Chicago-Kent Law Review

Volume 14 | Issue 2 Article 2

March 1936

The Status of Trust Funds as Claims against Insolvent Banks

Agnes M. Kasper

THE STATUS OF TRUST FUNDS AS CLAIMS AGAINST INSOLVENT BANKS

AGNES M. KASPER[1]

A CLAIM against an insolvent bank is usually predicated upon a deposit of some kind. It is generally understood that there are two possible types of deposits in a bank, namely, general and special. A general deposit is one which is made to the credit of the depositor and upon which he may draw from time to time in the usual course of business. Deposits are usually presumed to be general in the absence of any agreement indicating a contrary intent,[2] and the relation of debtor and creditor arises between the parties. In the event of the insolvency of a bank, the general depositors share equally in the assets of the bank after the prior and preferred claims have been satisfied in accordance with the orders of the court having jurisdiction over the dissolution proceeding.

A special deposit is one made under circumstances which in and of themselves create a fiduciary relationship between the parties rather than the usual debtor and creditor arrangement.[3] Circumstances which cause the relation of bailor and bailee, principal and agent, or trustee and *cestui que trust* to arise between the bank and its depositor, as a general rule, are sufficient to support a claim that a deposit made thereunder is a special one.[4]

[1] Member of Illinois Bar; alumna of Chicago-Kent College of Law.

[2] The People v. Home State Bank, 338 Ill. 179, 170 N. E. 205 (1930); Bayor v. American Trust and Savings Bank, Assignee, 157 Ill. 62, 41 N. E. 622 (1895).

[3] People, ex rel. Nelson v. State Bank of Maywood et al., 354 Ill. 519, 188 N. E. 853 (1933); People ex rel. Russell, Auditor of Public Accounts v. Farmers State & Savings Bank of Grant Park, 338 Ill. 134, 170 N. E. 236 (1930); Pitts v. Pease et al., 39 F. (2d) 14 (1930); Anderson v. The Pacific Bank, 112 Cal. 598, 44 P. 1063 (1896).

[4] People ex rel. Russell, Auditor of Public Accounts v. Farmers State and Savings Bank of Grant Park, 338 Ill. 134, 170 N. E. 236 (1930); Woodhouse v. Crandall, 197 Ill. 104, 64 N. E. 292 (1902); Mutual Accident Assn. of the Northwest v. Jacobs, Assignee, 141 Ill. 261, 31 N. E. 414 (1892); Wetherell, Assignee v. O'Brien, 140 Ill. 146, 29 N. E. 904 (1892); People ex rel. Andrew Russell, Auditor of Public Accounts v. Iuka State Bank, 229 Ill. App. 4 (1922); Pitts v. Pease et al., 39 F. (2d) 14 (1930).

Special deposits are entitled to preferential treatment in the liquidation of the affairs of an insolvent bank, but clear and satisfactory proof of the existence of circumstances out of which a special or fiduciary relationship of any sort might arise must be produced.[5]

Prior and Preferred Claims

Prior and preferred claims are terms frequently used interchangeably, but they are by no means synonymous. Prior claims are those claims for which the legislature has created a statutory preference against the assets of an insolvent bank regardless of an obligation to establish the existence of a fiduciary relationship in connection therewith or to trace a particular fund into the hands of the receiver. Wage claims,[6] certain moneys due to the United States government on deposit in state banks,[7] and funds of the state[8] are a few of the claims granted a priority in Illinois.

Preferred claims, however, after they have been proved to be such, are entitled to preferential treatment only to the extent that the proceeds of the fund on which the claim is based can be traced into the hands of the receiver. Proof of the existence of a trust relationship between the bank and a depositor is only the first step in obtaining a preferred claim.

The necessity for tracing the proceeds of a deposit based on a fiduciary relationship is predicated on the very natural situation of an owner seeking the return

[5] Marble v. Marble's Estate, 304 Ill. 229, 136 N. E. 589 (1922); Roth v. Michalis et al., 125 Ill. 325, 17 N. E. 809 (1888); Fralick v. Coeur d' Alene Bank and Trust Co., 36 Ida. 108, 210 P. 586 (1922); In re Cooper County State Bank, 67 S. W. (2d) 109 (Mo. App., 1933).

[6] Smith-Hurd's Ill. Rev. Stat. (1935), Ch. 82, par. 63; Ill. State Bar Stats. (1935), Ch. 72, par. 1.

[7] U. S. R. S., sec. 3466; 31 U. S. C. A., sec. 191.

[8] People v. Bank of Rushville, 355 Ill. 336, 189 N. E. 299 (1934); People v. West Englewood Trust and Savings Bank, 353 Ill. 451, 187 N. E. 525 (1933); People v. Dime Savings Bank, 350 Ill. 503, 183 N. E. 604 (1932); People v. Marion Trust and Savings Bank, 347 Ill. 445, 179 N. E. 893 (1932); People v. Bank of Chebanse, 340 Ill. 124, 172 N. E. 50 (1930); People v. Farmers State Bank, 335 Ill. 617, 167 N. E. 804 (1929).

of his property from another in whose custody he had placed it, but to whom beneficial ownership has never passed. It follows, therefore, that it is necessary for the claimant to identify his property, or the proceeds thereof, and show that it is still in the possession of the bank and has not been dissipated.[9] Where the property constituting the trust fund is capable of identification and remains intact, it should be immediately surrendered to the *cestui que trust,*[10] or where the bank has converted the original trust *res* into other property which, however, can be identified, that other property can be recovered by the *cestui que trust.*[11] However, where the property constituting the original trust *res* has been mingled with the assets of the bank and is incapable of identification and can not be traced, in its altered form, as the proceeds of the trust *res,* a real and sometimes insurmountable difficulty arises.

The theory behind the tracing of trust funds is that the beneficial ownership of the trust *res* never passed to the bank, and it could not, therefore, become a part of the assets thereof which passed into the hands of the receiver, but must be returned immediately to the rightful owner.

In the earliest decisions on this point it was held that any commingling of the proceeds of the trust *res* with the general assets of the bank defeated the trust and gave the *cestui que trust* only a general claim against the assets of the bank, because the commingling rendered the trust *res* incapable of identification, and because money was not ear-marked and could not be recovered in specie.[12]

[9] People ex rel. Nelson v. State Bank of Maywood, 354 Ill. 519, 188 N. E. 853 (1933); Schuyler v. Littlefield, 232 U. S. 707, 58 L. Ed. 807 (1914); First Nat. Bank of Ventura v. Williams, 15 F. (2d) 585 (1926); Farmers' Nat. Bank of Burlington et al. v. Pribble, 15 F. (2d) 175 (1926); Jones v. Chesebrough et al., 105 Iowa 303, 75 N. W. 97 (1898).

