien. However, the Government's brief in *United States v. Sampson* refers to *United States v. Reese* as involving a dispute between two lien claimants in bankruptcy. Brief for the United States, p. 20.

108. *Seymour v. Wildgen*, 137 F. 2d 160 (C. C. A. 10th 1943); *Lerner Stores Corp. v. Electric Maid Bake Shops*, 24 F. 2d 780 (C. C. A. 5th 1928). Although state law determines the validity of the state lien, *City of New York v. Hall*, 139 F. 2d 935 (C. C. A. 2d 1944), it is a matter of federal law whether the state lien seeks to displace lien or priority rights of the United States which have previously attached. *Michigan v. United States*, 317 U. S. 338 (1943); *United States v. Waddill, Holland & Flinn, Inc.*, 323 U. S. 353 (1945).

109. The reference by the court in *United States v. Reese* to the "liens" created by Section 3466 is particularly unfortunate and casts some doubt as to whether the court actually realized that the priority demanded by Section 3466 over inchoate liens was applicable to Section 3186 only by analogy. COLLIER, *op. cit. supra* note 94, seems to think the case correctly decided and the analogy good.

This can be readily demonstrated if we assume the case of a state statute providing that the state tax shall be a lien and attach to the property at the time the statute is passed. Each year the state determines and assesses the tax which, until paid, is a lien on the property from the date of the taxing statute. The lien of the United States may arise years prior to the year for which the state tax remains unpaid. Yet by the mere *ipse dixit* in the state statute creating a lien date, the lien of the United States is lost even though everything necessary to be done to establish the state lien takes place after Section 3186 has arisen.<sup>110</sup> The priority of Section 3186 would thus be dependent upon the choice of words of the state statute. If the state statute creates a first lien without specifying a lien date, Section 3186 wins; but if the state statute dates the lien to a time when the statute was passed or property acquired, the state wins.

Section 3186 is to be interpreted as are other parts of the Internal Revenue Code in accordance with a nationwide scheme of taxation.<sup>111</sup> Its priority is not to be subject to technical differences in language used by state legislatures in setting up their own tax liens. The perfection of an inchoate state lien to the detriment of the United States must be put in the same category as the imposition of a totally new state lien.

So far we have proceeded upon the theory that to give priority to an inchoate state lien perfected after the federal lien for taxes has arisen is an interference with the federal power to lay and collect taxes. Moreover, is not such action also an attempt to tax property of the United States? In *United States v. City of Greenville* Judge Parker advanced as an alternative ground for denying priority to the subsequently imposed state tax lien the thought that when the federal lien attached the property had two owners, the taxpayer and the United States to the extent of the lien. This being so the subsequent tax by the state was in effect a tax on the Federal Government. The same reasoning would seem to apply to the inchoate lien cases if *United States v. Alabama*<sup>112</sup> does not stand in the way.

In *United States v. Alabama*, the state statute provided that the lien for taxes was to arise on October 1, although the tax rate was to be determined and the taxes assessed thereafter. On October 1, United States purchased property in Alabama. Where one sovereign purchases the property of another something usually happens to the liens of the

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110. It may be said that Section 3186 arises in the same way and that a judgment may attach between the time the assessment list is received by the collector and demand is made on the taxpayer. The demand would be a subsequent exercise of the power to tax by the Federal Government, for without demand there is no lien. But the Federal Government can provide that its lien shall have retroactive effect as against state liens.

111. *Burnet v. Harmel*, 287 U. S. 103 (1932); *United States v. Snyder*, 149 U. S. 210 (1893).

112. 313 U. S. 274 (1941).

first. Although in some instances the liens may still be enforceable against the new sovereign owner, in other instances they may be destroyed and the land sold free and clear of the liens, or the liens may lie dormant and be revived on a subsequent sale of the property to a private person.<sup>113</sup> After the United States acquired the land Alabama determined the tax rate, assessed the tax against the former owner, and claimed that its liens were good against the United States, asserting that when it assessed the tax, the liens related back to October 1, the day the United States purchased the property. On an original bill to quiet title, under which the United States argued that Alabama was attempting to tax the property of the United States, the Supreme Court concluded that although the lien of Alabama was inchoate at the time the United States acquired the land nothing prohibited the lien from being perfected while the United States owned the land, and this did not amount to a tax on property of the Federal Government. The state liens were, therefore, held to be valid although unenforceable so long as title to the property remained in the United States.

