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Federal Tax Lien—Rights of Surety v. Federal Government—Property Interest under Pennsylvania Law.—Atlantic Refining Company v. Continental Casualty Company

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Federal Tax Lien—Rights of Surety v. Federal Government—Property Interest Under Pennsylvania Law.—*Atlantic Refining Company v. Continental Casualty Company.*[1]—Plaintiff refining company, as owner, entered into a no-lien construction contract for the building of two service stations. The agreement gave the owner the right to withhold certain payments to the contractor if the latter failed to pay materialmen.[2] Upon completion of the project the owner withheld final payment because of such failure, and the surety company, as required under its contract, paid the materialmens' claims. After the execution of the surety agreement, but prior to payment by the surety, the federal government filed a lien against the contractor for unpaid withholding and F.I.C.A. taxes. The owner filed a bill of interpleader to determine who had priority to the withheld funds. The U.S. District Court (W. D. Pa.) HELD, inter alia: (1) the contractor did not have any property rights in the withheld balance of the contract price upon which liens for federal taxes might attach, and (2) the surety was subrogated to the rights of the owner in the withheld payments and was entitled to receive them.

Section 6321 of Int. Rev. Code of 1954 provides that "if any person liable to pay any tax neglects or refuses to pay same after demand, the amount . . . shall be a lien in favor of the United States on all property and rights of property . . . belonging to such person."[3] In the leading case of *United States v. Bess*,[4] the Supreme Court held that the section creates no property rights but merely attaches consequences, federally defined, to rights created under state law.[5] It is well settled that the lien for federal taxes extends only to property in which the taxpayer has an interest.[6] Since the contracts in the instant case were made and performed in Pennsylvania the court had to decide whether the contractor taxpayer had under the law of that state any property interest in the withheld funds.[7] It reasoned that since the contractor failed to pay the materialmen whose claims substantially equaled or exceeded the balances withheld, the express promises of the contractor to the owner to pay materialmen were materially breached.[8] Consequently, the contractor had no property interest in the withheld funds to which a

[1] 183 F. Supp. 478 (W. D. Pa. 1960).

[2] The contract stated: "The final payment shall be made within thirty (30) days after final test and acceptance of the work, provided the contractor shall have submitted to the owner a satisfactory release of liens showing that all claims and bills for labor and materials have been met and paid as hereinbefore provided."

[3] 26 U.S.C. § 6321 (1958).

[4] 357 U.S. 51 (1958).

[5] Fidelity and Deposit Company of Maryland v. New York City Housing Authority and United States, 241 F.2d 142 (2d Cir. 1957).

[6] United States v. Burgo, 175 F.2d 196 (10th Cir. 1949).

[7] Erie Railroad Company v. Tompkins, 304 U.S. 64 (1937); Fidelity and Deposit Company of Maryland v. New York City Housing Authority and United States, supra note 5.

[8] A material failure of performance by one party to a contract not justified by the conduct of the other discharges the latter's duty to give the agreed exchange. Restatement, Contracts § 274-75 (1932); Wright v. Barber, 270 Pa. 186, 113 A. 200 (1921).

federal tax lien could attach.[9] In the absence of a Government appeal it appears that there has been a retreat from the Government's previous position that private contractual provisions cannot diminish the government's rights under the tax statutes.[10] The Government's contention has been that the contractor's interest in any earned but unpaid funds is a right to property subject to tax liens, notwithstanding contractual provisions limiting the contractor's right to payment.[11] The weakness of this position lies in the fact that it would give the Government money which the contractor never actually received. Dismissing the claim of the U.S., the court found no difficulty in bringing Pennsylvania law into accord with federal cases by declaring that in a no-lien construction contract the owner has an equitable obligation to see that materialmen are paid and, when the surety pays them, the surety is subrogated to the rights of the owner in the withheld balances as of the date of the original contract.[12]

The surety in the instant case also claimed it was entitled to the funds under equitable assignments given to it by the contractor at the time of the execution of the bonds, an issue never reached by the court. Assuming the court did find the contractor had a property interest in the withheld funds and that there had been a valid equitable assignment to the surety, would the federal government have been given priority in withheld payments? The decision probably would have been in the affirmative under the so-called inchoate lien doctrine.