[10] Woodhouse v. Crandall, 197 Ill. 104, 64 N. E. 292 (1902).

[11] Ibid.; Union Nat. Bank of Chicago v. Goetz et al., 138 Ill. 127, 27 N. E. 907 (1891).

[12] Lanterman v. Travous, 174 Ill. 459, 51 N. E. 805 (1898).

This rule, however, was modified to a certain extent by the decision in the case of *Woodhouse* v. *Crandall,*[13] in which it was held that, if the trust *res* be moneys, it is not essential that the money or bank bills should be identified because the suit is not to recover a specific thing but a certain sum of money held in trust and it is the identity of the fund and not the identity of the money which is to be established. It was also held that it makes no difference if the fund was mingled with other moneys so as to lose its identity as currency, as the character of the fund held by the bank in a fiduciary capacity has not been changed by being placed with other moneys; and further that where moneys are so mingled, the law will presume that the trustees draw out their own money first. However, if it can be shown that the entire fund was withdrawn or actually dissipated so that none of it remains, the rule would necessarily be different; if the fund has once been disposed of, no charge can be made against the general estate to the exclusion of other creditors.[14]

It is the generally accepted rule that where moneys are blended in an account which has been reduced from time to time by withdrawals, the presumption is that the sums withdrawn are from the moneys which the trustee had a right to use and the sums remaining include the trust fund which he had no right to use. However, this presumption is rebuttable by evidence to the contrary, and if at any time during the existence of the mingled account, the balance remaining therein is less than the trust money, the trust fund will be regarded as having been dissipated, except as to the balance remaining, and no

[13] 197 Ill. 104, 64 N. E. 292 (1902).

[14] Hauk v. Van Ingen, 196 Ill. 20, 63 N. E. 705 (1902); Estate of Seiter v. Mowe, 182 Ill. 351, 55 N. E. 526 (1899); Lanterman v. Travous, 174 Ill. 459, 51 N. E. 805 (1898); Bayor v. American Trust and Savings Bank, 157 Ill. 62, 41 N. E. 622 (1895); Wetherell v. O'Brien, 140 Ill. 146, 29 N. E. 904 (1892).

trust may attach to any subsequent deposits.[15] The foregoing is based on the well settled theory of the law which refuses to presume that a trustee will perform his duties in any other manner than a faithful and honest one until contradictory proof thereof is produced, but he cannot remove the evidence of his defalcation by replacing the funds which he had no right to use.

In the case of *People* v. *State Bank of Maywood,*[16] the Illinois Supreme Court, in keeping with the trend of the times, discussed the tracing of trust funds, and said:

> The true owner of a fund wrongfully withheld by another has a right to have it restored, not as a debt due and owing, but because it is the property of the former. A change or alteration in the nature or character of the fund does not affect the relation existing between the parties. Since the right to reclaim a trust fund is founded on the right of property, and not on the ground of compensation for its loss, the beneficiary must be able to point out the particular property into which the fund has been converted. When he is unable to do so, the trust fails and his claim becomes one for compensation only and stands on the same basis as the claims of general creditors. It is as necessary to trace the proceeds of a check or draft constituting part of a trust fund, as it is to trace the proceeds of any other species of personal property; and a trust fund traced into a bank account, if its identity can be established, and no superior rights of innocent parties have intervened, will be held for the benefit of the *cestui que trust.* The question in every case where it is sought to trace trust property is whether it can be identified in its original or altered form.

The foregoing rule, as laid down in the Bank of Maywood case, would seem to change the rule as to the tracing of trust funds as established in Illinois by requiring a more specific tracing of the trust *res,* or the proceeds thereof, into specific assets in the hands of the receiver, namely, the cash on hand and the cash on deposit in other

[15] Knatchbull v. Hallett, L. R. 13 Ch. Div. 696 (1879); Central Nat. Bank of Baltimore v. Connecticut Mutual Life Ins. Co., 104 U. S. 54, 26 L. Ed. 693 (1881); Smith v. Mottley, 150 F. 266 (1906); Board of Com'rs of Crawford County v. Strawn, 157 F. 49 (1907).

[16] 354 Ill. 519, 188 N. E. 853 (1933).

banks, rather than into the mass of assets, after a showing that they have been augmented by the addition of the trust *res*, or its proceeds.

It has been frequently held in Illinois that where an attempt is being made to trace property or money into a specific fund, it is essential to show that the property or money actually augmented the assets in the hands of the receiver in some way so that the preferred claim may be satisfied therefrom without affecting the rights of other creditors.

The Federal courts have followed the same theory on augmentation as is followed in Illinois, but they have further held that where it appears that the trust fund has been completely withdrawn or dissipated so that no portion thereof remains in the bank, there can be no preference against the general assets of the bank. The presumption that the trust fund came into the hands of the receiver is rebutted by a showing that the fund had been dissipated subsequent to its deposit.[17] A transfer of funds by bookkeeping entries, without any actual segregation, has been held not to amount to an augmentation of the assets of a bank, but to consist merely of a shifting of credits.[18]

Trust Funds

A discussion of trust funds and their status as a preferential claim against the receivership estate of an in-

[17] People v. State Bank of Maywood, 354 Ill. 519, 188 N. E. 853 (1933); Woodhouse v. Crandall, 197 Ill. 104, 64 N. E. 292 (1902); People ex rel. Nelson v. Bates, 351 Ill. 439, 184 N. E. 597 (1933); In re People v. Illiana State Bank, 265 Ill. App. 29 (1932); People ex rel. Russell v. Auburn State Bank et al., 215 Ill. App. 133 (1919); Miller v. Viola State Bank, 121 Kan. 193, 246 P. 517 (1926); Murray v. North Liberty Savings Bank, 196 Iowa 729, 195 N. W. 354 (1923); Hansen v. Roush, 139 Iowa 58, 116 N. W. 1061 (1908); People v. West Englewood Trust & Savings Bank, 253 Ill. 451, 187 N. E. 525 (1933); Covey v. Cannon, 104 Ark. 550, 149 S. W. 514 (1912); Hewitt v. Hayes, 205 Mass. 356, 91 N. E. 332 (1910); City of Lincoln v. Morrison, 64 Neb. 822, 90 N. W. 905 (1902).