It is difficult to reconcile the holding of *United States v. Alabama* with the well settled principle that a state can not directly tax the property of the United States.<sup>114</sup> In theory at least a state could continue to determine and assess taxes for years while property was held by the United States by the simple device of relating the lien for the taxes to some lien date prior to the time the property was acquired by the United States.<sup>115</sup> Though the lien could not be enforced against the United States directly, when the United States sold the property the purchaser, knowing that he would take subject to the state lien, would of necessity pay a price reduced by the state lien. It surely would seem that if the United States as an actual purchaser lays itself open to such indirect taxation by state use of inchoate floating tax liens, the United States as a lien creditor or Section 3466 priority claimant should be in no better position. But it is equally well settled that inchoate state liens can not override the priority of Section 3466. In fact in arriving at the conclusion that the tax lien of Alabama was good the court quite deliberately gave approval to the holding in *United States v. MacLay*<sup>116</sup> which refused to allow an inchoate lien to override the priority demanded by Section 3466 by any doctrine of relation back.

Although Section 3466 priority is not adversely affected by *United States v. Alabama*, is the same true for Section 3186? This is the problem which confronted the court in *United States v. Reese*. Realiz-

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113. See Note 158 A. L. R. 563 (1945).

114. *Van Brocklin v. Tennessee*, 117 U. S. 151, 179-180 (1886).

115. This seems to be the concern of the writer of the case note in 40 MICH. L. REV. 290 (1941).

116. 288 U. S. 290 (1933).

ing that to cast the United States in the role of a purchaser to the extent of the lien would run afoul of *United States v. Alabama*, yet realizing that the Section 3466 cases were still good law, the court charted its course between the two conflicting doctrines and came out with what, in view of *Michigan v. United States*, must be the proper result. In *United States v. Alabama*, Congress was silent as to the effect of the inchoate state lien. But Section 3186 is an affirmative exercise of the Federal power to lay and collect taxes. Congress has created a lien for taxes, and the lien can not be adversely affected by what a state does once the lien arises. If a state fails to determine and assess its state taxes no state lien will actually arise despite the existence of the inchoate state lien. Hence, the subsequent action of perfecting the inchoate state lien is an attempt, not to tax the property of the United States, but to displace the tax lien of the United States. The United States as a lien claimant or Section 3466 priority creditor thus stands in a better position with regard to inchoate state liens than it does as a purchaser. *Michigan v. United States* makes no mention of the earlier decision in *United States v. Alabama*. Although the state lien involved in *Michigan v. United States* was a "first" lien which did not arise on any particular lien day, the analogy drawn by the court to the Section 3466 cases reveals that the perfection of an inchoate state lien is a subsequent exercise of state power which can not displace a lien of the United States imposed under the constitutional authority to lay and collect taxes. *United States v. Alabama* seems wrong and there is no need to extend its holding beyond its exact facts.

To hold that inchoate liens can not relate back and supplant the lien of the United States will not conflict with any policy expressed in the recording provisions of Section 3186. The recording provisions were designed to protect creditors who rely on the state of the record. But it is not enough for the creditor merely to lend money before the United States has recorded. The creditor must record before United States gives notice.<sup>117</sup> Hence, just as a judgment or mortgage creditor who lends money to the debtor before Section 3186 arises but fails to record until after notice of Section 3186 has been filed will lose his priority, so too a creditor's inchoate lien can be displaced by the United States any time prior to its perfection without violating the policy of the recording provisions.