Under this doctrine a lien, competing with a federal tax lien, to be entitled to priority must not only be prior in time but also be perfected and choate.[13] To meet these requirements, (1) the property subject to the lien must be definite, (2) the identity of the lienor established, and (3) the amount of the lien be exact and determined with finality.[14] Whether these requirements are met is to be decided as a matter of federal, not state, law.[15] In the instant case, even though the assignment was made previous to the filing of the tax lien, the status of the interest of the surety-assignee was merely that of an unperfected security interest holder, the lien being inchoate until its certainty was established, that is, at the time of payment to the materialmen. This event did not occur until after the federal tax lien attached. The doctrine of the inchoate lien has been the subject of severe

[9] Lancaster County National Bank's Appeal, 304 Pa. 437, 155 A. 859 (1931); Prairie State National Bank of Chicago v. United States, 164 U.S. 227 (1896); Sundheim v. Philadelphia School District, 311 Pa. 90, 166 A. 365 (1933).

[10] United States v. Kings County Iron Works, 222 F.2d 232 (2d Cir. 1955).

[11] United States v. Manufacturers Trust Co., 198 F.2d 366 (2d Cir. 1952).

[12] Henningsen v. United States Fidelity and Guaranty Co., 208 U.S. 404 (1907); Prairie States National Bank of Chicago v. United States, supra note 9.

[13] United States v. Security Trust & Savings Bank, 340 U.S. 47 (1950).

[14] Illinois ex rel. Gordon v. Campbell, 329 U.S. 362 (1946).

[15] United States v. Gilbert Associates, 345 U.S. 361 (1953). This is in direct contrast to the question of a "property interest", discussed above, which is a matter of state law. The Supreme Court has introduced inconsistency into an area of law which by its very nature demands uniformity.

criticism,[16] and possibly the court in the instant case, by deciding that the contractor had no property interest in the funds, has found a loophole to avoid the harsh application of this doctrine.

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Judgments—Collateral Estoppel Used Defensively by One Not a Party, or in Privity with Party, to Former Action.—***Emil Eisel v. Columbia Packing Co.***[1]—A products liability action was brought in the Federal District Court in Massachusetts by a Connecticut consumer of ham against the packer, a Massachusetts corporation. In a previous action brought by the consumer in the state courts of Connecticut both the retailer and packer had been named as parties defendant. On motion by the packer, he had been dropped as a party defendant, the action thereafter being prosecuted only against the retailer. Judgment was had by the retailer on a finding that the consumer's injuries did not result from any defective condition of the ham. The packer, relying on the prior adjudication, moved for judgment in the present action, contending that the consumer was collaterally estopped from maintaining the suit. HELD: the plaintiff having had full opportunity to litigate his claim against the retailer, and having been unsuccessful for reasons unrelated to any personal defense of the retailer, is precluded from relitigating the same issue against the packer. While every man is entitled to his day in court there is no persuasive public policy allowing the relitigation of a claim when the issue has been fully tried in substantially the same context in a prior suit. Where the successful prosecution of a suit against a retailer would permit of the defendant's indemnification by the manufacturer, unilateral estoppel precludes the unsuccessful plaintiff from subsequently suing the manufacturer on substantially the same issue, the policy of the doctrine of res judicata being that there should be an end to litigation.

The plea of res judicata is available when the parties and issues in a prior case are identical to those presently before the court.[2] In such case each of the parties is estopped from setting up his claim or defense against the other, there being, consequently, a mutuality of estoppel. However, where a party has several claims against two or more persons, he may pursue his remedy against each separately (absent procedural rules requiring joinder) and he is not precluded by a failure of successful prosecution against one, from thereafter pursuing his claim against the other. But a judgment for a defendant will not be conclusive against the plaintiff in a subsequent action brought by him against a new defendant, unless a favorable judgment for the plaintiff in the first case would have either permitted

16 MacLachlan, Improving the Laws of Federal Liens and Priority, 1 B. C. Ind. & Com. L. Rev. 73 (1959). Kennedy, The Pernicious Career of the Inchoate and General Liens, 63 Yale L.J. 905 (1954).

1 181 F. Supp. 298 (D. Mass. 1960).

2 Old Dominion Copper Mining and Smelting Co. v. Bigelow, 203 Mass. 159, 89 N.E. 193 (1909), aff'd, 225 U.S. 111 (1911).