[18] Thompson v. Common School District No. 54, 67 F. (2d) 284 (1933); Mechanics' & Metals Nat. Bank of New York v. Buchanan, 12 F. (2d) 891 (1926); State Bank of Winfield v. Alva Security Bank et al., 232 F. 847 (1916); Beard v. Independent District of Pella City, 88 F. 375 (1898).

solvent bank seems naturally to divide itself into two general classes, each of which must be considered and treated separately. The first class includes pure trust deposits, such as deposits under an express declaration of trust, bailments, or cases in which the bank is acting as executor, administrator, guardian, or conservator of an estate, or as an escrow agent; and the second class includes those deposits which, because of the circumstances surrounding either their acceptance or treatment by the bank, are held to be trust funds, such as deposits of state funds, deposits under order of court, and the like. In the latter class will be included a consideration of various classes of claims for which there has been a repeated but unsuccessful effort to establish a preference.

Express Trust Deposits

A trust fund has been defined as "a fund held by a trustee for the specific purposes of the trust,"[19] but in order to establish the existence of such a fund it is necessary to establish first of all the existence of a trust relationship between the parties. Under ordinary circumstances when one person holds the property of another without having any claim thereto, it is not, usually, an extremely difficult matter to obtain its return to its rightful owner, but in the case of a deposit of funds in a bank, special circumstances must be shown to rebut the presumption that the relation created between the parties by such deposit was not the generally accepted relation of debtor and creditor.[20] It is necessary, therefore, to show that funds on deposit were delivered or deposited for a specific purpose or with a specific understanding as to their treatment in order to establish the existence of the fiduciary relationship between the bank and its depositor which necessarily arises on account of such a deposit.

[19] Black's Law Dictionary, p. 1762.

[20] Sachs v. Sachs, 181 Ill. App. 342 (1913).

In cases in which the bank is acting as trustee, executor, administrator, guardian, or conservator, or where a written declaration of trust has been executed by the bank and the depositor setting forth the special circumstances of the deposit, it is well settled that in the event of the insolvency of the bank, claims founded on such funds are entitled to preferential payment. On that point it has been held that money which a bank holds as trustee is not a part of its assets,[21] nor legally subject to the claims of its creditors, and the Missouri Court of Appeals, in the case of *Flint Road Cart Co.* v. *Stephens*,[22] said:

> . . . a trust fund received in such a manner that the ordinary relation of debtor and creditor is not established, should properly be returned intact, either by the insolvent bank or by the receiver subsequently appointed.

In order to establish a preferential claim based on a trust fund, however, one thing more is necessary—the fund must be traced into the assets of the bank and must be shown to have augmented such assets when they came into the hands of the receiver. A bank has no authority to mingle a special deposit or trust account with its general assets or funds, and so long as the owner or depositor of such funds can show that he had no knowledge of and did not authorize the commingling, he can trace his funds while they are capable of identification. The right to a preferred claim on account of a special or trust deposit ceases only when the means for ascertaining the identity of the deposit or fund comprising such deposit fails.

In the case of *Union National Bank of Chicago* v. *Goetz et al.*,[23] the Supreme Court of Illinois adopted the rule

[21] People v. West Englewood Trust and Savings Bank, 353 Ill. 451, 187 N. E. 525 (1933).

[22] 32 Mo. App. 341 (1888).

[23] 138 Ill. 127, 27 N. E. 907 (1891).

laid down in *Thompson's Appeal*[24] by the Supreme Court of Pennsylvania, and quoted therefrom as follows:

"Whenever a trust fund has been wrongfully converted into another species of property, if its identity can be traced it will be held, in its new form, liable to the rights of the *cestui que trust.* No change of its state and form can divest it of such trust. So long as it can be identified, either as an original property of the *cestui que trust* or as the product of it, equity will follow it, and the right of reclamation attaches to it until detached by the superior equity of a bona fide purchaser for a valuable consideration without notice. The substitute for the original thing follows the nature of the thing itself, so long as it can be ascertained to be such; but the right of pursuing it fails when the means of ascertainment fail."

Again in the case of *Woodhouse* v. *Crandall,*[25] the court said:

So long as it can be identified, either as the original property of the *cestui que trust* or as a product of it, equity will follow it, and the right to reclaim it fails only when the means of ascertaining its identity fails.

In the case of *People* v. *State Bank of Maywood,* already referred to, the court, after citing the rule as laid down in *Union National Bank of Chicago* v. *Goetz,* said:

It follows that a receiver of a bank in which a fund impressed with a trust was deposited cannot be required to re-pay it in preference to the claims of general creditors, unless the trust fund can be identified, or traced into some other specific fund or property.

It would seem to follow, therefore, that pure trust funds have a preferential status as a claim against the assets of an insolvent bank only after their identity as such has been established and traced into the assets in the hands of a receiver appointed for the purpose of liquidating the bank, and this applies not only to moneys deposited for a specific purpose or trust, but to other property as well.

[24] 22 Pa. St. 16 (1853), erroneously cited in the Illinois case as 27 Pa. St. 16.

[25] 197 Ill. 104, 64 N. E. 292 (1902).

Deposits by Fiduciaries

It does not follow, however, that deposits by a person acting in a fiduciary capacity are prima facie entitled to preferential treatment. The mere fact that a deposit is made in the name of an individual as "trustee," "administrator," "executor," or "guardian" does not alter the character of the deposit itself, unless some special agreement or arrangement is made with the bank. The test in such cases is whether a fiduciary relation has been established between the bank and the depositor, not the relation between the depositor and his fund and third persons. The fact that a depositor is acting in a fiduciary capacity with reference to his funds on deposit in a bank does not entitle him to any preference, but simply renders the bank a debtor to him in the particular capacity in which he has made his deposit.[26]

On this point the Supreme Court of Missouri, in its decision in the case of *Paul* v. *Draper*,[27] said:

> The fact that the deposit was of a trust fund, and known to the bank to be such, would not of itself make the bank a trustee of the fund for the benefit of the *cestui que trust*. In order to have that effect there must have been something in the circumstances of the deposit to constitute it a special, as contradistinguished from a general, deposit, into which two classes all deposits in commercial banks may be divided. If the deposit belonged to the former class, the fiduciary relation might well arise; if to the latter, in the absence of *mala fides*, it could not do so, for by a general deposit in good faith the title to the deposit passed, the bank became the owner thereof. The relation of debtor and creditor, and not that of trustee and *cestui que trust*, was created.

It has also been held that the deposit of court funds in the hands of a clerk of a particular court in a bank designated by the court is not, as such, entitled to a preference

[26] People v. Home State Bank, 338 Ill. 179, 170 N. E. 205 (1930); People ex rel. Nelson v. Chicago Bank of Commerce, 275 Ill. App. 80 (1934); People v. Farmers State Bank, 338 Ill. 134, 170 N. E. 236 (1930); Bridge v. First Nat. Bank-Detroit et al., 5 F. Supp. 442 (1933).