A variation of a problem previously touched upon can now be examined. One of the characteristics which makes a lien inchoate is that the amount of the lien is uncertain. Suppose goods are seized in a suit started by attachment, say for \$75,000, but judgment is rendered

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117. *Mackenzie v. United States*, 109 F. 2d 540 (C. C. A. 9th, 1940).

for only \$25,000. After attachment but before final judgment, the United States acquires and files notice of its lien under Section 3186.<sup>118</sup> If the United States were claiming under Section 3466, the United States would take priority, either because the suit by attachment created no perfected lien,<sup>119</sup> or because the amount of the lien was not liquidated and certain. The lien of attachment should likewise fall before Section 3186 since the aid of the court is necessary to fix the amount of the judgment for which the lien of attachment is security by relation back.<sup>120</sup> It is true in this type of case the subsequent exercise by the state court is not under the taxing power, but the important feature is not under what color or claim of right the state court acts but rather the effect of its action on the federal power to collect taxes.

In the above situation the amount of the original attachment or lien was greater than the amount of the final judgment. Suppose, however, a liquidated and definite amount is first claimed, but after the Federal lien has attached, additional sums are added. This was true in *United States v. Sampsell*<sup>121</sup> where attorney's fees and interest went into the principal sum of the mortgage ahead of Section 3186, and in *First National Bank of Alex, Oklahoma v. Southland Production Co.*<sup>122</sup> where state taxes secured by a so-called specific perfected prior lien were subsequently discovered to be understated to the detriment of the claim of the United States. With regard to the latter case, although there would be no reason for allowing subsequent accruing taxes to be related back to an earlier lien date, the mere error in computing the amount of the state lien should not affect its priority.

The problem of attorney's fees and interest is somewhat different. Interest has a sort of special place in creditors' rights.<sup>123</sup> Technically the problem is to what extent the United States has consented to give the mortgage priority. Probably to the extent of the principal sum plus interest plus those attorney's fees necessary to protect the mortgage against unsubstantiated claims of the United States to displace it. Since the United States if it foreclosed would have to pay the expenses of foreclosure and give the principal sum to the mortgagee, it seems only right to allow such expenses to take precedence when paid for by the mortgagee. This is somewhat similar to the collector selling goods and paying the costs of the sale before collecting the tax.<sup>124</sup>

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118. As in *Board of Supervisors of Louisiana State University v. Hart*, 26 So. 2d 361 (La. 1946). The Louisiana court held in favor of the private creditor.

119. *Willing v. Bleeker*, 2 S. & R. 221 (D. C. Phila., Pa. 1816).

120. Cf. *United States v. Texas*, 314 U. S. 480 (1941).

121. 153 F. 2d 731 (C. C. A. 9th 1946); see also *Ormsbee v. United States*, 23 F. 2d 926 (S. D. Fla. 1928).

122. 189 Okla. 9, 112 P. 2d 1087 (1941).

123. See *Ticonic Bank v. Sprague*, 303 U. S. 406 (1938); *Louisville Bank v. Bradford*, 295 U. S. 555, 557 (1935).

124. See INT. REV. CODE § 3694; *In re Wyley*, 292 Fed. 900 (N. D. Ga. 1923).

## CONCLUSION

The Government has been most zealous in protecting the revenue where state action has attempted to encroach upon the priority demanded by Section 3466.<sup>125</sup> However, it has refused to push its demands for a final adjudication in lien cases<sup>126</sup> which have in many instances greater importance and wider application. For the lien affords the Government its only real protection in bankruptcy. It complements the use of Section 3466 to override the priority of earlier as well as subsequent claims. Further where the taxpayer is solvent, or being insolvent, has committed no act specified in Section 3466, that section does not apply; and unless the priority of the federal lien is definitely established, the assets of the taxpayer will be taken over by competing creditors with the United States standing by with an empty Section 3466 on the one hand and a subordinate tax lien on the other.

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125. See cases cited note 8 *supra*; also the recent case of *United States v. Remund*, 15 U. S. L. WEEK 4355 (March 17, 1947).

126. The Solicitor General refused to authorize certiorari in *United States v. Sampsell*, 5 P-H FED. TAX SERV. ¶ 71,077 (1946) and *Board of Supervisors of the Louisiana State University v. Hart*, 5 P-H FED. TAX SERV. ¶ 71,111 (1946).