[27] 158 Mo. 197, 59 S. W. 77, 81 Am. St. Rep. 296 (1900).

in the absence of some special agreement between the bank and the depositor regardless of the fact that the bank and its officers were aware of the source of the funds being placed on deposit. In the case of *Otis* v. *Gloss*,[28] which is the leading case in Illinois on this particular point, the court said:

> The mere fact that this was a fund in court does not give the claim of the court a preference over other just claims. It may be a misfortune and a great hardship that the money was deposited in this institution, but it is equally so that the other creditors were so unfortunate as to repose confidence in dishonest or incompetent men, and deposit their means with them.

However, where it appears that the funds were deposited under some special and definite agreement or arrangement with the bank sufficient to take the deposit out of the class of general deposits or where it appears that the bank was specifically appointed by order of court to act either as a depositary or in a representative capacity, the rule is different.

Deposits of funds under express order of court have been held to be trust funds, and in the case of *People* v. *Citizens Trust and Savings Bank*,[29] where a deposit of a minor's funds under an order of the Probate Court of Cook County was accepted by a bank, a preferred claim was allowed by the court with priority in payment over the claims of all general creditors. In that case the bank sought to avoid the claim for preference by showing that it had not been qualified under the Trust Companies Act,[30] but the court held that the bank did not have the power to defeat the purpose of the statute and cause the deposit to become a general one, either by bookkeeping methods or otherwise, even though the trustee made no objection to the methods employed by the bank in handling the transaction, because the bank was charged with

[28] 96 Ill. 612 (1880).
[29] 272 Ill. App. 444 (1933).
[30] Ill. State Bar Stats. (1935), Ch. 32, par. 345 et seq.

knowledge of the source of the fund and also with knowledge that the deposit was being made in accordance with the Trust Companies Act. On that point, the court said:

> The bank had knowledge of the character of the deposit and the purpose for which it was made, and is chargeable with knowledge of the statute governing the deposit, and, as it had not qualified under the act, the receipt of the deposit under such circumstances was unlawful. Where a deposit itself is unlawful, it constitutes a trust and not a general deposit, and upon the insolvency of the bank a preferred claim will be allowed.

Constructive Trusts

Where money or property has been wrongfully, unlawfully or fraudulently obtained by a bank, the owner of the money or property so obtained is entitled to a preferred claim against the said bank in the event of its insolvency based on that money or the value of that property. The theory upon which such claim is allowed is that by its conduct the bank became a constructive trustee or a trustee *ex maleficio*.[31] So also where a judgment based on fraud and deceit has been previously obtained against a bank, the judgment creditor thereunder is entitled to a preferred claim against the bank, because the rendition of the judgment created a trust in favor of the customer who had been defrauded, but every demand which grows out of a fraudulent transaction perpetrated by an officer of a bank will not, ordinarily, give the creditor presenting such claim any preference.[32]

In the case of *People* v. *American Trust and Savings Bank of Kankakee*,[33] in which case a preferred claim based on a judgment for fraud and deceit was allowed, the court said:

> Fraud and deceit by the bank, whereby the bank obtains money of the customer, creates a trust in favor of the customer.

[31] People ex rel. Nelson v. State Bank of Maywood, 354 Ill. 519, 188 N. E. 853 (1933); People v. Citizens State Bank, 274 Ill. App. 444 (1934).
[32] Michie on Banks and Banking, sec. 174; Bluefield Nat. Bank v. Picklesimer, 102 W. Va. 128, 135 S. E. 257 (1926).
[33] 262 Ill. App. 458 (1931).

A constructive trust is held to be where one clothed with some fiduciary character, by fraud or otherwise, gains something for himself which equity will fasten upon his conscience, converting him into a trustee of legal title. To raise a constructive trust there must be some element of fraud at the time of the transaction, or a confidential relation and influence whereby one obtained legal title to property which he ought not, according to the rules of equity and in good conscience, to hold and enjoy. *Streeter* v. *Gamble,* 298 Ill. 332.

A constructive trust is raised also where moneys are delivered to a bank for a specific purpose, such as for the purchase of particular securities and the bank fails to make such purchase or misappropriates the funds in any way. In the case of *Nelson* v. *John B. Colgrove & Company State Bank,*[34] which was a consolidation of a number of similar claims, one Margaret Schuessler delivered to one Gallogher, as cashier of said bank, the sum of four thousand dollars ($4,000.00) for the purchase of 6 per cent City Warrants, which she never received, although interest thereon was duly paid every six months. Upon the closing of the bank, a note for four thousand seventy-three dollars ($4,073.00), bearing interest at the rate of 6 per cent per annum, was found in an envelope bearing an endorsement of Mrs. Schuessler's name, and the court, in allowing a preferred claim to Mrs. Schuessler, said:

It is claimed that the money was placed with the other funds of the bank and used by the bank in its business and therefore its identity had been destroyed. It is the identity of the fund, and not the identity of the money or currency, which is to be established. As stated before, this money never was deposited to the claimant's account in the bank or given to the bank for that purpose but only for the specific purpose of purchasing said warrants and the receipt given for it conclusively impresses it with a trust.

This rule, however, does not apply where moneys are turned over to the bank merely for investment, with-

[34] 270 Ill. App. 411 (1933).

out any specific instructions as to the nature or type of investment to be made, and the bank purchases securities which subsequently become worthless, since, in such case, the bank has done all that it was requested to do. In the Colgrove Bank case the court, in discussing a deposit of one Minnie Waggoner for investment in "customer's loans" and her claim for a preference based on the fact that some of the notes contained in an envelope bearing an endorsement of her name, which had been delivered to her upon the closing of the bank, were worthless, said:

> The fact that one of the notes was uncollectible would not impress the whole transaction with a trust or even a general claim against the bank, as we do not understand the law to be that if a person asks a bank to invest his money in the purchase of securities and the bank does so in accordance with the request, the mere fact that one or more of the securities may have become uncollectible when the bank became insolvent, would establish a claim against the bank, either general or preferred.

When a bank accepts a deposit which it has no legal right to accept, a constructive trust is raised in favor of the rightful owner of the fund. This doctrine was fully discussed in the case of *People* v. *The Peoples State Bank of Maywood,*[35] wherein the bank accepted deposits of village funds in excess of its indemnifying bond to the village board, the acceptance of such deposits being in violation of a village ordinance of which the bank was charged with knowledge, because it had furnished indemnity bonds to the village thereunder. In that case the court said:

> The omission to observe a mandatory provision of a statute or ordinance renders unlawful the act or proceeding which it governs or to which it relates. (*People* v. *Graham,* 267 Ill. 426.) A deposit is wrongful and unlawful when made by the custodian of public funds in a bank which, owing to its failure to furnish the bond of indemnity required by an ordinance passed pursuant to statutory authority, is not qualified to receive the deposit. Likewise, a deposit of public funds in excess of the penalty of the

[35] 354 Ill. 519, 188 N. E. 853 (1933).

bond of indemnity given by a qualified depositary, when prohibited by statute or authorized ordinance is, as to such excess, wrongful and unlawful. The receipt of such funds, in either of these situations, the officers of the bank having knowledge of the illegality of the deposit, does not give rise to the relation of debtor and creditor. Such funds, deposited in violation of law, do not become assets of the bank, but are impressed with a constructive trust.

Checks and Drafts

As has been said before, the generally accepted theory of a deposit of money in a bank is that the relation of debtor and creditor is created between the bank and the depositor and that that relation continues as to the deposit in the absence of special circumstances altering or changing the relationship.

Prior to 1931 frequent attempts were made to establish a claim for preference based on the purchase of a certified or cashier's check or draft by a depositor, but such claims were always held to be based on a mere purchase of the bank's credit and entitled to no preference.

In the case of *Jewitt* v. *Yardley*,[36] it was held that where a depositor in a bank obtains from it two drafts upon another bank, paying therefor by checks against his deposit, the relation between the bank and the depositor with respect to such drafts remains that of debtor and creditor, and is not changed to a fiduciary relation, entitling the depositor, upon the bank becoming insolvent before the drafts are paid, to have the assets in the hands of its receiver applied by preference to the payment of such drafts in full.

A similar rule was applied in Illinois[37] prior to July 8, 1931, on which date the Legislature passed "An Act defining the relations between banks and their depositors

[36] 81 F. 920 (1897).

[37] Clark v. Chicago Title and Trust Co., 186 Ill. 440, 57 N. E. 1061 (1900); People ex rel. Nelson v. Builders & Merchants Bank, 264 Ill. App. 388 (1932).

with respect to the deposit and collection of checks and other instruments payable in money."[38] Paragraph 2 of section 13 of that act provides that when a drawee or payor bank has presented to it for payment an item or items drawn upon or payable by or at such bank and at the time has on deposit to the credit of the maker or drawer an amount equal to such item or items and such drawee or payor shall fail or close for business, after having charged such item or items to the account of the maker or drawer thereof, the assets of such drawee or payor shall be impressed with a trust in favor of the owner or owners of such item or items for the amount thereof, and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into such other assets of such failed bank.

The constitutionality of that provision was presented for the consideration of the Supreme Court of Illinois in the case of *McQueen* v. *Randall*,[39] in which case McQueen sought a preferred claim for the amount of certain certified checks which he had purchased for the purpose of forwarding them with certain bids for government work which he had prepared in connection with his employment as a contractor and which were subsequently returned to him by the government upon the awarding of the contract to some other contractor. The receiver of the bank from which McQueen had purchased the checks refused to recognize them, and on McQueen's intervening petition for a preference, he attacked the constitutionality of paragraph 2 of section 13 of the Act of 1931 on the ground that it was an amendment to the Banking Act and had not been submitted to a vote of the

[38] Ill. State Bar Stats. (1935), Ch. 16a, pars. 25-39.
[39] 353 Ill. 231, 187 N. E. 286 (1933).

People as required by section 5 of Article XI of the Constitution of 1870. The court held, however, that the Act of 1931 only changed the time respecting the deposit and collection of instruments payable in money when the bank gains title to the proceeds of such instruments, and, therefore, it was not violative of any constitutional provision requiring that amendments to the Banking Act be presented to the People for approval.

The constitutionality of the Act of 1931 was again raised in the case of *People* v. *Dennhardt,*[40] but the Supreme Court held that the law as laid down in the case of *McQueen* v. *Randall,* was decisive on the question of constitutionality and allowed a preferred claim based on a draft for which Dennhardt sought a preference. In its decision of the case, the court said:

> By charging the drawer's account with the amount of the check or instrument presented, that amount is in effect taken from his account and held in trust by the bank for the legal holder of the check or other instrument.

The foregoing Bank Collection Code, however, was further, and more successfully, attacked on the point of constitutionality in the case of *People ex rel. Barret* v. *The Union Bank and Trust Company,*[41] wherein the Supreme Court of Illinois affirmed a decision handed down in the Circuit Court of Stephenson County declaring section 13 of the Act of 1931 to be invalid. In this case, the receiver of the First National Bank of Freeport sought a preference on account of a draft drawn to its order on The Continental Illinois National Bank and Trust Company of Chicago by the Union Bank and Trust Company in payment of a balance due for clearings between the two banks. The Union Bank was declared insolvent before the draft had an opportunity to clear and the receiver of the Union Bank moved to strike the peti-

[40] 354 Ill. 450, 188 N. E. 464 (1933).
[41] 362 Ill. 164, 199 N. E. 272 (1935).

tion for preference on the ground that section 13 of the Bank Collection Code was unconstitutional because it sought to control the distribution of the assets of insolvent national banks in violation of the enactments of Congress[42] and the decisions of the Supreme Court.[43] The claim for preference was denied and the circuit court held that section 13 of the Act of 1931 was unconstitutional.

On appeal some question was raised as to the propriety of an attack being made on the constitutionality of the aforementioned act by the receiver of a state bank, the contention being that the question could be raised only by a receiver of a national bank, but the court declined to entertain the objection and was of the opinion that the receiver of a state bank had such an interest in the question of the validity of the statute as would entitle him to present the point for consideration.

The court was also of the opinion that the Legislature in passing the Act of 1931, better known as the Bank Collection Code, intended that it would apply to state and national banks alike, and that a declaration as to the invalidity of section 13 alone would alter the Act to such an extent as to change the intent of the Legislature in passing the statute. It was, therefore, decided that, inasmuch as the plan of the Legislature in enacting the Code would be destroyed by declaring a portion of the Code illegal, the entire Bank Collection Code would have to be declared to be unconstitutional.

Collection Items

It is held that the insolvency of a bank at once terminates its authority to proceed further, and if collec-

[42] U. S. C. A., Tit. 12, Banks and Banking, sec. 194.

[43] Davis v. Elmira Savings Bank, 161 U. S. 275, 40 L. Ed. 700 (1896); Cook County Nat. Bank v. U. S., 107 U. S. 445, 27 L. Ed. 537 (1883); Old Companies Lehigh, Inc. v. Meeker, 71 F. (2d) 280 (1934); National Bank of America et al. v. United States Fidelity & Guaranty Co., 71 F. (2d) 618 (1934).

tions are afterwards made or those previously undertaken are completed, the proceeds are held in trust for the owners.[44] In Illinois this matter was governed by statute[45] and insolvent banks were specifically required to return with reasonable diligence any and all items mailed to them or entrusted to them for collection or payment but before the collection thereof. This statute also impressed the assets of the collecting bank with a trust in favor of the owner of such items if collected and if the bank became insolvent before remittance to the owner; and the statute gave the said owner a preferred claim against the assets of such bank, regardless of whether the fund representing the items could or could not be traced into said assets. But the statute referred to was declared unconstitutional by the Supreme Court of Illinois in the Union Bank case, just discussed.

In forwarding checks for collection and remittance, it has been frequently held that the relation of debtor and creditor is not thereby established, and inasmuch as it would be a manifest fraud upon the party forwarding the collection item if the collecting bank were permitted to appropriate the proceeds thereof, a trust has been held to attach thereto.

In the case of *Nelson* v. *John B. Colgrove & Company State Bank*,[46] on an appeal from a decree of the Circuit Court of Christian County allowing a preference to the claim of Moore-Lowry Flour Mills Company, based on a certificate of deposit which failed to go through the clearing house before the closing of the Colgrove Bank, the court said:

> It has been held by all the courts of this State which have passed upon the question that where an account has been sent to a bank with instructions simply to collect, the collection of the

[44] 7 C. J. 625, sec. 301.
[45] Ill. State Bar Stats. (1935), Ch. 16a, par. 37.
[46] 268 Ill. App. 49 (1932).

fund establishes the relation of debtor and creditor only between the parties, but when the paper is sent with express instructions to collect and remit, then the money when collected by the bank becomes a trust fund. *People* v. *Iuka State Bank,* 229 Ill. App. 4; *Bates* v. *People ex rel. Nelson,* 265 Ill. App. 1.

In the case of *People* v. *Auburn State Bank,*[47] it was held that where a draft is forwarded for collection and remittance, and the collection is made, the proceeds become a trust fund for the benefit of the forwarder. And in the case of *People ex rel Nelson* v. *The Peoples Bank and Trust Company of Rockford,*[48] in allowing a preferred claim based on a check for $10,000 which had failed to clear before the closing of the defendant bank by the Auditor of Public Accounts, the Supreme Court of Illinois cited the decision in the case of *Skinner* v. *Porter,*[49] wherein it was said:

> It is quite generally held that when a bank receives paper for collection and remittance from a stranger, who is not a depositor of the collecting bank or between whom there are no reciprocal accounts, and accepts in payment a check or checks drawn upon itself, a trust fund in favor of the drawer or forwarding bank is thereby created, which fund may be followed and recovered from the receiver or assignee of said bank if the latter shall become insolvent.

It was also held by the Supreme Court of Illinois in the case of *People ex rel. Nelson* v. *The Peoples Bank and Trust Company of Rockford,* that bookkeeping entries may constitute a sufficient *res* upon which a trust may operate.[50] And it has been held that a demand by a depositor in a bank for the amount of his deposit and the refusal by the bank to comply with that demand cre-

[47] 215 Ill. App. 133 (1919).

[48] 353 Ill. 479, 187 N. E. 522 (1933).

[49] 45 Ida. 530, 263 P. 993 (1928). See also, In re Citizens' State Bank, 44 Ida. 33, 255 P. 300 (1927); National Bank of the Republic v. Porter, 44 Ida. 514, 258 P. 544 (1927).

[50] Goodyear Tire & Rubber Co. v. Hanover State Bank, 109 Kan. 772, 204 P. 992, 21 A. L. R. 677 (1921); Washbon v. Linscott State Bank, 87 Kan. 698, 125 P. 17 (1912).

ates a trust in favor of the depositor.[51] This holding is based on the theory that a bank holds the money of its depositors subject to demand, but it must appear that the bank was solvent at the time of the said demand and able to pay the same, and where the money to pay a demand is partly counted out at the time the bank is taken over by the Auditor of Public Accounts or some other duly constituted official, the relation of debtor and creditor has not been changed to one of trust so as to create a trust in favor of the depositor in the assets of the said bank.[52]

Veterans' Claims

The law with reference to the preferred status of a claim for moneys paid to a war veteran or his guardian, conservator, or beneficiary has been rather well settled by the Supreme Court of the United States in the case of *Spicer* v. *Smith,*[53] wherein the guardian of a mentally incompetent war veteran sought a preferred claim for the amount of his ward's deposit in an insolvent bank on the ground that the proceeds of said deposit were the property of the United States and as such entitled to preferential treatment by the receiver. The Court of Appeals of Kentucky, in which state the cause of action arose, in the case of *Smith* v. *Spicer's Guardian,*[54] denied the claim for preference and held that the deposits of the guardian did not make the bank a debtor of the United States. In its consideration of the case, the Supreme Court of the United States sustained the decision of the Court of Appeals of Kentucky and held that "payment to the guardian vested title in the ward and operated

[51] People ex rel. Nelson v. Chicago Bank of Commerce, 275 Ill. App. 68 (1934) and cases cited. But see People ex rel. Nelson v. Chicago Bank of Commerce, 282 Ill. App. 155 (1935) and People ex rel. Nelson v. First Italian State Bank, 281 Ill. App. 1 (1934), where the court took a contrary view.

[52] People v. Bryn Mawr State Bank, 273 Ill. App. 415 (1934).

[53] 288 U. S. 430, 77 L. Ed. 875 (1933).

[54] 244 Ky. 68, 50 S. W. (2d) 64 (1932).

to discharge the obligation of the United States in respect of such installments.'"[55] The Supreme Court also held that the guardian was not the agent or instrumentality of the United States in the performance of his duties.[56]

Prior to the decision in *Spicer* v. *Smith,* two theories were urged in the effort to obtain preferential treatment for deposits arising out of money paid by the United States to its ex-soldiers on account of adjusted service certificates or pensions. One of these theories was that urged in *Spicer* v. *Smith,* and the other was that payment to a guardian or other representative did not completely discharge the obligation of the United States to the veteran or his beneficiaries so that the funds deposited by a guardian remained moneys of the United States until actually expended for the benefit of the veteran or his beneficiaries.[57] However, the question appears to have been finally and conclusively determined, and the Appellate Court of Illinois in the cases of *People* v. *Stony Island State Bank,*[58] *Annie Chamness, Guardian, etc.* v. *James,*[59] and *People* v. *First State Bank of Mineral*[60] has, on the basis of the decision in *Spicer* v. *Smith,* denied a preference to the claims in those cases in which claims were based on pensions and adjusted service certificates.

In the case of *People* v. *Stony Island State Bank,*[61] which was heard by the Supreme Court of Illinois on a certificate of importance, after a preference had been denied in the Appellate Court for a claim based on a deposit constituting the proceeds of a loan on an adjusted

[55] Citing Taylor v. Bemiss, 110 U. S. 42, 28 L. Ed. 64 (1884); Maclay v. Equitable Life Assurance Society, 152 U. S. 499, 38 L. Ed. 528 (1894).

[56] Citing Shippee v. Commercial Trust Co., 115 Conn. 326, 161 A. 775 (1932); Puffenbarger v. Charter, 112 W. Va. 488, 165 S. E. 541 (1932).

[57] Nelson v. John B. Colgrove & Co. State Bank, 267 Ill. App. 317 (1932).

[58] 272 Ill. App. 365 (1933).

[59] 275 Ill. App. 206 (1934).

[60] 275 Ill. App. 123 (1934).

[61] 358 Ill. 118, 192 N. E. 682 (1934).

service certificate, the Supreme Court held that not only was the petitioner not entitled to a preference, but also that the taking over of the assets of the bank was not a seizure under legal or equitable process from which adjusted service certificates and the loans thereon are exempt.[62] On that point the court held:

> The protection of section 618 with respect to the property defined is afforded where the veteran is a debtor and a third person has a claim or demand against him. Without a relationship in which the veteran is the debtor or obligor, the section has no application. A veteran does not, by the deposit in a bank of all or a part of the proceeds of a loan upon his adjusted service certificate become a debtor or obligor; he becomes, on the contrary, a creditor of the bank. Manifestly, a relationship wherein the veteran is the creditor and the bank is the debtor does not enable the bank, or, if insolvent, its receiver, to subject property of the veteran to attachment, levy or seizure by any legal or equitable process.[63]

State Funds

The right of state funds to preferential treatment finds its origin in the English common law, and its basis is the general principle of the common law that "where the King's right and that of a subject meet at one and the same time, the King's shall be preferred."[64] The priority to which the King was entitled at common law was predicated upon his sovereignty and inasmuch as the State has succeeded to that sovereignty and we have adopted the common law, the State is entitled to the rights incident to sovereignty. The right is likewise founded on public policy since a sovereign has an inherent right to have its revenue protected so that it may be adequate

[62] 36 U. S. C. A. 618.

[63] Citing Mobley v. Jackson, 171 Ga. 434, 156 S. E. 23 (1930); Andrew v. Colorado Savings Bank, 205 Iowa 872, 219 N. W. 62 (1928); Reichert v. Berlin State Bank, 265 Mich. 150, 251 N. W. 340 (1933); State v. Bank of Bristol, 165 Tenn. 461, 55 S. W. (2d) 771 (1933); Shaw v. Williams, 60 S. W. (2d) 1073 (Tex. Civ. App., 1933); Burke v. Shaw, 63 S. W. (2d) 1117 (Tex. Civ. App., 1933).

[64] 8 Bacon's Abridgment 91.

to sustain the public burdens and discharge public debts, and it is the duty of the courts to preserve and protect it in the absence of statutory provision evincing a legislative intent to abandon, repeal, or waive the right. However, the right of priority exists only in favor of the State as a single and indivisible unit, and does not exist in favor of the various subdivisions of the State through which a great deal of the actual work of administration is done. It follows, therefore, that only so long as the funds belonging to the State, which are usually in the form of tax moneys of one type or another, remain undistributed are they entitled to any preferential treatment as a claim against an insolvent bank.

The case of *People* v. *Farmers State Bank*[65] is authority for the proposition that money which has been paid and collected for taxes is the property of the State until it is distributed to the various municipalities and particular subdivisions entitled thereto. However, if a particular county collector has already paid over the moneys due to the various county subdivisions which are entitled to share in its revenue, so that the remainder on deposit to the credit of the county collector in a closed bank will necessarily be turned over to the county, that fact would not deprive the State of a prior claim before that remainder is actually transferred by the county collector to himself as county treasurer (who is ex officio county collector).[66]

The Supreme Court of Illinois, however, has steadfastly refused to extend the doctrine of the priority of public funds to make it apply to tax money or alleged public funds after they have been allotted or delivered to the various municipalities or political subdivisions en-

[65] 335 Ill. 617, 167 N. E. 804 (1929).

[66] People v. West Englewood Trust & Savings Bank, 353 Ill. 451, 187 N. E. 525 (1933).

titled thereto. In the case of *People* v. *Ohle,*[67] the court said:

> Priority as to public moneys deposited exists only in favor of the State as an entire and indivisible sovereignty and does not extend to the various political subdivisions or agencies through which the State functions.

In accordance with that decision the Supreme Court has consistently refused to allow priority to school district funds,[68] general county funds,[69] sheriff's fees,[70] and road and bridge funds,[71] as well as many other particular funds which have been distributed to the various municipalities and political subdivisions in order to meet their financial obligations and the expenses of the administration of their affairs.

In the case of *People* v. *Seward State Bank,*[72] the township treasurer of Township 26 sought to protect himself from liability by having his account designated as a "Special Trustee Account" and marked "Special" on the books and records of his bank and further by executing an agreement with the cashier of the bank, who was acting under authority vested in him by the Board of Directors of the institution, containing special provisions as to the special character of his account, but the court saw fit to disregard his numerous precautions and look behind the careful designations to the actual handling of the account, which, as a matter of fact, was no different from the handling of any other general account of the bank. The court held that in order to deserve preferential treatment the situation must exist in just the way that it is purported to exist, and, in accordance

[67] 345 Ill. 405, 178 N. E. 163 (1931).

[68] People v. Farmers State Bank, 338 Ill. 134, 170 N. E. 236 (1930); People v. Ohle, 345 Ill. 405, 178 N. E. 163 (1931).

[69] People v. Bank of Chebanse, 340 Ill. 124, 172 N. E. 50 (1930); People v. Dime Savings Bank et al., 350 Ill. 503, 183 N. E. 604 (1932).

[70] People v. Waukegan State Bank, 351 Ill. 158, 184 N. E. 237 (1933).

[71] People v. Home State Bank, 338 Ill. 179, 170 N. E. 205 (1930).

[72] 268 Ill. App. 32 (1932).

with the established rule in Illinois, also held that the official capacity of the depositor did not entitle him to any preference despite the fact that such deposits were made in such official capacity. The court held also that the agreement which had been executed by the depositor and the cashier of the bank was absolutely void and of no effect since the bank had no authority to enter into a secret agreement assuring one depositor that he would be entitled to a preference over other depositors in case the bank became insolvent. The court said:

> Banking corporations being creatures of law possess only such powers as are expressly granted by law or are impliedly granted because necessary to carry out powers expressly granted, and the making of secret agreements for the benefit or protection of one depositor, as herein attempted, does not fall in either class.
>
> Banks publish financial statements showing assets and liabilities and public policy prevents any secret understanding or agreement which would in any manner give one depositor an advantage or preference over another depositor.[73]

Various attempts have been made from time to time to demonstrate that the sovereign's prerogative has been abolished by implication of law or has been lost because of failure to assert it in proper time. In the case of *People* v. *West Englewood Trust and Savings Bank,* already cited, it was contended that the common law right of the State to prior payment of its claims had been abandoned and abrogated with the enactment of the County Treasurer Act which relates to counties having a population of more than 150,000.[74] The act referred to was approved in 1915 and amended in 1925, and provided for the giving of security by banks before permitting them to act as depositaries of state funds.

The court held that although depositary acts have been held to have abrogated the State's prerogative to prior

[73] See Commercial Banking and Trust Co. v. Citizens Trust and Guaranty Co. of West Virginia, 153 Ky. 566, 156 S. W. 160, 45 L. R. A. (N. S.) 950 (1913).

[74] Ill. State Bar Stats. (1935), Ch. 36.

payment in some states, namely, Texas,[75] Arkansas,[76] Utah,[77] Wyoming,[78] Missouri,[79] and Arizona,[80] it was of the opinion that no repeal was effected by the depositary law of Illinois because the act was silent on that point and the repeal of laws by implication is not favored when the laws effect the citizens of the State or the sovereign power of the State and especially when they affect the sovereign power. The court also held that if it had been the intention of the Legislature to abolish the common law method of protecting public revenues, it would have said so specifically.[81]

In the case of *People* v. *The Waukegan State Bank et al.*,[82] it was contended that the State's claim for priority should have been asserted before the appointment of the receiver and that by failing to claim that priority the State had forfeited its right thereto, that right being extinguished by the appointment and confirmation of the receiver. This contention was based on the theory that because the amendment of section 2 of the Banking Act in 1929 vested the title to the assets of the bank in the receiver "for the purpose of the receivership,"[83] the State has no right to assert its prerogative after a receiver has been appointed and his appointment confirmed. The court held:

[75] Shaw v. United States Fidelity & Guaranty Co., 48 S. W. (2d) 974 (Tex. Com. App., 1932).

[76] Maryland Casualty Co. v. Rainwater, 173 Ark. 103, 291 S. E. 1003 (1927).

[77] National Surety Co. v. Pixtor, 60 Utah 289, 208 P. 878 (1922).

[78] National Surety Co. v. Morris, 34 Wyo. 134, 241 P. 1063 (1925).

[79] In re Holland Banking Co., 313 Mo. 307, 281 S. W. 702 (1926).

[80] In re Central Bank of Wilcox, 23 Ariz. 574, 205 P. 915 (1922).

[81] See Booth v. State of Georgia, 131 Ga. 750, 63 S. E. 502 (1908); State ex rel. Rankin v. Madison State Bank of Virginia City, 68 Mont. 342, 218 P. 652 (1923); Maryland Casualty Co. v. McConnell, 148 Tenn. 656, 257 S. W. 410 (1924); United States Fidelity and Guaranty Co. v. Bramwell, 108 Ore. 261, 217 P. 332 (1923); United States Fidelity and Guaranty Co. v. Central Trust Co., 95 W. Va. 458, 121 S. E. 430 (1924); American Bonding Co. of Baltimore v. Reynolds, 203 F. 356 (1913); In re Carnegie Trust Co., 206 N. Y. 390, 99 N. W. 1096 (1912).

[82] 351 Ill. 548, 184 N. E. 237 (1932).

[83] Ill. State Bar Stats. (1935), Ch. 16a, par. 11.

The amendment of 1929 was not intended to destroy the State's prerogative or make it ineffective after the appointment of a receiver. There was no purpose, desirable to the State, to relinquish such a valuable right, and it is well settled that the rights of a sovereign are never impaired by a legislative enactment unless such an intention is expressly declared in the statute.

In the case of *People* v. *The Marion Trust and Savings Bank,*[84] a similar contention to the effect that the failure of the State to claim its priority before the appointment of the receiver was a waiver thereof was raised, but the court was of the opinion that a legislative enactment would be necessary to abrogate such a valuable right of the State.[85]

The claim of the State for priority, however, is not confined to deposits in the insolvent banks, but extends to taxes and other charges due therefrom as well, and in the case of *People* v. *The Bank of Rushville,*[86] the court said:

A claim for taxes is entitled to priority over individual debts. Taxes are levied for the support of the government and take precedence over all other demands against the property owner. The property of the owner may be seized and sold though there may be other liens upon it. Payment of taxes may be enforced to the exclusion of all other creditors.

A preference based on a state claim was also allowed in the case of *People ex rel. Barrett* v. *The Peoples Savings Bank and Trust Company,*[87] wherein the East Moline State Hospital claimed a preference for a deposit made up of operating funds, profits from the operation of the commissary which was designated as an amusement fund

[84] 347 Ill. 445, 179 N. E. 893 (1932).

[85] See American Bonding Co. of Baltimore v. Reynolds, 203 F. 356 (1913); Marshall v. New York, 254 U. S. 380, 41 S. Ct. 143, 65 L. Ed. 315 (1920); State Bank of Commerce v. United States Fidelity and Guaranty Co., 28 S. W. (2d) 184 (Tex. Civ. Ct. of App., 1930); Maryland Casualty Co. v. McConnell, 148 Tenn. 656, 257 S. W. 410 (1924); United States Fidelity and Guaranty Co. v. Central Trust Co., 95 W. Va. 458, 121 S. E. 430 (1924); Denver v. Stenger, 295 F. 809 (1924); Fidelity and Deposit Co. v. McClintock, 68 Mont. 342, 218 P. 652 (1923).

[86] 355 Ill. 336, 189 N. E. 299 (1934).

[87] 362 Ill. 395, 199 N. E. 824 (1935).

and various sums deposited with the hospital for the use and comfort of various patients of the hospital, both past and present. Statutory provision has been made for the disposition of the profits from the commissary operation and the funds left from the deposits for the benefit and comfort of former patients.[88]

The Supreme Court allowed the preference and held that the maintenance of a hospital for the insane was a governmental function and, as such, deposits of funds to be used in its operation were state funds. The court also held that the preference extended to the entire fund regardless of its source and the purposes for which it was intended.[89]

As to the class of trust funds not created by an express agreement or arrangement, it would seem to follow that their right to a preference is dependent, first, upon bringing them within one of the classes wherein they will be treated as trust funds because of the circumstances surrounding the deposits and, second, in tracing the proceeds of the trust funds into the hands of the receiver, except as to funds granted a statutory priority, where no tracing is necessary.

[88] Ill. State Bar Stats. (1935), Ch. 23, par. 25.

[89] University of Tennessee v. Peoples Bank, 157 Tenn. 87, 6 S. W. (2d) 328 (1928); In re Blalock, 31 F. (2d) 612 (1929).